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More documents related to this discussion can be found at
<http://www.oecd.org/daf/competition/barriers-to-exit.htm>

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Spain*

1. Supply side barriers to exit and competition policy in the Spanish banking Industry restructuring

1. Over the past decade, the most important concerns regarding barriers to exit the Competition Authorities have come across in Spain were probably linked to the restructuring and resolution of banks.

2. Given the scope of the financial crisis and the particular features of banking activity (information asymmetries, externalities and contagion risks, etc), public authorities, and Spain was no exception, turned to different tools: liquidity injections, direct asset purchases, guarantee schemes, capital injections and nationalizations, mergers, etc. The implementation of public policies to restructure some banks and ensure the orderly exit of other raised some concerns over its potential impact on competition. There could be inefficient incumbents not being allowed to exit the market or not doing it in a timely and appropriate manner, as a result of a trade-off between competition policy and the preservation of financial stability. But concerns and solutions evolved. Fortunately, the banking industry in Spain allowed for further consolidation (i.e. an HHI well below 1000 at that time), and State Aid and Resolution frameworks for banks were gradually developed, so that a balance between both objectives could be struck. Financial regulation played an important role to deal with exit barriers, in a way that was not within the grasp of competition policy.

3. Before the 2012 Financial Assistance Programme, the Spanish Banking sector was already going through an intense restructuring process. For instance, the savings banks consolidation process (their number had gone down from 45 to 15) had an important impact on the size, business model, balance sheets and efficiency of these institutions, as the European Commission (EC) put it¹. But, positive as these achievements were, there also was a number of shortcomings. The Commission considered that some of the mergers “*resulted in bigger but not necessarily stronger entities and they continue to pose challenges to the financial stability of the Spanish banking sector. In addition, [...], further improvements with respect to the corporate governance of savings banks are recommended*”. So, there were improvements to be made, according to the experience gathered in the restructuring of the financial sector in Spain and other member states.

4. As a result, competition policy, financial assistance (when implemented) and financial regulation followed a complementary strategy that served to minimize the risk of exit barriers hindering competition in the banking sector. The alleged trade-off between competition policy and financial stability was managed through the simultaneous and convergent use of these instruments.

- **Financial Assistance Programme:** on July 2012 the Eurogroup agreed on a financial assistance programme for the recapitalization of Spanish financial institutions, following restructuring and resolution plans approved by the European

* Contribution prepared by CNMC.

1 EUROPEAN ECONOMY Occasional Papers 118 | October 2012. The Financial Sector Adjustment Programme for Spain

Commission under state aid rules. It made available up to €100 billion for a period of 18 months². The amount finally used was slightly above 40% of the total envelope. The July 2012 MoU included both bank-specific conditionality, in line with State aid rules, and horizontal conditionality.

It is worth noting that, as the Commission's Evaluation Report of the Programme concludes "The implementation of the programme was framed in an evolving environment in the EU with regard to bank supervision and restructuring/resolution structures. A common framework at supranational level for bank restructuring and resolution was being put in place during the programme period, but it had not yet entered into force. The measures implemented under the programme followed the direction of this new framework while they also complied with EU State aid rules". That is to say, a convergence path between different instruments was being planned and the Programme reflected that circumstance.

As a matter of fact, the bank-specific conditionality³ included, besides a comprehensive diagnostic of the capital needs of individual banks, the segregation of impaired assets from the balance sheet of banks receiving public support, and the recapitalization and restructuring of viable banks and an orderly resolution of non-viable banks, with private sector burden-sharing as a prerequisite. These conditions were later incorporated in the stated aid and resolution frameworks. As the Commission says in its evaluation of the Programme of Financial Assistance to Spain "Conditionality with regard to the restructuring and resolution of credit institutions was designed in a context of transition from national solutions compliant with EU State aid rules to a common resolution framework"⁴.

Besides, horizontal conditionality, which applied to the entire banking industry, included the adoption of series of measures, among others, the strengthening of the regulatory, supervisory and bank resolution framework and of the governance structure of savings banks and of commercial banks controlled by them, in order not to encounter the same governance problems again.

- **Resolution framework:** In June 2012, the European Commission launched a proposal for a directive establishing a framework for the recovery and resolution.

2 In its evaluation of the Programme the Commission concludes that "Implementation of the programme's financial sector conditionality was overall fast and forceful, with most major measures frontloaded to 2012. Overall, the adopted measures were effective in achieving the programme's objectives in a short period of time [...]. The use of the financial envelope, less than half of the available amount, achieved the programme's objective while meeting EU competition rules requiring to minimise the amount of granted State aid."

3 It applied to banks unable to meet capital shortfalls identified by the bank-by-bank stress test without having recourse to State aid

4 Such common framework "aimed at minimising the risk to financial stability and was based on the principle that shareholders and creditors should bear an appropriate share of the losses when resolution action is taken. Compared to the existing frameworks in most Member States at the time, the proposal overall extended the possibilities for burden sharing by the private sector. The burden sharing provisions in the MoU followed the spirit of the discussions on the common resolution framework at the time, considerably expanding loss sharing compared to previous euro area programmes. Partly as a result of this evolving framework, bail-in provisions were not fully consistent across the euro area". Evaluation by the Commission of the Programme of Financial Assistance to Spain

In January 2015 the Bank Resolution and Recovery Directive (BRRD) entered into force, introducing the default option for failing banks to go into normal insolvency proceedings, unless the resolution authority decided that it is in the public interest to resolve the bank in line with the BRRD. It also required that state aid to failing banks notified to the Commission after 1 January 2015 could only be granted if the bank was put into resolution, with the exception of the so-called "precautionary recapitalization". The bail-in requirements for banks in resolution under BRRD required that contributions from the Single Resolution Fund could only be made after a bail-in of at least 8% of the bank's total liabilities, and could also entail converting senior debt and uncovered deposits. Any contribution of the Fund was subject to a State Aid Decision by the Commission. Hence, EU State aid rules would continue to apply in full in parallel.

- **State aid control:** The applicable State aid Communications were updated by the Commission to adapt to the evolution of the financial crisis and reflect the lessons learnt thus favoring the convergence process (i.e. from 2013 on shareholders and subordinated debtholders would have to contribute before aid could be granted, state aid would no longer be granted on a temporary basis but only on the basis of an agreed restructuring plan and after all private capital-raising measures had been exhausted).

5. The changes the Spanish banking industry have gone through in the past decade are very important. The Spanish Resolution authority (FROB) has, somehow or other, intervened in approximately one third of the Spanish banking industry. The sector has digested the imbalances accumulated before the crisis mainly through mergers and acquisitions. From the existing 122 institutions existing in 2008, the number has gone down to the current 61. The assets of the banking sector have been reduced by nearly 20%, and 20.000 branches (44% of the total number in 2008) and about one out of three jobs (nearly 89.000) have disappeared in the process.

6. The market concentration has inevitably increased. In 2008, according to the ECB structural Financial Indicators, the five largest banks (CR5) accounted for 42% of the market, in terms of total assets whereas in 2018 their joint share in terms of total assets was 68,5%. The ECB calculated HHI based on total assets rose from 497 to 1138, still well below the usual benchmark of 1800.

7. The Spanish Competition Authority has approved during the last 10 years more than forty mergers within the banking industry, all of them in phase I, with neither remedies nor need for in-depth analysis. In many cases, in particular, under the assistance Programme, as the Commission Evaluation says, *the restructuring plans of banks receiving State aid foresaw that those banks should refocus their business model on retail and SME lending in their historical core regions*. Geographical overlaps were limited in scope. In more recent cases, such as the acquisition of BMN by Bankia or Banco Popular by Santander, conclusions do not change. In the Santander/Popular case, once the ECB decided that Popular was "failing or likely to fail", the Commission adopted a decision based on Article 7(3) of the Merger Regulation granting the derogation from the standstill obligation and later gave the green light in phase I.

8. It is true that in the retail banking market, in principle of national scope, if a regional analysis in the most recent transactions is carried out, aggregate market shares of the merging parties in a few provinces can reach between 30 and 40%. But both the EC and the CNMC conclude that important competitors remain present, thus leading competition authorities not to oppose the transactions. As experts claim *"Despite undergoing one of the*

*most profound financial sector consolidation efforts within the EU, at the national level, the Spanish banking sector remains below the threshold level of a highly concentrated market, although a provincial-level analysis reveals higher levels of concentration.*⁵ As a matter of fact, in the retail banking market, both EC and CNMC complement the analyses performed at the national level with the impact at the provincial level to prevent any problems.

9. To sum up, the Spanish banking Industry has carried out an intense consolidation process. The risks that such process entailed in terms of possible exit barriers or risk to competition have been largely offset by the parallel and complementary action of competition policy, financial assistance conditionality and financial regulation. In particular, the financial assistance programme was consistent with EU rules and future regulatory initiatives and benefitted from them, as the Commission recalls.

10. This should be a lesson to keep for the future, because risks remain. For example, it is important that the common resolution framework is completed with the necessary harmonization of the bankruptcy regime applicable to credit institutions in the Banking Union. Insolvency proceedings are usually slow and inefficient to form an equally effective alternative to the resolution of a non-viable bank by authorities such as the Single Resolution Mechanism (SRM) or the Spanish FROB. The regulations of some Member States provide for special regimes that favor the agility necessary to handle bankruptcy. However, in other countries, there is no a fast and reliable procedure for these entities in the system. Therefore, whereas the SRM turns to a harmonized resolution regulation, in case of regular insolvency proceedings 19 different insolvency regulations could apply which implies possible different treatments for identical liabilities within the Banking Union. The most important consequence of this situation is that, to the extent that the concept of public interest, which is the key that triggers either resolution or insolvency proceedings, is relatively dynamic and flexible, the existence of bankruptcy proceedings more or less effective can end up leading to different treatments for similar situations. That is to say, exit could be handled in a different way due to legal heterogeneity. It is important to rule out that kind of risks. That is a risk that could affect competition, but that cannot be dealt with from the competition legal framework. Once again, regulators have an interest to intervene in other areas to protect competition.

2. Demand side barriers to exit and mergers:

11. In some cases, the introduction of barriers to exit for customers (making it more expensive to switch to other supplier) plays as a barrier to entry for new competitors. So, competition authorities turn to offsetting remedies:

2.1. Reducing barriers to exit imposed on partners to reduce the impact of vertical integration: Case COFARES HEFAME (Merger from 2006)

12. In contrast with the situation in other EU Member states, medicine wholesalers in Spain belong to a long extent to the pharmacists who run pharmacy offices (retailers). Such

5 “Banking concentration in Spain at the provincial level.” Joaquin Maudos SEFO FUNCAS. <http://www.sefofuncas.com/pdf/Maudos.pdf>

vertically integrated wholesalers, under the form of cooperatives, have a high number of cooperating partners.

13. This vertical integration can present advantages for pharmacists (on one hand, stemming from the tax regime of cooperatives, and, on the other, linked to the reversion to the retail pharmacist of the profits of the wholesale distribution activity by aggregating demand to obtain volume discounts from pharmaceuticals). But it can also play as an entry barrier for independent newcomers who might face:

- competition not only from their peer wholesalers but also from retailers participating in the incumbent wholesalers, and
- lack of transparency to assess the incumbent's cost chain due to the transfers of income between the cooperatives and their partners.

14. Cooperatives turn to a number of instruments to strengthen the loyalty of their retail partners: economic tools like the supply of financial, IT and other services, or discounts to their partners, and legal or statutory tools aimed at capturing their partners such as trial periods for new partners, minimum periods of membership in the cooperative or minimum thresholds for purchases to the cooperative.

15. The merger COFARES/HEFAME, the first and third medicine products wholesalers in Spain, would have led to a market share of nearly 30% in Spain (and above 50% in some provinces) nearly tripling the market share of the second player. So, the transaction threatened to undermine effective competition in a number of provinces. This risk was also increased by the low number of competitors in regional markets, the low price-elasticity of demand, the insufficient pressure to be exerted by potential competitors, and the vertical integration of the resulting entity that create increased legal barriers to entry through the statutory obligations that their retail partners had to comply with.

16. So, in spite of the contribution to efficiency the transaction could entail, the risks for effective competition in some regions were such that the competition authority approved the merger subject to a single condition: the statutory reduction by the resulting entity of the duration of the minimum membership period to one year and the reduction of threshold of minimum purchases to the resulting entity to 25% of the total purchases of each retail pharmacist in the cooperative.

17. In short, in this case the reduction of statutory barriers to exit imposed on the partners of the merging entities, that prevented retail pharmacists from turning to other suppliers (minimum number of years for members to be able to recover their investment and minimum purchase threshold) was used as a remedy to reduce the barriers to entry created by vertical integration. On such condition the merger was approved although the parties finally desisted.

18. A similar assessment of vertical integration and barriers to exit in these markets has taken place in subsequent mergers between cooperatives⁶, in many of which the less restrictive statutory conditions of one of the merged parties have been extended to the

6 C 0725/16 HEFAME / COOFAMEL ACTIVOS; C- 0745/16 CECOFAR / FARMANOVA GROUP (creation of BIDAFARMA); C-866/17 BIDAFARMA / COFAGA C-0958/18; BIDAFARMA / ZACOFARVA; C- 0959/18 BIDAFARMA / SOCOFASA: In all these transactions between cooperatives present in the medicine products wholesale market the analysis is similar, and the outcome is the resulting entity adapting to the least restrictive statutory barriers between the merging parties.

partners of the other to mitigate the risk of increasing barriers of exit from the merged entity.

2.2. Reducing barriers to exit from the demand side (exclusivity requirements) to offset scale and network economies: C/0730/16 JUST EAT/ LA NEVERA ROJA

19. On February 2016, the CNMC received the notification of the acquisition of exclusive control of the Group Yamm Comida a Domicilio, S.L., which operated under the brand “La Nevera Roja” (LNR), by Just Eat PLC. (JUST EAT).

20. The merger affected the national market for online food delivery service. The resulting entity would have very important market shares, both parties were close competitors and had similar business strategies. The size of the rest of competitors was far smaller, either in terms of affiliated restaurants or volume of managed orders. Some competitors had left the market (Ikiora) whereas there were some newcomers (Deliveroo).

21. Before the transaction, JUST EAT and LNR had already important scale and network economies. This was reflected in the greater attractiveness of their commissions charged to restaurants, and had led competitors to deploy alternative competitive strategies.

22. The relevant market had important barriers to entry, as strong investments in advertising and marketing (coupons and discounts) were needed to reach a significant scale.

23. It seemed, though, that both parties had not turned intensively to exclusivity strategies. As a matter of fact, a very important number of restaurants on one platform was simultaneously present on other competing platforms. But it could not be ruled out that after the transaction the resulting entity had the capacity and incentives to use exclusivity strategies with restaurants. Increasing the cost of multihoming or the cost of switching to other platforms was a likely risk stemming from the merger.

24. In view of that, there were serious doubts about the effects of the merger, in the absence of commitments, as it could significantly hamper competition in the Spanish online platform for food delivery service.

25. So Just Eat committed itself, for a three-year period:

- Not to maintain or establish any formal or de facto exclusivity clauses, total or partial, in its contractual relationship with restaurants (current or future) affiliated to their platforms in Spain.
- Not to link, neither direct nor indirectly, the level of commissions agreed with restaurants (current or future) with any kind exclusive relationship with JUST EAT SPAIN platforms.
- Not to penalize affiliated restaurants (current or future) for joining third party platforms.

26. As a result of these commitments, the CNMC concluded that JUST EAT would see severely limited its ability to develop exclusivity strategies to stop or hinder the growth of alternative online platforms

27. Besides, given that the online market for food delivery service was expanding and considering that the competitors of the resulting entity were developing different competitive strategies, the CNMC concluded that the resulting entity could not foreseeably prevent the development of alternative competitors if subject to such commitments.

28. So effective competition in the Spanish market for online food delivery service was protected by eliminating the risk of creating barriers to exit for restaurants. Recent merger control assessment in this market has proven the effectiveness of these remedies. The successful entry into this market of new players such as Deliveroo, Glovo or UberEats probably would not have taken place in the absence of JUST EAT's commitment on the use of exclusivity clauses.

3. Advocacy: Railways liberalization and power generation plants closure

29. Barriers to exit have been dealt with by the Spanish competition authority on several occasions, from an advocacy perspective. Two recent examples illustrate this:

3.1. Study on the liberalization of passenger transport services by rail 2019 (July 2019): how to reduce sunk costs to make liberalization attractive to newcomers.

30. The Spanish Competition Authority published on July 2019 a "*Study on the liberalization of passenger transport by rail*" (E / CNMC / 04/19). This report is part of a set of initiatives aimed at promoting the opening of the sector to competition as of December 2020. The objective of this study is to analyze the market for commercial passenger transport services by rail in Spain, and to assess the main challenges and obstacles for the introduction of competition, in order to formulate recommendations to the competent authorities to ensure its effective liberalization. The study draws on the liberalization experiences of the markets for domestic commercial passenger services by rail in several European countries, which have drawn positive results in terms of increasing the number of passengers, distance travelled, train frequencies, quality of service and lower prices.

31. The strategic relevance of rail transport and its nature as a network industry explains why the State has traditionally had a strong presence in the sector. In recent years, the European Union has promoted the gradual opening of this sector to competition. The liberalization process has been implemented through the so-called "railway packages". The Fourth Railway Package, adopted in 2016, completes this process by opening the market of commercial passenger transport services by rail in the year 2020.

32. In Spain, the transposition of European Directives into national laws promotes a model of vertical separation in which the infrastructure management operations, entrusted to ADIF and ADIF Alta Velocidad (ADIF High Speed) are unbundled from the provision of transport services, provided by the incumbent operator RENFE. All of these companies remain state-owned, and they are operated under the Spanish Ministry of Public Works.

33. The railway sector exhibits certain features that can favour liberalization. In particular, the Spanish railway infrastructure presents excess capacity and low levels of congestion, which makes it easier for new operators to access the infrastructure. In addition, the small overlap between commercial services and those subject to Public Service Obligations (PSO) facilitates entry into the market.

34. The study focuses on several problems that need to be solved in order to have a successful liberalization, among which, sunk costs stemming from access to rolling stock stand out. The access to and maintenance of rolling stock is a considerable barrier to entry for new operators due to the high cost, the technical characteristics specific to the Spanish

network and the absence of rolling stock leasing companies and maintenance companies independent from RENFE.

35. Access to rolling stock constitutes an important entry barrier for rail operators (in fact, it is an outstanding sunk cost that makes exit very expensive), due to the high investment and the time required for its authorization to put into service. For instance, high speed trains entail investments between 20 and 30 million euros per train. This amount could be higher in Spain, due to the different signaling technologies, which require, to ensure complete network coverage, that the rolling stock is interoperable in the different systems (ASFA, LZB, ERTMS levels 1, 2 or both, etc.), or, on some occasions, the issue of the Iberian railways width. Related markets for the sale and rental of rolling stock have been defined at European level as different markets since there are differences that make, for practical purposes, few substitute markets in the short term. Compared to the acquisition of rolling stock, the rental has a significantly lower cost and, therefore, operators face lower market entry costs. In addition, the acquisition of railway material may be slower because it requires approval, and it can take between two and three years.

36. Therefore, the CNMC recommends:

- facilitating the opening of new maintenance facilities and guaranteeing that new entrants have access to the heavy maintenance services of the incumbent, Renfe Fabricación y Mantenimiento (Renfe Manufacturing and Maintenance), as well as to the rolling stock that RENFE does not need to provide its services and PSO, on a transparent, objective and non-discriminatory basis.
- promoting the structural independence between Renfe Alquiler (Renfe Leasing) and Renfe Fabricación y Mantenimiento from Renfe-Operadora (Renfe Operator), by means of creating separate companies for leasing and maintaining rolling stock that are completely independent from Renfe-Operadora.

3.2. The CNMC assessment on the creation of barriers to exit in power generation: report on the Royal Decree Draft regulating the closure procedure of power generation facilities (January 2018 at the request of the Secretary of State for Energy. IPN/CNMC/039/17)

37. This Royal Decree Draft aimed at developing the provisions of article 53 of Electricity Sector Act 24/2013, which regulates the final closure of generation facilities. It tried to make sure that decisions on the closure of power plants were consistent with the energy planning instruments and with the objectives of security of supply, climate change and energy prices. Therefore, it had a direct impact on exit costs.

38. The Project allowed the authorization of the closure of an installation only when this closure did not threaten the security of power supply, and when unfavorable effects were not expected on electricity prices, on competition in the electricity market and in the compliance with the objectives in current energy and climate planning.

39. However, as the CNMC underlines in its report on this regulatory initiative, the 24/2013 Electricity Sector Act only foresees that the definitive closure of generation facilities requires the report of the System Operator which will only give a green light if the plant closure does not jeopardize the security of supply. But that Act does not mention the rest of the criteria contemplated by the Project (unfavorable effects on prices, or on competition or on planning objectives), when assessing the possibility of refusal of the closing request. Therefore, the possibility of conditioning the closing authorization by

criteria other than the security of supply itself could contradict the general principles of freedom of enterprise and the indicative nature of power generation planning.

40. Besides, from the point of view of the European legal framework, the application of these criteria could be contrary to the objective of the Proposal for a Regulation on the internal market raised in the Winter Package that was being negotiated at that time. According to it, market regulations must allow the entry and exit of generation companies. Thus, article 3 establishes the freedom to leave the plants based on their economic viability: "*the market rules will allow the entry and exit of electricity generation and supply companies based on the evaluation of the economic and financial viability of its operations*".

41. With regard to the impact on competition, the CNMC notes how unusual it would be to prevent an agent from leaving the market to safeguard the level of competition, a measure that has a difficult fit in national and EU competition law. The CNMC considers that it is inconsistent to deny the closure of plants for that reason when, precisely, at least from a dynamic point of view, the level of competition in the market depends on the freedom of entry and exit into it. In this sense, it stressed that the Electricity Sector Act itself foresees that the generation activity is carried out under a free competition regime, being essential for this that there are no unnecessary, disproportionate or unjustified obstacles to its entry or to its exit. Additionally, even recognizing that, temporarily, the closure of plants could affect the degree of concentration of the plants active in the market, it should be recalled that there are already ex post monitoring tools that allow the CNMC, within the scope of its supervisory powers under Law 24/2013 of the Electricity Sector and Law 15/2007 on the Defense of Competition, to sanction, where appropriate, an eventual non-competitive behavior of agents that could arise after the closure of a plant. In fact, the additional provision 8 of Law 24/2013 provides for the possibility of issuing reports by the CNMC on the market when there is evidence of lack of effective competition.

42. Regarding the impact criteria on the planning objectives, the CNMC recalls that, in accordance with Act 24/2013, electricity planning analyzes the resources necessary to meet the demand, "*all in terms that foster an adequate balance between efficiency of the system, security of supply and protection of the environment*". However, such planning, in the field of generation, is indicative, so it is considered that in order to achieve the objectives set out in the planning, it would be more appropriate to use other tools such as mechanisms to support renewable energy or even the capacity mechanisms themselves that, according to the Winter Package, allow the plants to be discriminated based on their CO₂ emissions, and can also be granted to renewable energy, with the corresponding caution that there is no over-compensation.

43. So, to sum up, the CNMC report concludes, among other considerations, that:

- Although there is currently excess capacity, it is considered necessary to develop the regulatory framework that is applicable in a future scenario of possible security of supply problem. However, in order to consider the impact that plants closure may have on the competitiveness and sustainability of the energy system, it is necessary to address this regulatory framework together with the revision of the security of supply methodology, the development of the hibernation procedure, the review of the capacity mechanism, and the authorization procedure to ease the entry of new facilities.
- The Draft contemplates a series of criteria (unfavorable effects on prices, or on competition or on planning objectives) when assessing the possibility of refusal of

the closure request that is not included in Law 24/2013 or in the European regulations in preparation and that turn out to play as barriers to exit in an activity that must be carried out under a regime of free competition (Article 8 of the Law).

- The closing authorization procedure, in the proposed wording, does not fit with the provisions of Act 24/2013 of the Electricity Sector.

44. The government decided on March 2018, on procedural grounds, to turn the Draft Royal Decree into an ordinary Draft Law that was sent to the Parliament on April 2018. In September 2018, the Draft Law was not finally endorsed by the Parliament.