COUNTRY STUDIES

# Czech Republic - Peer Review of Competition Law and Policy

## 2008

## Introduction

“Peer review” is a core element of OECD work. The mechanisms of peer review vary, but it is founded upon the willingness of all OECD countries and their partners to submit their laws and policies to substantive questioning by other members. The Czech Republic competition law and policy have been subject to such review in 2008. This report was prepared by Mr. Mike Wise for the OECD.

## Overview

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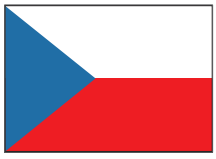


2008

# COMPETITION LAW AND POLICY IN THE CZECH REPUBLIC

# AN OECD PEER REVIEW

## -- 2008 --

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# FOREWORD

This report, prepared by the Secretariat of the OECD[1], was the basis for a peer review examination of the Czech Republic in the OECD Competition Committee on 11 June 2008. Since the Committee's last review in 2001, the Czech Republic has become a member of the European Union, and its competition law and policy have become fully consistent with European law and practice. The Czech competition agency, ÚOHS, has evolved through a change in leadership and a shift in its enforcement approach. Competition policy attention has concentrated on problems in network and service sectors, where results have been mixed. Enforcement against hard-core price fixing has stepped up. A major case in 2007 was an important opportunity to show how clandestine international cartels operate and how leniency can be used to uncover them. Enforcement could be strengthened further by providing for stronger sanctions.

1 This report was prepared by Michael Wise.

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# COMPETITION LAW AND POLICY IN THE CZECH REPUBLIC

**Box 1. Summary**

Competition policy and law in the Czech Republic have converged on European practices. Since the last OECD review of Czech competition policy, in 2001, the country has substantially completed the process of reconstruction and joined the European Union. The Competition Act has been revised twice and now closely follows the substantive terms and enforcement methods of the EC. The competition agency, ÚOHS, has evolved through a change in leadership and a shift in its enforcement approach.

Competition policy attention has concentrated on problems in network and service sectors. Results have been mixed. ÚOHS has moved vigorously against abuses in telecoms, taking advantage of its new power to apply the EC Treaty despite the exclusion of this sector from the Czech Competition Act from 2005 to 2007. In electric power and natural gas, decisions about privatisation led to re-creation of integrated national-scale firms. Problems about access to storage are slowing the development of competition in the natural gas sector.

Enforcement against hard-core price fixing has been limited, but it has stepped up recently. The switchgear case in 2007 was an important opportunity to show how clandestine international cartels operate and how leniency can be used to uncover them. Correcting and eliminating resale price agreements is a high priority now. For most non-hard-core matters, ÚOHS is willing to advise businesses about how they can comply with the law and to work with them to resolve problems through measures other than formal enforcement action: ÚOHS describes this approach as "advocacy."

Most recommendations in the 2001 Review were about improving framework institutions of corporate governance and finance that support competitive markets. That process is now completed. One recommendation about enforcement encouraged the implementation of the proposed leniency program. Early applications were not very effective, but the new program adopted in 2007 is proving to be a better tool against hard-core cartel agreements. Enforcement could be strengthened further by providing for stronger sanctions, against individuals who are involved in cartel behaviour and associations that are the vehicle for reaching prohibited agreements.

# 1. Foundations

Competition policy and law in the Czech Republic have converged on European practices. At the time of the last OECD review of competition policy in the Czech Republic (OECD, 2001; "2001 Review"), the principal task for establishing vigorous market competition was still to restore and improve framework institutions of the market economy in finance and in corporate structure and governance, so that the Czech economy would be competitive in modern market conditions. The 2001 Review observed that competition policy would play a secondary role in that task. The country has substantially completed the process of reconstruction. The independent national competition agency, the Office for the Protection of Competition ("Office" or "ÚOHS", the Czech acronym), has evolved since 2001, through a change in leadership and a shift in its enforcement approach. With the competitiveness of Czech manufacturing and distribution now on a solid footing, competition policy attention concentrates on problems in network and service sectors.

## *1.1 Context and history*

The Czech Republic is reclaiming its historic position as a technical and transport centre of the central European economy, having weathered the transition difficulties of the late 1990s that were described in the 2001 Review. The reconstruction of the pre-1990s institutional system, economic as well as political, culminated with membership in European Union in 2004. Privatisation is essentially complete, except for holdings in network sectors. The bank that was formed to facilitate transition restructuring, Konsolidacni banka, was reorganised into an agency in 2001. That restructuring agency was then abolished at the end of 2007, when a new, comprehensive bankruptcy law finally became effective. The institutional foundation for a competitive, efficient modern enterprise economy is now in place.

Solid economic performance and stable growth have followed from post-transition integration into European markets and institutions. The annual rate of growth in real GDP exceeded 6% for the past three years, although it is expected to dip in 2008. Output has been growing steadily, while inflation was moderate until the end of 2007. Unemployment has declined substantially, to below 5% at the end of 2007. Czech GDP per capita is about 75% of the euro-zone average, on

a purchasing-power-parity basis, and if trends continue the gap with the euro-zone could close within a decade. (ODCD, 2008) Improved economic performance is driven by export-oriented manufacturing, notably in international production chains in auto and electronics manufacturing. Interchange with other large economies and within the EU, and linkage to their markets and to competition policies in the EU, do much to ensure the competitive vigour of the economy.

### *1.2 Competition Act*

The Competition Act has been substantially revised twice since the 2001 Review. The first revision, in 2001, updated the transition-era framework statute that had been adopted in 1991. That earlier law had drawn on European models and substantive concepts, but it also included features designed to address particular national problems, notably the historically monopolised structure of most markets at that time. This revision, which was in process when the 2001 Review was being prepared, replaced these features with the basic elements of EU law. The Czech law adopted the system of block exemption regulations and individual exemptions from the general prohibition against restrictive agreements, as well as the *de minimis* thresholds for applying it. The definition of "dominance" incorporated terms from European jurisprudence, superseding a definition that had presumed dominance at a market share of 30%. Provisions about merger control were added. A rule targeting anti-competitive actions by government-related entities was replaced with provisions that parallel the EC Treaty in applying competition law to holders of exclusive rights and providers of public services.

The second major revision of the basic law accompanied the Czech Republic's accession to membership in the EU in 2004.2 This revision adapted Czech law to the modernised EU system of enforcement. Now, under Czech law as under EU law, exemption criteria as well as prohibitions apply directly. Block exemption regulations under EU law are incorporated into Czech law automatically. Conforming enforcement practice to the new EU methods, the Office no longer deals with applications for individual exemption. The standard for mergers is now the same in Czech law and the EU merger regulation, and the Czech merger notification rules have also been revised. The law empowers the Office to apply EU law as well as national law. The first case under the EC treaty, about abuse of dominance in telecoms, was

2 Act No. 143/2001 Coll, as amended, Parenthetical citations in the text are to this law, as amended through 2007, unless otherwise indicated.

opened in 2004. As the Office has embraced EU enforcement methods, in 2007 it replaced its original 2001 leniency program, which had not produced many results, with a revised program that follows the European Competition Network model. The overall theme of the improvements in Czech legislation is clearly to align with EU institutions and practices.

Proposals to legislate special treatment for particular sectors have created some controversy. The Parliament excluded the telecoms sector from the jurisdiction of the Czech competition law in 2005. That exclusion only lasted for two years before being repealed in 2007. Another, continuing controversy is over whether to add the concept of "economic dependence" to the competition law, in order to regulate disparities of bargaining power in distribution relationships. Parliament approved such an amendment, but the President vetoed it. The Office supports the goal but would prefer a more narrowly targeted measure.

Legislation to strengthen enforcement powers is in preparation. The government has proposed to provide for sanctions against individual managers and officials. These would be applied by the prosecutor through criminal proceedings, separate from but co-ordinated with the Office's administrative enforcement involving the firms. Other potential improvements could include broader investigation powers and more substantial sanctions against associations.

### *1.3 Competition policy goals*

The statement of policy purpose in the Competition Act is general, saying that the law is to protect economic competition against elimination, restriction or distortion, whether actual or threatened. The listing of purposes was slightly revised in the recent amendments to underline that the law also deals with threats. (Art. 1(1)) This supports taking prospective action without waiting for actual harm to appear, but it does not imply any different policy goals. The law does not elaborate further about what "economic competition" means, nor about what aspects or outcomes of market competition should be treated as particularly important goals. The Office's conception of the goals of competition policy is set out in other statements, such as the decree about merger review.

"Effective" or "sufficient" competition is the pragmatically-phrased goal of policy. Statements about the value of effective competition emphasise how it promotes innovation, reduces production costs and stimulates firms to offer more choices, which can include items or services of higher quality or lower price.

Process fairness is important in the priorities of the Office. A major part of its workload is enforcement of the law on public procurement. The policy goals of this part of its work, as explained on the Office's website, are the efficient use of public funds, compliance with competition law and avoidance of discrimination, through requiring public purchasing bodies to use competitive tendering methods.

Competitive industry structure and protection of small and medium sized enterprises are also recognized as goals. During the period when privatisation was still a major task, competition policy sought to influence the creation and development of a competitive environment, either by eliminating a position of monopoly or dominance or by preventing the establishment of a new position. The Office has described this goal as ensuring the efficiency of the market structure. Preserving competitive structures has been an important theme. The Office relies on preserving "competitive structure" as a reason to prohibit abuse of economic dependence.

Consumer benefit and innovation are elements of the public interest in preventing restrictions of competition. In explaining the motivation of competition policy, the Office also claims expected larger-scale benefits from effective market competition such as better resource allocation, long-term growth, technological progress and greater social welfare.

## 2. Substantive issues: content of the competition law

Czech competition law is based on familiar European concepts, prohibiting restrictive agreements and abuse of dominance and requiring approval for major mergers. Features of the original 1991 law that were tailored for dealing with transition problems have been removed or revised. As a result, the substantive law is essentially identical to EU norms. Enforcement practice is also now fully integrated into the EU system. Czech competition law is likely to become increasingly derivative of EU law, in substance and practice, as the circumstances that called for special national rules have passed. But differences in the capacities and priorities of the national competition agencies within the EU could be significant. Notably, the Office has been active about vertical agreements and abuse of dominance in network industries, but it has not yet produced significant local cartel cases.

### *2.1 Restrictive agreements*

The prohibition against anti-competitive agreements and the provisions about exemption from the prohibition follow the terms of the EC Treaty and enforcement regulations. The law prohibits agreements, decisions by associations and concerted practices that restrict competition or that might restrict competition. (Art. 3(1)) Agreements that improve production or distribution or promote technical or economic progress, and that afford to consumers a fair share of those benefits, are exempt from the prohibition. But if these benefits could be achieved without the restrictions, then the agreement is not exempted. In addition, to qualify for exemption, the agreement must not lead to eliminating competition in a substantial part of the market that is the object of the agreement.

Agreements of minor importance are not prohibited. (Art. 6(1)) The measure of whether an agreement is "minor" is the market share of the parties. The cut-off level varies depending on the nature of the agreement. In general, the threshold for horizontal agreements is a combined share of 10% attributed to all the parties to the agreement. For vertical agreements, the cut-off is a combined share of 15%. Hard-core agreements, including resale price maintenance as well as horizontal price fixing and market division, cannot receive the benefit of de minimis exemption, regardless of low market shares. These de minimis thresholds were raised when the Czech law was revised to follow the modernised EU enforcement system.

A complex proviso removes de minimis protection where there is a system of agreements about a comparable product. This proviso is applicable principally to vertical agreements that have a "hub-and-spokes" effect. The Czech rule about these systems of parallel agreements is phrased slightly differently than the similar EU rule, but the intention and effect are the same. The Czech law describes the necessary degree of comparability as "identical, comparable or substitutable goods". If a single entity is a party to a number of such contracts, and the aggregate share of all of the contracting parties in the market for the comparable product is greater than 15%, then the de minimis exemption does not apply to the individual contracts. If the system of contracts restricts access to the market, and there are parallel networks of such systems whose cumulative effect is to restrict competition in the relevant market, then the de minimis exemption applies only in a system in which the combined share of parties to horizontal agreements, or the share of any party to a vertical agreement, is no greater than 5%. (Art. 6)

Block exemption regulations adopted by the EU apply automatically under Czech law to agreements that would not be covered by the EU regulations because they may not affect trade between Member states. (Art. 4(1)) The Office also has the power to issue block exemptions under Czech law, defining categories of restrictive agreement that are permitted. The Office has not issued any block exemption regulations on its own.

Exemption criteria apply directly. A prior decision from the Office granting an exemption is no longer required. The Office has issued a few negative clearance decisions since 2004. The Office may decide in an enforcement matter to withdraw the benefit of an exemption and prohibit an agreement because it does not meet the statutory criteria for exemption. If the conditions that had qualified for a block exemption change, the Office can withdraw the benefit of the exemption. (Art. 4(3))

### *2.2 Horizontal agreements*

Hard-core agreements are singled out. Agreements about prices or market division are specifically prohibited. (Art. 3(2)) The text does not itself provide that this prohibition is strictly per se; however, because direct or indirect price fixing, output restraints, market division or customer allocation would not benefit from the de minimis exemption under the statute, the Office describes such agreements as prohibited per se. The Office also considers bid rigging to be prohibited per se, although it is not on the statute's list of agreements that do not qualify for *de minimis* exemption, because a bid rigging agreement is simultaneously an agreement on price and on division of the market.

Enforcement experience against hard-core price fixing has been limited. The most prominent and important recent case, announced in April 2007, was the Czech contribution to the multi-jurisdiction enforcement against the international bid-rigging cartel for gas-insulated switchgear. The EU had issued its decision in the matter in January 2007, and the Hungarian Competition Office and others were also taking action against this cartel. There has been one other significant horizontal enforcement action since 2005, against four pharmaceutical firms for a short-lived agreement to limit the range of products they sold to three teaching hospitals. The firms claimed that measure was justified to make the hospitals pay their debts, but the Office said they could not adopt this output restraint jointly and fined them a total of CZK 113 million.

Older cases typically involved exchanges of information, common prices or simultaneous price increases. Sometimes the pattern was condemned as a concerted practice, and sometimes it was the basis for inferring that the parties had reached a prohibited agreement. One well-known "concerted practice" case, from 2001, resulted in a very large fine against petroleum distributors who had communicated about price levels at a time when prices were increasing. (This case is still on appeal, to correct a curious judicial ruling denying that a firm could be held liable for a violation by its pre-merger corporate antecedent.) In the same year, cattle breeders were found liable for an exchange of information about prices and pricing plans that led to maintaining a minimum price. In 2003, the Office sanctioned three baked goods firms that had evidently co-ordinated price increases, as well as sugar producers that had been exchanging information monthly through a trade association about production, sales, exports and imports. In the sugar case, the Office inferred an agreement to allocate the market. Because prices, trade and production were heavily regulated, the main outlet for competition was access to customers.

Some bid-rigging situations have come to the Office's attention in the course of its work overseeing the public procurement system. Most appear to be handled as procurement violations, but there are a few investigations pending now under the Competition Act, involving forestry and construction.

Self-regulation is a current issue. Several matters are pending about the rules of professional associations regulating advertising, fees and solicitation of clients. One association is under investigation for prohibiting, as unfair conduct, the practice of granting a new-customer discount. Sanctions against associations may be insufficient to deter misconduct. Fines are based on the turnover of the association itself, not that of its members. ÚOHS is working on proposed legislation to correct this and thus support fines that more accurately reflect the economic interests and incentives involved.

Fines, rather than commitments, are preferred in hard-core cases. The Office's policy is that it will not accept commitments about future conduct to close investigations of hard-core agreements. Rather, it will insist on a fine or order. The largest fine to date was issued in the 2007 gas-insulated switchgear bid-rigging case. The 16 firms were fined a total of CZK 941.9 million. The largest was against Siemens, for CZK 107.2 million. This sanction was computed to deter. The computation was based on the violation from July 2001 to March 2004, during which orders in the Czech Republic for these products totalled about CZK 700 million. The total fine takes back a great deal more than

the firms' profits from their violation, and thus it includes a factor adjusting for the unlikelihood of detection. To be sure, since the cartel had actually existed since the 1990s even a fine this large may not have exceeded all of the parties' gains. The switchgear case is the only horizontal matter that the Office has concluded so far as the result of a leniency programme. One of the parties avoided fine in the Czech Republic by qualifying for leniency. The first leniency application about this cartel was made to the European Commission and led to a DG Comp dawn raid in March 2004.

Sanctions against individuals may be strengthened. ÚOHS has proposed to hold individuals criminally liable for cartel conduct. The government has agreed to include this proposal in the new criminal code that is being submitted to Parliament. The basic individual punishment for price fixing would be imprisonment of up to three years. The sentence could be as long as eight years if the damage or improper gain from the violation exceeded CZK 5 million. Enforcement would be handled by police and prosecutors.

### *2.3 Vertical agreements*

Agreements setting resale prices do not qualify for de minimis exemption. (Art. 6(2)) Agreements reserving exclusive resale territories or otherwise ensuring exclusivity and thus preventing resale competition are also prohibited regardless of market share. The other common forms of vertical agreement that are listed in the statutory prohibitions are those that tie sales of one product or service to another or that discriminate among customers. But discrimination and tying agreements may benefit from the de minimis exemption.

Czech law incorporates EU block exemption regulations for dealing with agreements about distribution and other vertical relationships. These include agreements transferring or granting intellectual property rights, since the separate clause on that topic was removed from the Czech law.

Correcting and eliminating resale price agreements is a high priority now. The Office finds that the business public still needs to be educated about this issue. Firms behave as though they do not know it is prohibited. The Office has combined enforcement with willingness to accept commitments when firms reform offending contracts. For example, in 2005 the Office fined Tupperware CZK 2.3 million for fixing resale prices and preventing resale; the decisions were reversed by the Regional Court, though, on procedural and jurisdictional grounds, and the matter has been appealed further. On the other hand,

in 2006 investigations of price restrictions in contracts for distribution of watches and for distribution of movies were closed after the offending contract provisions were corrected. A pending investigation highlights the common controversy about resale price controls for published works: a publisher is trying to steer sales of a likely best-seller to traditional bookstore outlets, instead of the mass marketers that had discounted the price of the previous volumes in the series.

### *2.4 Abuse of dominance*

The Czech law about abuse of a dominant position adds some detail to the EC treaty model. One addition is a competitive-effects test: abuse is prohibited if it harms other businesses or consumers. The list of abuses in the Competition Act is longer. The Czech law describes the trading conditions that would be considered "unfair", and hence abuses, as performance demands that are "conspicuously inadequate to the counter-performance" when a contract is concluded. (Art. 11(1)(a)) Other additions include the essential facilities doctrine and a clause about unfairly low prices. (Art. 11(1)(e), (f))

Market power, and hence dominance, is determined by an undertaking's market share, its economic and financial power and its level of vertical integration, and by aspects of the market context such as the market shares of its competitors and legal and other barriers to entry. In principle, the degree of market power would not be relevant to determining whether conduct constitutes abuse. But the scope of harm is relevant to setting fines, so an abuse that affected an large share of a significant market might draw a higher fine.

Market share and structure are important factors in identifying a dominant position, although the Office maintains that evidence about other criteria is necessary unless the share is virtually 100%. A market share of 40% or less is presumed not to represent a dominant position. (Art. 10(3)) Nonetheless, dominance could be found at a lower share, if the evidence of other factors supported that conclusion. Markets where the HHI index is over 2000 are considered concentrated, and below 1000, non-concentrated. The early law that was in effect from 1991 to 2001 had defined dominance, conclusively, as a market share of 30% or more. A mechanical, irrebuttable presumption may have been appropriate as a fixed point of reference for transition restructuring, but it is obviously too rigid for realistic application after that task is done. A presumption at such a low market share can lead quickly to inappropriate re-regulation of an industry if, as happened in the Czech Republic, two or three firms in a market are each found to be

individually dominant and hence subject to stricter oversight of their conduct, including their prices.

Collective dominance is mentioned several times in the Competition Act, but the term is not separately defined. The features that establish "jointness" will presumably be determined by reference to interpretations and applications of the parallel provisions of the EC Treaty.

Exploitation of market power by setting high sales prices, or low purchase prices, is not mentioned specifically in the Competition Act. The only reference to prices in the section on abuse of dominance is to prices that are unfairly low, not unfairly high. Nonetheless, the Competition Act may be applied against exploitative pricing. For example, one recent investigation examined a complaint about the prices and terms in a bilateral monopoly, captive supplier-customer situation. Other cases have involved consumer prices for telecoms and banking services.

The "consistent offer and sale of goods for unfairly low prices" is an abuse if it "results or may result in distortion of competition." (Art. 11(1)(e)) In addition to this predatory pricing rule in the Competition Act, the Price Law also bans sales below cost.3 The terms of the Price Law resemble a competition law: it prohibits the abuse of significant economic power, and one of the abuses it prohibits is setting prices below costs. Although the Price Law prohibition thus depends on something akin to market power, it does not contain the same "competitive effects" test as the Competition Act. The Price Law is enforced by the Ministry of Finance. Courts have rejected claims that ÚOHS cannot pursue predatory pricing violations because the Price Law covers the same subject.

Under the "essential facilities" rule, a dominant firm must grant access, for reasonable reimbursement, to infrastructure facilities such as a distribution network or transmission grid, if the party seeking access cannot operate in the same market as the dominant firm, for legal or other reasons, without that access or joint use. (Art. 11(1)(f)) The dominant firm can avoid liability by showing that granting access would be unfeasible or unreasonable. Access to intellectual property may also be required, subject to the same considerations of necessity and reasonable reimbursement and proportionality.

3 Act No. 526/1990 Coll., on Prices, as amended.

A dominant firm may not refuse to deal on reasonable and non-discriminatory terms, regardless of whether its facility is deemed "essential". A 2005 decision about access to a bus terminal examined the relationship between the two obligations. The terminal operator claimed that its capacity was saturated so it could not provide access. Moreover, it claimed there were alternative sites to park and load a bus, which the complainant was in fact using. That is, the terminal was not essential because the complainant was still in the market. ÚOHS found that providing service at a terminal was far superior to the alternative of using a road-side bus stop, whether or not the terminal was "essential". Investigators sent to observe a day's operations also found that the terminal was not saturated, although it was busy, handling buses operated by the terminal owner. ÚOHS decided that the terminal had a dominant position in the market for being the local bus terminal, and thus it had a duty to makes its facility available on non-discriminatory terms. The fine, of CZK 2 million, was reduced on appeal to the Chairman, in part because the terminal operator relented and implemented objective, non-discriminatory terms of access. A similar result was reached in a telecoms case about prepaid mobile phone cards. ÚOHS required the mobile phone company to state objective criteria for selecting distributors of phone cards and to enter a contract with any firm that met those criteria. The decision responded to a negative clearance inquiry: Eurotel (which is now Telefonica O2) asked whether refusal to sell to distributor who planned to resell direct to consumers, rather than through retailers, would be an abuse of dominance.

Network sector problems are common. Competition law enforcement here considers issues that might also be the object of economic regulation. For example, an important case about "loyalty" pricing in telecoms challenged the structure of a rate offering. The Office fined Český Telecom CZK 205 million because its lump-sum price plans dampened competition. The plans charged a single price for a combination of services, some for which the firm had a dominant position and others for which competition was developing. By encouraging customers to treat services as "free" within the flat rate, the plans discouraged switching to other providers. The theory of the case evidently depended in part on the design of the rate structure. That is, customers did not get credits for unused flat-rate calling minutes, and the plan did not distinguish the line charge from the use charge. When the case arose, several years ago, the regulatory structure for the sector was not yet well established. The Office's decision was delayed until 2005 by the complex combination of regulatory and competition law issues and by conflicts about jurisdiction. The fine was affirmed by the

Regional Court; a further appeal is still pending. This decision was the first ÚOHS case applying Art. 82.

Another telecoms case found that pre-emption, making too much of a first-mover advantage, could be an abuse. Český Telecom announced its own retail ADSL service and the terms on which resellers could get access to its network on the same day (in November 2003). The announcement was made five weeks before the effective date. ÚOHS found that this period was too short. The dominant firm should have allowed more time for its would-be reseller competitors to negotiate access to the ADSL network and plan and market their alternative offerings to the public. The competition problem was not price predation or a squeeze of the competitors' margins. because the prices and terms of the offers were not set at levels that would have prevented resellers from making a profit. Rather, the problem was the timing. ÚOHS imposed a fine of CZK 80 million. Another decision suggests that a dominant firm must give customers, as well as competitors, time to react to changes in strategy, at least if the firm is providing a public service. In 2006, a bus firm cancelled service on five days' notice. Even though ÚOHS agreed that the firm's financial problems justified ending operations, it found that doing so without giving customers enough time to find alternatives was an abuse, calling for a fine of CZK 700 000.

Competition law enforcement reinforces sector regulation. A recent, important example is a 2006 ÚOHS decision in the natural gas sector, which led to the largest fine the Office had issued by that date, CZK 370 million. The problems that the Office and the energy regulator were dealing with could be traced to an early ÚOHS merger decision that had permitted the creation of a vertically integrated monopoly, RWE-Transgas. The decision found violations of both the Competition Act and Art. 82 of the EC Treaty. Discriminatory contracts favoured the regional distributors that are members of the RWE-Transgas group over others. Territorial constraints prohibited distributor customers from reselling outside their territories. Discriminatory pricing terms prevented access to storage; that is, setting the same price for "authorized" customers that the energy regulator had set for "protected" customers was considered discriminatory, because the costs of serving these two classes of customers differed. In addition to the fine, ÚOHS issued an order to reform the contracts to end discrimination against non-group distributors and to remove barriers. The Office and the energy regulator are still working on ways deal with the storage problems.

Fines in cases about abuse of dominance are often substantial. Until the 2008 gas switchgear case, the high fines against abuse, compared to

the lower fines against collusion, implied that dominance was a more important problem, or else that stronger sanctions were needed to deter misconduct by dominant infrastructure firms because the firms and markets involved were much bigger. Orders to reform offending exclusionary or discriminatory terms are common. The Office has not yet made much use of its power to order interim relief in applying the EC Treaty. (Art. 20a)

### *2.5 Mergers*

The substantive test for approving a merger is whether it would result in a substantial distortion of competition in the relevant market, particularly because it would result in, or would strengthen, a dominant position in that market. The statutory standard for legality was amended in order to follow the revision of the EU merger regulation. The goal of merger control is to prevent firms from creating market structures in which they would be in a position to affect competition significantly by raising price or limiting output or choice.

Product markets are determined principally by considerations of substitutability in consumption, such as product characteristics, intended uses and prices. Supply-side substitutability is treated as more relevant to identifying geographic markets in which conditions of competition are sufficiently homogeneous and distinguishable from other areas. Criteria for defining geographic markets include the nature of production and the costs of shipping. In defining markets, the Office evidently relies more on characteristics of products and production than on predictions about how demand or supply would respond to hypothetical changes in price.

There is a structural safe-harbour, although it is not conclusive: if the combined share is no greater than 25%, it is presumed that the combination will not adversely affect competition. This presumption can be overcome, though, by evidence about likely effects. (Art. 17(3)) Other factors that the Office considers are the "efficiency of the market structure", potential for dynamic efficiencies and effects on consumers. The Office will also take into account the criteria and analysis in the European Commission's Guidelines on the assessment of horizontal mergers and of non-horizontal mergers. Market share effects are used to sort out potentially significant cases. A rule of thumb that the Office evidently applies calls for paying closer attention to horizontal mergers involving a combined market share over 15% and to vertical mergers involving combined shares over 25%. In these cases, the Office is likely to solicit the views of customers, suppliers and competitors.

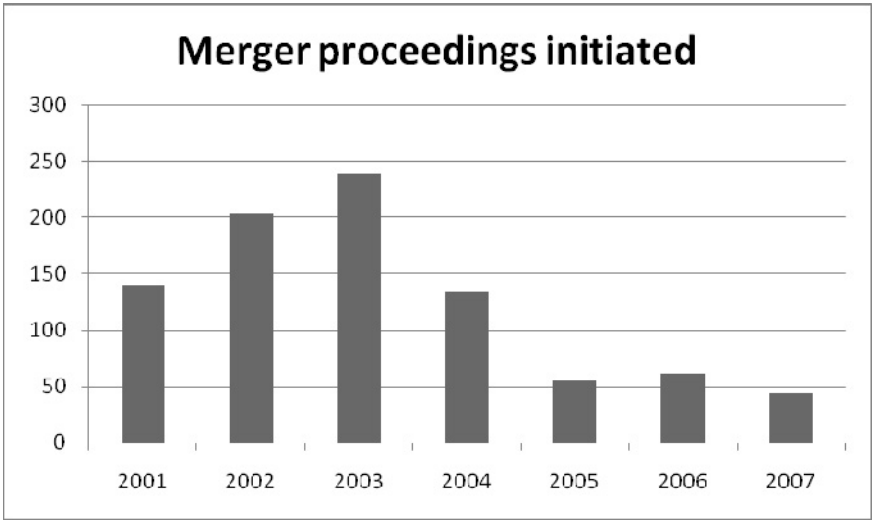
Only ÚOHS has merger control power with respect to competition. There is no provision for involving ministries or other bodies or for invoking the public interest or other policies. Concentrations in the financial sector also require approval from the Czech National Bank, but that review does not assess effects on competition. The Office's merger decisions do not show explicit consideration of other policies or a balancing between restraints on competition and improvements in efficiency. Some decisions, such as the approval of privatisation transactions that re-created an integrated monopoly in natural gas, may be best understood as anticipating production or import efficiencies, or perhaps accommodation of other policy concerns. The prohibition against merging before ÚOHS has completed its proceeding has occasionally been relaxed or waived in order to permit firms in financial trouble to combine and avoid layoffs.

After a change in notification standards in 2004, increasing the threshold and including a "local nexus" element, the number of filings that the Office must consider has declined. The law establishes a system for co-ordination between the Office and the European Commission about merger matters. Consistent with the emphasis on negotiation and dialogue with business, the Office now encourages pre-notification contacts, so merging parties and the staff can identify possible issues early and accelerate the formal review process. If their transaction meets the threshold requirement, parties must notify the Office before consummating it and pay a filing fee of CZK 100 000. The Office then has 30 days to decide whether to initiate proceedings. If it decides that the transaction raises serious concerns, it must notify the parties and then reach a final decision, to reject the transaction or approve it with conditions, within five months. The deadlines are tolled pending the parties' response to the Office's request for further information. The deadline can be extended 15 days to consider the parties' proposals for commitments. If there is no decision by either deadline, the Office is deemed to have approved the transaction and the parties may proceed with it. Notification is not confidential. The Office publishes information about the filing, on its website and in the Commercial Bulletin, to give potentially interested parties an opportunity to communicate their views and concerns to the Office.

The basic standard for determining whether a transaction must be notified is that the parties' combined turnover in the Czech Republic exceeded CZK 1.5 billion in the most recent year, and each of two (or more) parties had turnover in the country greater than CZK 250 million. These levels are higher than the thresholds that applied before 2004, which were CZK 550 million combined and CZK 200 million for each.

An alternate threshold is turnover greater than CZK 1.5 billion in the Czech Republic for a party to a merger or joint venture or for the target of an acquisition or open-market purchase, and worldwide turnover of another party to the transaction greater than CZK 1.5 billion. This is a refinement of the previous alternate threshold, which had required notification if the combined world-wide turnover of at least two parties exceeded CZK 5 billion. The early law had included market share (over 30%) as a notification criterion; that was dropped in the 2001 revision.

The Office's merger-review docket has shrunk since entry into the EU in 2004 and revision of the threshold for notification to incorporate a "local nexus" test and thus reduce the number of filings. From a peak of 213 filings in 2003, the total fell to 49 in 2007, with only one second-phase proceeding.




*Source: ÚOHS*

Approval may be made subject to conditions, but the Office no longer has the power to impose conditions upon its own initiative. Since the 2004 amendments, its powers are limited to approving or disapproving what parties propose. If the Office finds that proposed commitments would be insufficient, it must disapprove the merger completely. Typical conditions can be structural divestitures or behavioural commitments such as terminating or entering contract arrangements. The Office may also accept quasi-structural conditions about the exercise or transfer of intellectual property rights. Out of 687 merger decisions from 2001-2007, the Office only rejected three

transactions. In 22 decisions imposing conditions, those most frequently imposed were divesting shares or assets (13), prohibiting discrimination (9), maintaining supply arrangements (9), prohibiting price increases (6) and transferring intellectual property rights (4).

The Office's reasoning in setting structural conditions is illustrated by a decision in 2003 approving the combination of two major producers of generic pharmaceutical products. Product markets were defined according to international therapeutic classifications, as is standard in European case-law. The Office was concerned about the merged firm's increased financial and portfolio power, which would distort competition by increasing its negotiating strength and pricing flexibility. The merged firm was required to divest production and distribution operations for products for which its market share was over 60%.

The maximum fine for violating the merger review rules by failing to notify or merging before the Office has completed its review is CZK 10 million or 10% of turnover. The first sanction for premature implementation was in 2002, for "jumping the gun" by influencing the vote at the merger partner's annual meeting before ÚOHS had approved the merger. That resulted in a fine of CZK 100 000. In 2003, two firms that implemented a merger before ÚOHS had ruled were fined CZK 10 million. On the merits, ÚOHS disapproved the merger because it would reduce competition in the market for bottled mineral water, and thus it ordered divesture of the shares in the acquired firm. This is one of the only mergers that the Office has ever disapproved. The acquiring firm had a market share over 50% and excess capacity, but the share of the target was only 2-3%. Imports at that time were not yet significant because prices in the Czech Republic were still well below prices elsewhere in Europe for comparable products. When the parties revived their merger plan in 2006, the Office approved it subject to conditions, and it cited changes in market circumstances to justify its shift of position. Notably, imports had increased significantly, which the Office had not anticipated in 2001, and the market shares of private brands had increased, revealing that barriers to entry had been low. Nonetheless, the Office required the merged firm to keep the products effectively separate for five years and to maintain the pre-merger relative market shares of the cheaper brands.

Two other transactions have been prohibited outright. One, from 2004, resembled the bottled water case the year before, both in the market setting and in the misplaced doubt about the possibility of entry. A proposed combination of the top two major industrial bakeries supplying chain stores was rejected. The combined market share would

have been under 30%, but the Office was concerned that the merged firm would have had advantages such as nationwide service, a wide range of products and superior negotiating strength that might drive others out of the market and enable it later to raise prices. The Office also found that reducing the number of important competitors itself represented an anticompetitive distortion of the market structure. The Office did not believe that the chains had alternatives at the time of the merger; however, within two years some of the chains had set up their own in-house bakeries. The other rejected merger would have reduced the number of firms in the markets for industrial and household sugar from three to two. The firms were also major factors in nearby geographic markets (which were considered separate because of heavy regulation in each country) and in alternative industrial sweeteners. The Slovak competition office also rejected the merger, and the Hungarian competition office insisted on strong conditions. Facing opposition from the national competition agencies in the markets affected, the parties eventually abandoned their plans.

Restructuring and privatisation of the electricity and natural gas sectors were the most important and difficult merger decisions the Office has addressed. During the deliberations over the plan for restructuring the electricity sector, the Office objected to re-establishing a monopoly through the distribution level, but it lost the argument. The Office allowed ČEZ to buy most of the regional electricity distribution companies. Despite the government backing for the overall plan, the Office nonetheless imposed some conditions on its approval of the ČEZ acquisitions. The first condition was partial divestiture of its interest in the monopoly transmission grid. The second was to sell its partial share in three power companies. The third was to divest one of the five distribution firms it acquired to a third party, so that ČEZ would hold four of the eight regional distributors. The last condition failed, though. The firm was not divested, and the condition was ultimately withdrawn and replaced by a duty to create "virtual power plants" to make energy available in the wholesale market.

In natural gas, ÚOHS approved a transaction that created a vertically integrated national monopoly. The merger of RWE Gas AG with Transgas combined the monopoly importer and transmission system with six of the eight regional distribution companies. The principal condition of approval was that the new firm could not acquire the country's only gas producer, which was significant principally because this producer's gas field could be used for storage. In addition, the new firm was barred from making acquisitions or investments in the electric power and heating sectors during a five-year transition period,

until 2007, anticipating that those sectors would be liberalised by then. Current controversies over access to storage show that the conditions were not sufficient to protect competition and that the Office's expectations about how formal liberalisation would lead to real competition may have been unrealistic.

Several major privatization transactions have been reviewed by the Office. Except in the network utility sectors, none have raised substantial competition issues. Most amounted to new entry, as assets were taken over by firms and investors from other markets. The combination of Société Générale and Komerční banka was a friendly takeover, for example. One heavy industry privatisation led to competition disputes later: when a steel firm was privatised, fabrication was split into two firms, and one of them remained as part of an integrated operation. Non-integrated fabricators complained about a margin-squeeze, and the integrated firm asked the Office for negative clearance about its pricing practices.

The Office is working on guidelines about notification and substantive analysis. The guidelines about notification issues are expected to be issued in late July 2008. They will address technical questions about calculation of turnover and the definitions of the types of parties and transactions subject to the notification obligation. The Office is also planning guidelines about the criteria for assessing impact on competition, so parties will have a better idea of the Office's likely views about their transactions.

An amendment to the Competition Act about merger review is now in preparation. In one respect, it will bring merger review closer to the processes used for other competition matters, by introducing the formal "statement of objections" step if the Office wants to block a merger or impose conditions. For certain types of combination that rarely raise problems, the process will be simplified. The time for deciding whether to proceed to a full phase two investigation will be shortened from 30 days to 20 days. The kinds of transactions that are implicitly deemed unlikely to affect competition, because they will be subject to this simplified procedure, are changes of control, conglomerate mergers, vertical mergers involving combined market shares below 25% and horizontal mergers involving combined market shares below 15%.

### *2.6 Procurement and state aid*

Public procurement has been a responsibility for the Office since 1995. The policy goal of this regulatory program is to ensure that public funds are being used appropriately and economically. The subject is

important because the amount of money involved is large. Procurement rules apply particularly to public entities, to entities awarding contracts supported by public funds and to public entities or others exercising exclusive rights in public service sectors such as natural gas, heating, electricity generation, water, public transport, ports and airports, postal services and fuel exploration and extraction. When the Office finds a violation involving a contract that has not yet been implemented, it can cancel the tender process or order a new one. Otherwise, the principal sanction is a fine. The legislation that was adopted in 2004, to conform to EU norms at the time of accession, was revised in 2006. The two laws on public contracts and on concession contracts and procedures transpose directives about procedures for award of contracts in general and in the key sectors of water, energy, transport and postal services.4 The new laws expand coverage to smaller public contracts and provide for simpler and more flexible procedures (among other things). Another EU Directive issued in 2007 will require a further amendment to the Czech law. This recent action amended older directives about remedies and procedures dating from 1989 and 1992. Notably, contracts that result from particularly serious breaches may be declared void.

The potential synergy between procurement oversight and enforcement against bid rigging has been recognised. It was noted, for example, in the 2001 Review. But few, if any, bid rigging cases under the Competition Act have been developed based on ÚOHS experience with regulating procurement. Procurement regulation is a major part of the ÚOHS workload, but it is not integrated into the rest of the operation. The procurement section will be the last one to relocate from a different building to join with the rest of ÚOHS in its new headquarters.

The Office is no longer responsible for enforcement concerning state aid. When the Czech Republic became part of the European Union in 2004, enforcement responsibility for state aid matters shifted to the European Commission and the corresponding parts of the Czech competition law were eliminated. The Office was assigned responsibility for enforcement in this area in 2000. The subject had previously been handled by the Ministry of Finance. The Office has maintained a state aid staff since 2004 to advise Czech authorities and firms about compliance with EU regulation.

4 Act No. 137/2006 on Public Contracts, and Act No. 139/2006 on Concession Contracts and Concession Procedures; Directive 2004/18/EC and Directive 2004/17/EC.

## *2.7 Unfair competition*

Unfair competition rules are treated as matters of private law.[5] A general clause in the Commercial Code defines unfair competition as conduct contradictory to good manners of competition and capable of causing damage to other undertakings or consumers. The list of types of unfair competitive conduct includes misleading advertising, deceptive labelling, bribery, disparagement of a competitor, infringement of trade secrets and endangering the health of consumers or the environment. Links to competition law and policy are not clearly recognised. The Office has had few occasions to examine whether remedies against allegedly unfair practices might dampen legitimate competition.

Disparity in bargaining power is not part of the Competition Act now, but ÚOHS believes that law is needed to deal with firms that unilaterally extract favourable business terms in contracts with partners, even though they do not have a dominant position in a market. ÚOHS claims that abuse of partners' economic dependence may lead to serious distortions of competition. ÚOHS proposed a law incorporating the principle, but it withdrew its support after Parliament amended the bill to expand the scope of liability for accepting an offer of a discriminatory price. In general, ÚOHS objected to measures that would have amounted to a new ban on sale below cost, since that topic is already covered by the Competition Act prohibition against abuse of dominance and by the Price Act. Following the ÚOHS advice, the President vetoed the bill in June 2006. Parliament is now considering rules about fair trading that would apply to retailers with net turnover in excess of CZK 2 billion, that is, to supermarket chains.

## *2.8 Consumer protection*

The relationship between competition policy and consumer protection policy is reasonably well understood but not well implemented. Consumer policy about contract fairness, product safety and advertising and marketing is set by the Ministry of Industry and Trade. The enforcement agency is the Czech Trade Inspection. In addition, the Ministry of Agriculture sets standards for food products, which are enforced by the State Agriculture and Food Inspection and the State Veterinary Administration, the Ministry of Regional Development is responsible for consumer issues in the travel sector, the Ministry of Health Care deals with pharmaceuticals, toys, cosmetics

5 Commercial Code No. 513/1991 Coll., as amended; and the Rules of Civil Procedure No. 99/1963 Coll., as amended.

and products for children and the Ministry of Finance regulates price labelling. The Consumer Protection Act now incorporates unfair commercial practices, as those are described in EU legislation about unfair business-to-consumer practices.6 ÚOHS has participated in programs led by the EU to improve the interconnection between consumer and competition policies.

Civic associations that are active in protecting consumer rights and advising consumers include the Consumers Defence Association of the Czech Republic (CDA), the Czech Consumer Association, Civic Association of Consumers TEST and the Advisory Centres Association. ÚOHS and CDA entered a memorandum of understanding in October 2005, committing to consultation about cases that could affect consumers. The consumer organizations took part in the ÚOHS-sponsored conference about reforming liberal professions in March 2006. At a meeting with CDA in November 2007, ÚOHS proposed a general strategy for working with consumer organisations. Notably, ÚOHS undertook to try to calculate consumer losses in order to facilitate private enforcement actions by consumers and to involve consumer groups about proposals to terminate investigations through commitments. It will also do detailed impact analyses in markets where distortion of competition is particularly likely to affect consumers. These could include newly liberalised sectors, telecoms and electronic media, food products, financial services, auto sales and professional services.

## 3. Institutional issues: enforcement structure and practices

ÚOHS is the only authority responsible for applying the Competition Act. It is located in Brno, where it is moving into a refurbished building that will bring all of the staff units together. It has three principal organisational units, which are responsible for competition, public procurement and administration. The section that deals with procurement is still in a separate location, but will join the others as soon as the building is completed. The administration section also includes what remains of the office dealing with state aid.

The organic law for ÚOHS dates from 1996, when the previous Ministry of Economic Competition, established in 1992, was transformed back into an independent office.7 The chairman is

6 Consumer Protection Act (No. 634/1992); Directive 2005/29/EC.

7 Act. No. 273/1996 Coll. of 10 October 1996 on the Scope of activities of the Office for the Protection of Competition.

appointed by the President upon the proposal of the government. The chairman may be dismissed by the same process, but only for causes that are specified in the law, that is, for bringing ÚOHS into disrepute or impairing its independence or impartiality. The term of the appointment is six years, and the appointment may be renewed once. The current chairman was appointed in 2005, succeeding a chairman who served a full term but was not reappointed. The chairman may not be a member of a political party. This requirement does not mean that only academic experts or career bureaucrats are appointed, though. The current chairman had been a businessman and then deputy minister for trade, responsible for energy policy, before his appointment to ÚOHS.

The Office had been a Ministry from 1992 to 1996. On the one hand, in that position it had an inside voice in important policy and structural decisions. On the other hand, that position may have raised questions about the impartiality and independence of enforcement decisions. The Office is now fully independent of formal government or political control in its decision-making. Independence from the government is underlined by locating the Office outside of the capital. (For similar reasons, the Constitutional Court is also in Brno).

Decisions are now posted on the Office website and published in an annual bound compendium, in non-confidential form. The Office issues a regular annual report about its decisions and operations. Public relations has become a high priority activity. The Office issued 134 press releases in 2007, most of them – 75 – about competition matters, compared to only twelve in 2002.

The Office has some formal contact with the policy-making process, contributing to the work of government advisory bodies and ad hoc commissions about other policies. The Office is consulted in the discussion and drafting of legislation, and its staff participate in the working parties and drafting groups. Its authority to comment on the competitive implications of actions by other parts of the government is conferred by a government resolution, and its participation in the legislative drafting process is provided under the legislative rules.

### *3.1 Enforcement processes and powers*

Following the modernisation of the European Commission's enforcement system, the Office no longer issues individual exemptions from the prohibitions against anti-competitive restrictive agreements. Proceedings in the Office are governed by the general rules of the Administrative Procedure Act unless the Competition Act or other

legislation establishes special rules. The Administrative Procedure Act was revised in 2004.

Competition matters are investigated and prepared by officers designated pursuant to the Office's internal rules and supervised by the Director of the Competition Section. These can begin on the Office's own initiative or upon complaint by a third party. Consumers and other state authorities may be the source of complaints. A formal proceeding will be opened if a preliminary examination shows there is reasonable suspicion of anti-competitive conduct. Enforcement actions against abuse of dominance or cartels are treated as "own initiative" cases, even if they begin with a complaint. The Office will nonetheless inform the applicant about the outcome of this own-initiative proceeding. (Art. 21(3)) In a cartel case, the first formal action, and the first time the likely respondent learns of the investigation, may be an unannounced on-site inspection.

An oral hearing may be held if requested by a party and the Office decides it is necessary. (Art. 21(9)) The procedure is used principally to hear from the parties, but the Office may call other witnesses too. Whether or not there is a hearing, parties must have an opportunity to communicate their positions about the matter, to respond to the findings of the investigation and the action, if any, that the Office intends to take. A final decision must set out the legal basis for the decision, explain the justifications, such as the supporting facts and the considerations applied to assessing the evidence, and instruct the parties how to appeal.

Investigative powers include entering business premises and inspecting and copying documents and asking for oral explanations in the process. The Office can seal the premises until the inspection is done, although it has not yet had an occasion to do so. Responses must be complete, correct, truthful and timely. The Office's investigative power applies to undertakings and also to bodies of public administration, unless the latter are specifically excluded from coverage by another law. The Office is required to state the legal grounds and purpose for its investigation when it requests documents and information. Failure to comply with investigative process can result in fines, imposed by the Office, of up to CZK 300 000 or 1% of turnover. A natural person who obstructs proceedings or fails to testify or appear at a hearing may be fined up to CZK 100 000.

Other premises, such as at the home of an executive or employee, may be subject to investigation if there is reason to believe that evidence is located off of business premises. This step requires prior

authorisation from the court. The Office has not yet had any occasion to search homes for evidence.

Confidentiality is generally protected, but parties to a proceeding have access to confidential material in the file. Officials and employees of ÚOHS may not disclose business or trade secrets, and subjects of investigation may designate confidential material in documents for redaction (Art. 21(11)). But parties to proceedings and their counsel have unlimited access to the file, and thus ÚOHS cannot keep the identity of informants confidential. The Administrative Procedure Act does not permit restricting access to documents containing trade or business secrets unless particular legislation defines a category of documents or information that can be protected from access. The Competition Act provides that, if the file contains such protected information, and that information is a basis for the Office's proposed decision, then parties and their counsel may review it but may not make notes or copies.

The first-instance decision in an investigation is made by the Director of the Competition Section. That decision can be appealed, within 15 days, to the chairman of the Office. The chairman's second-instance decision is taken on the basis of a proposal by the appellate committee. This committee is a permanent advisory body of 16 to 18 practitioners, economists, scholars and other Office staff. A majority of this committee are not employed by the Office. Members are designated annually, and many members have served for several years. The committee's role is advisory, and the second-instance decision by the chairman need not follow the committee's advice.

Measures other than formal decisions and orders are now commonly used. The Office has the power to accept commitments proposed by the parties and terminate an investigation without making a finding about liability. (Art. 7(2), Art. 17(4)) The parties may propose such commitments within 15 days after receiving the Office's statement of objections. The Office must determine whether fulfilment of the commitments would be sufficient to protect competition and eliminate the competition problem. If the proposed commitments would not be sufficient, the Office must advise the parties in writing of its reasons for rejecting them. In addition, the Office has actively promoted disposing of relatively minor complaints about vertical restraints through negotiated resolution of problems, without opening formal proceedings at all. The Office calls this process, somewhat confusingly, "advocacy."

There is no deadline for completing competition matters, except for merger reviews. At one time, competition enforcement proceedings had

to be completed within a very short time, to meet the deadlines set by the Administrative Procedure Act. Decisions had to be issued within 30 days, and within 60 days in complex cases. Now that this aspect of the Office's procedures is no longer governed by that law, its proceedings have gotten longer. The average antitrust proceeding took about four months to reach the first-instance decision in 2005, and about 6-8 months in 2006 and 2007.

### *3.2 Sanctions and remedies*

Principles for setting fines follow those used generally in European competition practice. The base fine is a percentage of the infringing firm's turnover in the affected market. For horizontal price fixing, bid rigging, market division, abuse of dominance affecting a substantial market or merging without approval, the base fine percentage is up to 3%. For "serious" infringements such as resale price maintenance, it is up to 1%, and for less serious infringements, it is up to 0.5%. The base fine is increased if the violation has persisted. The multiple for duration ranges from 1, for a year or less, up to 3 for a violation that has gone on for 10 years or more. Aggravating circumstances can increase the fine by up to 50%. Mitigating circumstances can reduce it by 50%. The computed amount can be increased to ensure that the fine exceeds the improper gain from the infringement or the harm that it caused (where that can be estimated). In exceptional cases, the Office might reduce a fine because paying the full fine would jeopardise the respondent's economic viability. In any event, the maximum fine is 10% of the entity's total (worldwide) turnover in the preceding year.

Fines have not usually been set in the upper range of the scale that the law permits. Until 2005, the Office had a public reputation for setting high fines, or at least for setting fines that businesses found hard to accept. The current chairman announced when he took over that this strategy would change, although there would be no let-up concerning hard core cartels. Despite this public declaration of a more accommodating attitude, the Office has come down harder on hard-core price fixing and major abuse of dominance infringements. The total sanctions imposed in 2007 in first-instance decisions were a near-record of about CZK 1 billion. Nearly all of this was accounted for by the price-fixing case against gas switchgear makers. In second-instance decisions, the total was nearly CZK 1.4 billion, but much of that figure duplicates or overlaps first-instance actions.

Criminal liability against individuals for cartel conduct is included in the new criminal code that is under development. This proposal came from ÚOHS, and the government has approved it. The sentence could

depend on the effect of the cartel. It might be as high as eight years if damage or improper gain is over CZK 5 million. Otherwise, the maximum term would be three years. Companies would not be subject to criminal prosecution. ÚOHS envisages that cartel cases would proceed on parallel tracks, with ÚOHS handling administrative enforcement against firms and prosecutors handling enforcement against natural persons, where appropriate.

A new leniency policy was adopted in 2007. Compared to the previous program from 2001, it promises greater legal certainty to applicants who qualify. Unlike the previous program, the current leniency policy applies only to horizontal agreements. Complete immunity from fine will be granted to the first undertaking that submits evidence sufficient for the Office to launch an investigation of a cartel, before the Office had done so. The Office may grant immunity to a party that comes in afterwards, depending on the quality of the evidence it provides and on whether another party has already been granted conditional immunity. For parties that do not qualify for complete leniency but that admit their involvement and provide evidence that adds significant value to the Office's case, fines may be reduced by up to 50%. A firm that initiated the cartel, took a leading role in it or coerced others to participate cannot qualify for leniency. Leniency is subject to compliance with other general conditions about co-operation with the Office's investigation and ceasing involvement in the violation. The program generally follows the standard model of the European Competition Network, with one exception. The Czech program does not authorise the parties to continue the conduct in order not to tip off other conspirators before the investigation can be launched. Czech jurisprudence would not accept such a commitment by the enforcer not to pursue illegal conduct (or such a declaration of tolerance for it), at least formally. As a practical matter, ÚOHS could consider going along with the European consensus about forbearance, particularly if it came up in the context of an investigation and leniency applications that needed to be co-ordinated and consistent across several jurisdictions.

Under the 2001 leniency program, there were no significant enforcement matters. An early application about network agreements in telecoms was not pursued because the Office had already learned about the agreement before the parties approached the Office. Two other applications involved vertical agreements. Using leniency in that context, as a justification for reducing fines where the likely competitive harm is low or non-existent, has no relationship to the main policy motivation of adopting leniency programs, namely to detect and

destabilise clandestine horizontal cartels. One of these vertical cases was closed after accepting commitments proposed by the parties. The other was about an exclusive-sale agreement for a consumer product. The producer who had initiated this contract brought it to the Office's attention and was not fined.

### *3.3 Judicial review*

The first level of appeal from a final decision of ÚOHS is to an administrative court, the Regional Court in Brno. Appeals must be filed within 15 days of the prior decision. A further appeal can be taken to the Supreme Administrative Court. Beyond that, the Constitutional Court might consider claims about breach of fundamental constitutional right. The court structure has changed since the 2001 Review. At that time, the administrative court system, including the Supreme Administrative Court, had not yet been set up.

The courts are concerned principally with legal issues, but the courts may also examine the sufficiency of the evidence. The reviewing court may affirm the decision or cancel it and return the matter to the Office for further proceedings. The court does not have the power to enter its own decision contradicting the Office's finding about liability. The court may, however, reduce the level of a fine.

The Regional Court is not formally specialised in competition matters. As a practical matter, though, it is developing some expertise, or at least familiarity, with competition issues. All appeals from the Office are taken there, and the rate of appeal has been increasing, so there are many cases in which to learn. A few of the judges previously served on the staff of ÚOHS, and thus they learned about competition issues before joining the court.

The Office has completed three enforcement matters applying the EC Treaty, now that the 2004 Competition Law authorises it to do so. The judiciary has greeted this concurrent jurisdiction with scepticism. The Regional Court ruled that the Office could not decide that conduct infringed both the national competition law and Art. 82 of the EC treaty. It has objected to parallel proceedings at the Office and other EU enforcement bodies, on the grounds that this would violate the civil law principle of ne bis in idem. The Office has appealed these rulings to the Supreme Administrative Court.

### *3.4 Private party initiatives*

A private suit can be brought under generally applicable civil procedures in one of the eight regional courts. There is no longer a

separate rule about private litigation in the Competition Act. Remedies that the court might order in a civil action include damages, recovery of unjust enrichment, declaration of invalidity of a contract or an injunction controlling future conduct. The court has the power to decide whether the prohibitions of the Competition Act have been infringed. The court may suspend its proceedings pending a decision of the Office about liability, but it is not required to wait for the Office to act. If the Office has found liability, though, that finding is binding on the court. A prior decision of the Office could thus facilitate a claim for damages, at least in theory. The Office has been advised of only two private enforcement efforts. In one, the court asked the Office for its views about whether the conduct amounted to an infringement. The other was a follow-on suit for damages after the Office found an infringement. The next amendment of the Competition Act will include some explicit provision about private litigation, aimed at facilitating recovery of damages to consumers by relaxing the burden of proof.

Customers, competitors and suppliers who bring complaints to the Office are not treated formally as parties. They are informed about the outcome of the proceedings, but they do not have a right to appeal the Office's decision if they are dissatisfied with it.

### *3.5 International co-operation*

The "effects" test applies, so conduct outside the Czech Republic that has an anti-competitive effect inside it could be the object of enforcement action. But there would be no way to collect an administrative fine that the Office levied against a firm outside of the country. (By contrast, there might be means for extra-territorial enforcement of the judgment of a court). The Office has no powers to investigate outside of the country. In Europe, it can take advantage of the system of co-operation among national competition agencies to request that they undertake investigative measures on its behalf.

The principal vehicle for international co-operation now is the European Competition Network. So far, though, the Office has had little formal enforcement co-operation through this mechanism. The Office did enlist the aid of the Slovak competition authority in a vertical restraints investigation, which obtained information and documents for the Office from distributors in the Slovak Republic.

### *3.6 Resources and priorities*

Personnel levels have increased slightly over the last few years. In 2008, the Office expects to reach full capacity, when all of the staff will

move into its new facility. The rate of staff turnover, which had been a significant problem at the time of the 2001 Review, has slowed down considerably under the current chairman. The operating budget has increased somewhat since 2005. (The figures in Table 1 do not include CZK 218 million for the Office's new headquarters building). Merger filing fees now account for about 5% of the budget, and administrative fees for public procurement matters total about CZK 3 million annually. Of the staff who are assigned to particular enforcement activities, about 40 are in the competition section, about 30 in procurement and about 8 in state aid.

**Table 1. Trends in Competition Policy Resources**

| | Person-years | Budget (million CZK) |
|---|---|---|
| 2007 | 120 | 98.8 |
| 2006 | 115 | 95.5 |
| 2005 | 111 | 73.8 |
| 2004 | 114 | 73.0 |
| 2003 | 114 | 69.2 |

*Source : ÚOHS*

There are more lawyers than economists in the operating staff. Out of the total staff of about 125 as of January 2008, about 40 are economists and about 60 are lawyers. The Office has had a small separate team of economists for many years, but until recently the unit lacked a clear role and direction. Originally this unit reported directly to the Chairman. After a recent reorganisation, it is now in the competition section, where it is available to support investigations of particularly complex or problematic cases. The unit also works on general policy issues, including developing methodologies for evaluating the impact of interventions and assessing competitive conditions in markets, building on the Office's early experience with a numerical measure.

The number of cases and the amount of sanctions against horizontal agreements declined since the first part of the decade. The very large increase sanctions in 2007 is due to a single case. The increase in fines about abuse of dominance in 2006 is also due mostly to a single case.

**Box 2. The COMP methodology**

In the 1990s, the Office created and applied a simple scale for measuring competition. This "COMP" system combined five measures:

- HHI index,
- capital requirements for entry,
- innovation (including access to intellectual property),
- vertical integration, and
- residual or excess capacity.

A value from 1-5 was applied to each element, with higher numbers related to greater competition. Observation of conditions in markets implied that competition was sufficient where the total score for a market was 16 or higher. The COMP method was used mostly in privatisation decisions. It was discontinued, at least as a regular practice, after about seven years, after the main privatisation wave had been completed. Any such measure could only be used as an internal rule of thumb. As a creation of the Office, not of the law, it could not be used to justify a decision; by contrast, something of similar authority adopted by the European Commission might be accepted as authority in Czech courts.

## Trends in Competition Policy Actions

| | Restrictive agreements horizontal | vertical | Abuse of dominance | Mergers | Public procurement |
|---|---|---|---|---|---|
| 2007: new matters opened | | | | 44 | 321 |
| Sanctions or orders | | | | | 236 |
| Other matters closed | | | | | |
| Total sanctions imposed | 1 000 000 000 | | | | 10 802 |
| 2006: new matters opened | 4 | 1 | 3 | 61 | 293 |
| Sanctions or orders | 4 | 1 | 5 | 3 | 77 |
| Other matters closed | | 1 | 1 | 2 | |
| Total sanctions imposed | 168 000 000 | | 407 000 000 | | 3 467 000 |

| | Restrictive agreements horizontal | vertical | Abuse of dominance | Mergers | Public procurement |
|---|---|---|---|---|---|
| 2005: new matters opened | 2 | 3 | 4 | 55 | 334 |
| Sanctions or orders | 3 | 3 | 3 | 3 | 64 |
| Other matters closed | 1 | 1 | 6 | | |
| Total sanctions imposed | 279 250 000 | | 212 850 000 | | 2 349 000 |
| 2004: new matters opened | 3 | 4 | 11 | 134 | 340 |
| Sanctions or orders | 6 | 5 | 6 | 2 | 29 |
| Other matters closed | 1 | | 6 | 4 | |
| Total sanctions imposed | 1 065 000 000 | | 160 500 000 | | 1 470 000 |
| 2003: new matters opened | 11 | 2 | 6 | 239 | 334 |
| Sanctions or orders | 8 | 2 | 4 | 8 | 90 |
| Other matters closed | 2 | | | 2 | |
| Total sanctions imposed | 326 050 000 | | 119 500 000 | | 3 768 000 |
| 2002 new matters opened | | | | 217 | 379 |
| Sanctions or orders | 9 | 13 | 9 | 11 | 65 |
| Other matters closed | | | | | |
| Total sanctions imposed | 382 800 000 | | 72 700 000 | | 4 666 000 |

*Source : ÚOHS. Sanctions are in CZK. For 2002 and 2007, data for classifying matters is incomplete. For 2003 and 2004, figures do not include applications for exemption or negative clearance. For mergers, "sanctions or orders" means rejected (2 in 2002, 1 in 2003 and 1 in 2004) or approved with conditions; "other matters closed" is all other Phase II merger matters. For procurement, "matters opened" is administrative proceedings initiated, and "sanctions or orders" is number of fines imposed; in 2006, there were also 37 preliminary injunctions issued. For 2002 and 2003, the total sanctions includes those attributed to previous decisions which became effective in that year.*

The Office's latest annual report sets out its current priorities. Investigations are expected about price agreements in graphical design and about discrimination in distribution, notably between regular stores and internet outlets. Other markets to be watched are waste management and brown coal. Several issues are coming up in veterinary services, where rules in the profession prevent livestock farmers from employing veterinarians and from obtaining veterinary pharmaceuticals directly from distributors. In regulated sectors, the

Office continues to monitor telecoms, where it will seek to ensure that the shift to digital broadcasting happens without violations of the Competition Act, and the competitive conditions resulting from the separation of the freight operations of Czech Rail.

## 4. Limits of competition policy: exclusions and sectoral regimes

The only general provision that implies an exclusion from the Competition Act is for firms providing general public services. The terms of the Competition Act parallel Art. 86 of the EC Treaty. The Competition Act does not apply to "undertakings which provide, on the basis of a special act or on the basis of a decision issued pursuant to a special act, services of general economic interest" if its application would obstruct the provision of these services. The postal service, the central bank, broadcasting and telecoms are listed, in a footnote, as examples of laws that authorise such services of general economic interest. Determining whether a service qualifies for this treatment depends on general principles of European law, developed in the interpretation and application of Art. 86. The Czech Supreme Administrative Court has confirmed that Czech law is to be interpreted consistently with European case law under Art. 86. Notably, the service must be provided continuously over the entire area at uniform price and quality. Czech law does not include the phrase from Art. 86 that extends this treatment to services having the character of a revenue-producing monopoly.

Conduct that is required or authorised pursuant to other legislation will not be prohibited or sanctioned under the Competition Act. Thus, conduct in compliance with sector regulations setting prices and controlling services and entry could not be challenged as violations of the Competition Act.

Government-related commercial operations are not excluded from the Competition Act. The term "undertaking", which defines what the Competition Act covers, include groups and associations that are not legal persons or entrepreneurs if they participate in competition or could influence it by their activities. This includes commercial operations by government bodies, but not government bodies themselves acting in their government capacities. The early competition law had prohibited national and municipal government bodies from taking measures to restrict competition. The Office had no coercive power to enforce that prohibition, though. It was removed from the law in 2001 and replaced by the provision tracking Art. 86 about services of general interest.

## *4.1 Sectoral issues and special regimes*

The functions of sector regulators in telecoms and energy are carefully defined to be distinct from the Office's enforcement role. In Czech jurisprudence it is particularly important to define jurisdictions clearly and avoid overlapping competences. Regulators act ex ante, to promote competition where it does not yet exist and to prevent harm to the public where competition is not possible. The Office acts ex post, to protect competition by correcting and deterring conduct that undermines or restrains it. Court rulings in all of these sectors have confirmed this division of responsibilities, preserving the Office's role of ex post law enforcement against restraints on competition in regulated sectors. The most recent affirmation of this division of responsibilities was a decision by the Supreme Administrative Court in December 2007, announcing that there was no conflict between the jurisdiction and power of ÚOHS and that of the Energy Regulatory Office, because the regulator acts ex ante while ÚOHS acts ext post.

### *4.1.1 Telecoms*

The national monopoly, Czech Telecom (formerly SPT Telecom) was corporatized in 1994 and partially privatized in 1998. In 2000, it was still the exclusive operator in most of the country, and it owned a mobile phone operator that had a market share over 50%. New operators became more numerous after legislation in 2002 facilitated consumer choice. The public's controlling interest in Czech Telecom was sold in 2005; the new owner, Telefonica, also acquired some of the other outstanding shares. Telefonica holds all of the fixed-line assets and accounts for about 90% of the fixed line market, and thus it is regulated as a holder of significant market power in several services. There are three mobile providers, Telefonica, T-Mobile and Vodafone, each of them designated as an operator with significant market power for termination of calls on its own network. The market for originating mobile calls is considered fully competitive.

The Czech Telecommunication Office (CTO) was set up in its current form by the 2005 Telecommunications Law. The members are appointed and removed by the government, on a proposal from the Ministry of Industry and Trade. They serve for staggered 5 year terms, with protections against arbitrary removal that are similar to those that apply to the chairman of ÚOHS. Its responsibilities cover electronic communications, postal services and broadcasting. The Telecommunications Law calls for the CTO to consult with ÚOHS about draft regulations and decisions concerning protection of competition, notably those affecting price and having a significant

effect in relevant markets.8 At one time, there had been a formal memorandum about allocation of jurisdiction between the chairs of ÚOHS and the CTO. The most important areas of consultation are the market analyses leading to determination of significant market power, which is the predicate for CTO regulation to promote competition, and decisions about prices and remedies. The regulatory system follows and implements EU directives about competition in telecoms.

The telecoms sector was largely excluded from the Competition Act between May 2005 and May 2007. The Telecommunications Law in effect during that period barred ÚOHS from taking action where the regulator had the power to set fines or regulate conduct, by providing that claims about access to essential facilities in telecoms could not be addressed as abuses of dominance under the Competition Act. ÚOHS objected to this limitation on the Competition Act and pointed out that EU competition law would still apply in the sector, even if the national competition law did not. The European Commission also objected to the exclusion and began an infringement proceeding over it against the Czech Republic. Facing that opposition, Parliament repealed this exclusion in 2007.

ÚOHS had been very active enforcing the Competition Act to encourage liberalisation and prevent the historic incumbent from preventing competition. That activism may have prompted the industry to ask Parliament for the exemption. In 2002, ÚOHS fined the two principal mobile operators CZK 63 million for discriminatory pricing that discouraged competitive entry; one of these cases was returned to the office after appeal to the courts, and the decision is still pending. In September 2004, ÚOHS fined all three mobile operators a total of CZK 44 million for agreements on interconnection practices that discouraged using lower-cost alternatives. Two months later, ÚOHS fined Czech Telecom another CZK 23 million for abusing its fixed-line dominance by refusing to make a wholesale offer with the technical and business terms that potential alternative ADSL providers needed to make offers to final customers. In 2006, ÚOHS fined Czech Telecom CZK 80 million for another aspect of its efforts in 2003 to discourage competitive entry into broad-band service. And at the end of 2006, ÚOHS fined Czech Telecom CZK 205 million because the "loyalty" feature of its lump-sum pricing plans for small customers discouraged competitive entry. This decision was taken under Art. 82 of the EC Treaty. When the historic fixed-line monopolist took over full control of the principal mobile operator, ÚOHS conditioned its approval of the

8 Telecommunications Law, Art. 130.

transaction on a commitment to non-discrimination. In 2004 ÚOHS approved the merger of the two principal alternative providers of fixed line services, in order to create a stronger alternative to Czech Telecom.

The use of competition law to regulate market power is illustrated by a 2006 ÚOHS decision approving a merger in cable TV and related services. The combination created a firm that controls cable TV systems in all of the major cities and that also offers direct-satellite and broadband internet service. ÚOHS evidently thought that the combined cable firm would be more likely to invest in an alternative hardware network for internet service, while other technologies would become alternatives to cable and satellite delivery of programming. Nonetheless, the Office was concerned about anticompetitive effects at least in the short term, from depriving program suppliers of alternative means of reaching consumers and depriving consumers of alternative means of receiving programs. ÚOHS demanded five conditions before approving the combination. Other networks would have access to programs controlled by the merged firm and its parent on equal, non-discriminatory terms. Prices for services that include the merged firm's broadcast programming were capped. Current program offers to customers in the merged firms' territories would not be changed. Exclusionary tactics against other program providers were prohibited. Cross-subsidy with satellite TV would be disallowed, and the operations must keep separate accounts in order to check that. But customers are complaining that the commitments are not being honoured. ÚOHS may have to act like a regulator to oversee compliance with the terms it imposed.

### *4.1.2 Electric power*

The electric power industry has been substantially open for competition since 2006, when all customers were allowed to choose their supplier. Transmission is a publicly-held monopoly, CEPS, and transmission and distribution are still regulated. The successor to the historic monopoly, ČEZ, still accounts for most generating capacity in the country and for most of the traded energy. But its share of the market has been declining, as supplies from independent power producers and combined heat-electricity producers have increased. The transmission grid is interconnected with the rest of central Europe; however, imports were not an important competitive factor until recently because prices in the Czech Republic have been lower than in neighbouring markets. Instead, ČEZ has been an important exporter, in part because of its recently-operational nuclear base load power. In a liberalised European market, the location of the Czech Republic at the

heart of the grid would introduce competition to compensate for defects in the competitive structure of the domestic industry.

Generation was structurally separated from distribution in the 1990s. But then, in the course of partial privatisation, the industry was substantially re-integrated through acquisitions. A project to privatise separately ČEZ and the eight regional distribution companies was abandoned in 2002. ČEZ remains publicly controlled, with two-thirds of its shares held by the government. Instead, the government took ownership of the transmission grid, and ČEZ acquired control over five of the distributors. The ÚOHS decision approving this combination, which would have had a national market share of about 65%, required ČEZ to divest one of the five distributors. This was not done immediately. The Parliament then amended the Competition Act to permit parties that were subject to an order to ask that it be reconsidered on the basis of changed conditions. The amendment was clearly intended to permit reopening this divestiture order. In 2005, ÚOHS revised the order, eliminating the divestiture requirement and substituting a "virtual power plant". That is, ČEZ was required to make power available, at auction, to competing distributors. The distributors that ČEZ does not control include the Prague power company and two that are held principally by E.On. Some cross-holdings have been eliminated, to make the interests of ČEZ and these potential rivals more clearly distinct.

Further privatisation is not foreseen, at least not soon. In 2005, the deputy minister responsible for energy trade (who is now the chairman of ÚOHS) denied that the government was prepared to sell some of its stake in ČEZ and predicted that would not happen for at least five years. A government proposal to sell a 7% stake on the open market, coupled with ČEZ buybacks that would have the effect of maintaining the government's controlling share, has not materialised.

The sector regulator, the Energy Regulation Office (ERO) regulates transmission and distribution tariffs and supervises compliance with the Energy Act's requirements for non-discriminatory access to the grid. These requirements are elaborated in ERO's operating rules for the transmission and distribution systems. ERO issues licenses for transmission and for trading. Cross-ownership between transmission and other functions is not permitted. A power exchange is now operating, for futures trading in power from Czech generation sources, while an independent market operator under the Ministry of Industry oversees short-term clearing, balancing and the day-ahead market.

There may be a residual role for ÚOHS, to deal with abusive conduct that is not clearly provided for in these regulations. An early decision imposed a fine of CZK 7.5 million on ČEZ for agreements that prevented re-imports of its power between 1999 and 2003, a restriction that would have slowed the liberalisation that was already in process then.

### *4.1.3 Natural gas*

The gas market has been liberalised since January 2007, when all customers gained the right to choose their supplier. Like the electric power sector, the gas sector was restructured in the 1990s to separate transmission from distribution, but then it was re-integrated through acquisition. As in electric power, there are eight regional distribution companies. Six of them are owned by RWE, which also owns the main pipeline system, RWE Transgas Net. The other two regional distributors are now controlled by E.On. RWE has supply arrangements with Gazprom and with North Sea sources. Although the North Sea contracts could account for as much as 25% of Czech consumption, in fact they operate through displacement, so all of the physical gas that RWE sells in the Czech Republic comes from Russia. The principal suppliers of gas other than RWE are a subsidiary of Gazprom and a small producer in Moravia. In 2002 ÚOHS approved the RWE takeover of most of the parts of the traditional integrated monopoly. The ÚOHS decision observed that ERO would regulate prices and thus prevent exploitation of market power, while the company's larger scope of operation would offer better customer service and products such as long-term contracts at stable prices. ÚOHS also anticipated that competitors would enter once the European industry was liberalised. ÚOHS did not anticipate the measures that the incumbent could take to prevent that competition from being effective.

ERO regulates rates for transmission and distribution and issues operating licences for transmission, distribution and storage facilities. It also enforces the operating rules that set terms for non-discriminatory access to transportation and storage services. As the market for large customers opened in 2005, RWE tried to impose a schedule of prices rather than negotiate individual terms with customers. Over a dozen disputes involving customers and regional distribution firms were brought to ERO, which imposed price caps on RWE rates for 2006. The caps were lifted in 2007, but ERO continues to oversee the situation. Access to storage on reasonable terms is a key point of contention now. RWE controls essentially all of the underground storage capacity. Would-be suppliers to smaller customers need accessible storage

capacity to ensure service, but RWE has claimed that it needs all of the capacity to ensure its own commitments. ERO is still dealing with disputes between RWE and the two distributors it does not control about storage access in 2007. Clearer, more effective rules are needed soon, because plans for the next heating season must be made before the summer of 2008.

Competition law enforcement has supplemented regulation to promote liberalisation, sometimes through simultaneous action against the same abuse. In one matter, ERO imposed a fine and ÚOHS imposed both a fine and conditions banning terms in distribution contracts that would discourage dealing with other suppliers. ÚOHS found that RWE had set contract terms about prices and limits on delivery points that prevented competition, discouraging arrangements to supply customers who were authorised to choose their supplier. RWE declined to resolve the competition infringement proceeding by accepting commitments and took the matter to court, objecting to being subject to enforcement action from both ERO and ÚOHS. But the Supreme Administrative Court held that the two agencies played different roles, one of them in promoting competition and the other in deterring and sanctioning restraints on competition.9 Fines against competition infringements can be much larger than the sanctions for violating regulations. In this case, the ERO fine was CZK 15 million, and the ÚOHS fine was CZK 240 million.

### *4.1.4 Agriculture*

A general exclusion for aspects of agriculture is based on the EU's Common Agricultural Policy. The Competition Act does not apply to actions of undertakings in the field of production of and trade in agricultural products provided they act in compliance with the law of the European Communities. (Art. 1(8)) Under Community law, competition rules apply to production and trade in agricultural products unless they are an integral part of a national market organisation or are necessary to attain the Treaty objectives of Community agricultural policy.10 The European Commission has reserved to itself the power to decide about the scope of this exclusion. The exclusion was added to the Czech law in 2004, as many aspects of Czech law were being amended to conform to Community practices. ÚOHS objected to the amendment, and it contends that the exclusion could have no practical

9 Komp. 3/2006-511, *RWE Transgas*.

10 Council Regulation (EC) No. 1184/2006, 24 July 2006.

effect. No case has yet arisen to invoke the exemption. The 2004 amendment also tried to protect producers against unfair practices by retailers, such as demanding payment for product placement. That provision has since been removed from the law.

Another proviso in the Competition Act would exclude some agricultural-market practices without reference to European policy or law, but its scope is likely to be very limited. In principle, agreements of sales organizations and associations of agricultural producers about the sale of unprocessed agricultural commodities are not covered by the general prohibition against restrictive agreements. (Art. 6(1)(c)) But this treatment does not extend to horizontal agreements on price, output and market division or vertical agreements fixing resale price or exclusivity. Nor does it cover individual agreements that are part of a system of agreements involving a substitutable product, provided that the system meets the market-share criteria that apply to the de minimis exclusion.

### *4.1.5 Rail transport*

The Regulatory Reform Review included a chapter on transport, focusing on road and rail. (OECD, 2001) The only issues that it raised in road freight involved constraints on competitive interconnection with the EU, which are no longer an issue now that the Czech Republic is a member of the EU. In rail, reforms have followed EU measures. Freight service has been fully liberalised in principle since the beginning of 2007, but no operators qualified in other Member states provide service in the Czech Republic yet. A program is underway to restructure the historic integrated monopoly, Czech Railways (CD), into separate holding companies for freight service, passenger service and infrastructure construction and maintenance. The freight subsidiary was created at the end of 2007. An infrastructure administrator, SZDC, was created by statute in 2002, but the legal relationships remain complex. SZDC still lacks some necessary authorisations, so infrastructure work is still done by CD, under contract with SZDC. Completing the restructuring should improve transparency and end the cross-subsidies between freight and passenger operations. As entry into freight service has become theoretically possible, ÚOHS has investigated CD's pricing practices to be sure that discriminatory loyalty arrangements are not discouraging entry by tying up profitable customers.

### *4.1.6 Professional services*

Most professional associations have changed their rules to eliminate price lists and other obvious violations of the Competition Act. An

exception is the Czech Chamber of Architects, which still has legal authority under special legislation dating from 1992 to issue a schedule of prices and expected remuneration.

## 5. Competition advocacy and policy studies

The Office considers analysis and comment on regulatory proposals to be an important function. The Office is one of the entities that is regularly called on in the mandatory system for comment on draft regulations and conferring on privatisation proposals. The governments' legislative rules formalise this process and ensure that the Office has an opportunity to participate in the inter-ministerial consultation about draft bills and decrees.

Market studies have been undertaken, of sectors that are large and important to the economy, such as energy, transport and banking. Others were studied because they generated many complaints to the Office. These included water, cable TV and telecoms. The results have been published in the annual reports of the Office. The Office has also used the studies to plan its advocacy.

The Office participated in the negotiations leading up to the basic legislation about restructuring the rail sector in 2002, but not, evidently, in the more detailed recent legislation about transforming CD into a holding company. As the water and sewer sector consolidated through acquisitions and mergers, the Office proposed to set up an independent regulator to oversee these local monopolies. In postal services, the Office pointed out that a Parliamentary proposal to extend the monopoly to direct mail would not only be anti-competitive but it would violate EU directives; it was not adopted. A comment on a draft decree about handling electronic waste products objected to single, collective systems, because these would act like inefficient monopolies, preventing manufacturers from using potentially superior methods, including doing it themselves. The ministry was not persuaded, and the Constitutional Court is now deliberating about the issue.

The Office also uses the term "advocacy" in an unusual sense, to refer both to public education about the benefits of competition and also to its willingness to resolve enforcement matters through negotiation and informal undertakings, except for hard-core violations. The Office has prepared guidelines on this kind of "advocacy", to explain more clearly the kinds of cases for which it will accept commitments or not even open proceedings at all.

## 6. Conclusions and policy options

At the time of the 2001 Review, establishing and strengthening framework institutions and conditions for competitive markets was identified as the most important task for competition policy, one which could call for applying competition law in the process of privatisation and restructuring. Those processes are now largely complete. A comprehensive approach to competition policy, in which the predecessor of ÚOHS played an important role, marked the era of major restructuring. The country's generally good economic performance in recent years is due in significant measure to sound policies about markets and a welcoming approach to investment by foreign firms. Consumers are reportedly enthusiastic about the entry of efficient large-scale distribution chains.

But enthusiasm for competition was less apparent in restructuring network monopolies. After promising moves to create basic conditions for pro-competitive structural separation in the 1990s, decisions about privatisation led to re-creation of integrated national-scale firms. In electric power, ÚOHS argued against these decisions and tried to put conditions on the transactions in order to improve prospects for competition. But those conditions were not fully successful; moreover, Parliament indicated that it supported the incumbent's resistance to them. In natural gas, the decision by ÚOHS to permit formation of an integrated firm with a near monopoly on supply might reflect a realistic anticipation of the likely outcome if the legislature had intervened. In telecoms, after several ÚOHS rulings against abuses by the historic incumbent Parliament excluded the sector from the Competition Act. Here, closer integration into European institutions provided a valuable resource. ÚOHS could apply European law, while pressure from the European Union helped persuade Parliament to reconsider and repeal the exclusion.

Competition law has continued to move into the European mainstream. The carefully crafted legislation is consistent with the EU model, and ÚOHS participates in the integrated enforcement system. In applications, the principal focus has been on network industries, where ÚOHS action has been important while the sector regulators were still becoming established.

Enforcement policies and practices have shifted. A few years ago, the Office's findings in horizontal cases often appeared to rest largely on parallel price increases and information sharing. Some prominent actions challenged price increases for consumer products. These actions may have gotten the attention of business and the public, but they have

taken years to resolve on appeal. Decisions about mergers showed a propensity for structural justifications and regulatory conditions. One seemed to accept the "efficiency offence," ruling against a merger in part because the firm would be able to offer a broad line of widely available products. In two decisions prohibiting mergers, key assumptions about the low likelihood of entry proved to be incorrect. In one of those cases, the Office effectively reversed itself, by permitting the acquisition when the parties presented it again three years later.

Since 2005, new leadership has promoted some new approaches. The Office has stepped up its public relations. It has made clear that it is willing to advise businesses about how they can comply with the law and to work with them to resolve non-hard-core problems through measures other than formal enforcement action. Announcing this new approach may have reassured the business community that enforcement would become more predictable. The shift in approach could improve priority-setting, by targeting the Office's enforcement resources on more serious problems. The Office continues to concentrate on network monopoly abuses, and it has not yet dealt with many home-grown hard-core horizontal cartels. The recent switchgear case was an important opportunity for the Office to show how clandestine international cartels operate and how leniency can be used to uncover them. The outcome also showed how high fines should be to deter future violations, that is, even higher than the parties' total gain from the infringement.

The new leadership has also moved to improve the management of the Office. One result is a sharp decline in the high rate of staff turnover that had been reported in the 2001 Review. The staff has been encouraged to be more accessible to parties. Previously, all communications and contacts had to go through the chairman. In its early years, ÚOHS had a reputation for being opaque about its decisions and reasoning. This new, more open approach is one of several steps that ÚOHS has taken to improve transparency. But the new enforcement approach, toward resolving matters informally, could make outcomes less predictable unless the standards applied are subject to some check to ensure consistency.

The Office is still developing its capacities to do effective ex post enforcement investigations. A complication it is now facing is the treatment of business secrets. Parties have full access to the entire file, although the Office can impose conditions preventing them from making copies or taking notes. Broad access could make it more difficult to get information from reluctant complainants, if they fear that revealing their identity will lead to commercial reprisal. The Office is also concerned about how it can work within the ECN if it would be

required to disclose evidentiary material, even under these conditions, whose confidentiality would be protected at its source. The Office is considering resorting to its previous practice, of withholding particularly sensitive items in the file from full disclosure, instead only describing their contents to respondents. The ministries of justice and public administration are concerned that this practice would be inconsistent with the requirements of Czech administrative law. The impasse will complicate effective enforcement co-operation with agencies in other jurisdictions.

### *6.1 Developments concerning recommendation in 2001 Review*

The 2001 Review contained only a few recommendations about competition law and enforcement. Rather, it emphasised the importance of improving the institutions of corporate governance and finance, noting that the foundations and goals of competition policy, to encourage dynamic adaptability and consumer welfare, show the direction that solutions to those other problems should take, but that the tools of competition policy are not well suited to resolving those problems directly. Since that time, the state's interest in the economy has been transformed and the institutions of corporate governance and finance have become stronger. The state is no longer a major factor in the banking system. The revitalisation agency, created to facilitate the reorganisation of the inherited industrial base, has been closed down and the remaining debts absorbed by the state. The reformed bankruptcy law became effective in 2008. The remaining privatisation possibilities involve infrastructure, such as airports, airlines and the postal service.

The 2001 Review suggested there would be occasions to apply substantive rules and investigative tools of competition law to help solve problems raised by industrial restructuring. One potential issue, situations of interlocking control made possible by post-privatisation investment relationships, evidently never became serious. Not all problems could be forestalled. For example, restructuring in the steel industry apparently produced opportunities for the vertically integrated successor firm to put pressure on its downstream competitors' costs, and those firms have complained about it to ÚOHS.

Restructuring and regulation in electric power and gas involved consultation with ÚOHS, but the result fell short of the recommendations in the sectoral chapters of the 2001 Review. The 2001 Review examined the proposals that were pending at that time to re-establish integrated operations in electricity and gas in the process of

privatising some of the separate firms. It predicted that re-integration would disadvantage the new independent power producers and other potential entrants and dampen competition generally, and that higher revenues from privatisation would be offset by higher costs and inefficiencies hampering economic performance. In both industries, the Czech Republic passed up an opportunity, made possible by its early structural separation of the different operating levels, to create quickly conditions for strong competition in the liberalising European market. The 2001 Review called for requiring Transgas to divest enough storage capacity to support a competitive market, or failing that, for setting up an effective regulatory regime to assure access to storage. Neither has been done, and the consequences are hindering the emergence of effective competition.

To improve co-ordination with sector regulation, the 2001 Review recommended that the Office consider formalising its relationships with the new independent regulators. For a while, ÚOHS and the management of the telecoms regulator set out their respective responsibilities in a formal memorandum. That memorandum is no longer operative, but relations between them have stabilised, as the Parliamentary intervention in the assignment of jurisdiction has been repealed, while courts have recognised and articulated the agencies' different jurisdictions and roles.

Government-imposed constraints on competition were banned by Article 18 of the original Czech competition law. The Czech Republic was planning in 2001 to replace this transition-era rule with one analogous to Article 86 of the EC Treaty. The 2001 Review recommended reconsidering that step, pointing out the potential value of retaining a stronger statement of principle. But Article 18 was nonetheless replaced. ÚOHS feels that the general treatment that is used now is working reasonably well. Restraints arise mostly at the municipal level, where ÚOHS resorts to advocacy. But ÚOHS can also ask the Ministry of Interior to prevail on the municipality to change the law. The Ministry can suspend the effect of an anticompetitive local decree and ask the constitutional court for a ruling about it.

The only recommendation about competition law enforcement in the 2001 Review supported the plan to adopt a leniency program. Although a program was duly adopted, it was not applied for the purpose of making cartel enforcement more effective until much later, indeed not until it was overhauled in 2007. The first application of leniency in the old program was in an inappropriate setting, although the result was sensible: to impose a light penalty against an exclusive dealing arrangement that might not have had much actual anti-

competitive effect. For the current program to be effective, ÚOHS needs to be sure that its public messages are clear. Leniency programs encourage compliance by instilling fear that someone else in the cartel will reveal it, first. Promoting informal resolution of enforcement matters encourages compliance through accommodation, forgoing formal enforcement if firms are willing to fix problems. It is very important to be clear about what constitutes the hard-core violations for which ÚOHS will not work out a negotiated non-enforcement resolution, but for which leniency might be available to the first one to bring in the case.

## *6.2 Policy options for consideration*

### *6.2.1 Strengthen sanctions to deter hard-core violations.*

The threat of sanctions against individuals who are involved in setting up and running a cartel can make enforcement more effective. A new criminal sanction is included in the government's criminal code proposal and is now before the Parliament. ÚOHS has pointed out that this move follows trends in other jurisdictions. It would be limited to hard-core cartel behaviour, thus avoiding any concern that enforcement of other aspects of the Competition Act could be distorted by threats of unduly harsh penalties. Making the criminal sanction work will require establishing good working relationships with the prosecutors who will be responsible for applying it.

Another improvement in the sanctions system should also be considered. Where an association is the vehicle through which parties reach a prohibited agreement, the sanction against the association is determined by reference to the association's turnover. That is likely to be low, and the sanction against the association is not likely to deter the members (though by increasing the association's costs or putting it out of business, it would increase the members' transaction costs of organising agreements). Basing the sanction on the turnover of the members of the association, who are the actual beneficiaries of the restraint on competition, would lead to more effective deterrence.

### *6.2.2 Make investigative powers more effective.*

The Competition Act authorises the Office to engage in dawn raids. This power would be more effective if the Office could rely on support from law enforcement bodies when businesses resist granting access or hinder the Office's investigators. The Office has found that police have not been able to help out in these situations, apparently because they feel their other duties take higher priority. Enactment of the proposed

criminal sanction might tend to improve the level of co-operation generally. Giving prosecutors an important role in enforcing competition law could make the law enforcement community more supportive.

### *6.2.3 Avoid conflicting goals by keeping bargaining-power disputes out of the Competition Act.*

ÚOHS has been willing to add liability for abuse of "economic dependence" to the Competition Act. The proposals that ÚOHS has supported would define "dependence" in terms of the parties' relative bargaining positions and the dependent parties' lack of profitable alternatives. The factors involved in assessing whether parties were dependent would include market share, proportionality of consideration, absence of alternatives, specialisation in labelling or packaging and risk to competition from the counter-party's economic and financial power. Trying to sort out these distribution-chain disputes can embroil competition enforcement in technical minutiae and inhibit strong price competition. If problems that deserve attention are traced to practices by large retailers that do not amount to abuses of market power, those ought to be addressed by other measures, such as clearer and more efficient means for resolving commercial disputes.

### *6.2.4 Avoid conflicting outcomes by applying the Price Law only to exploitative abuses.*

Even though the courts have permitted the Price Law's rule about pricing below cost to co-exist with oversight of predation under the Competition Act, it would be better to eliminate the overlap by eliminating that special rule. The Price Law rule is either confusing, by being something like a competition law but outside the jurisdiction of the competition enforcement agency, or it is not really a competition law but instead something that could be used to dampen competition rather than protect or promote it. Removing the separate rule about pricing below cost would eliminate a source of potential "false positives". It might be appropriate to leave the rest of the Price Law in place, available to support intervention against exploitative price abuses where there is reason to be concerned that new entry would not correct them quickly enough.

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