



Competition Law and Policy in the Czech Republic

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Introduction

Competition law and policy in the Czech Republic have converged on European practices. Since the OECD review of Czech competition policy in 2001, the country has joined the European Union, while the Czech Competition Act has been revised and now closely follows the substantive terms and enforcement methods of the European Commission. The Czech competition agency, ÚOHS, has evolved through a change in leadership and a shift in its enforcement approach. For most issues, ÚOHS is willing to advise businesses as to how they can comply with the law and to work with them to resolve problems through measures other than formal enforcement action.

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 when this sector was excluded from the Czech Competition Act (from 2005 to 2007). In electric power and natural gas, decisions about privatisation led to the 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. 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. The new leniency program adopted in 2007 should be a more effective 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 against associations that are the vehicle for reaching prohibited agreements. ■

How has EU membership changed Czech enforcement?

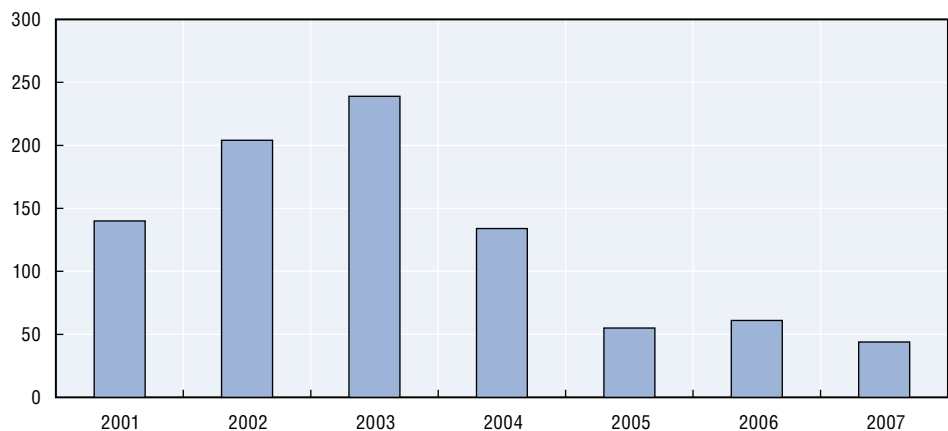
When the OECD reviewed competition policy in the Czech Republic in 2001, the principal task for establishing vigorous market competition was to restore and improve framework institutions in finance and in corporate governance. Since then, the reconstruction of the pre-1990s system has culminated in membership of the European Union in 2004. Solid economic performance and stable growth have followed from post-transition integration into European markets and institutions. Along with those changes, improvements in Czech competition law have aligned it with EU institutions and practices.

The Czech Competition Act has been substantially revised twice. The first revision, in 2001, updated the transition-era framework statute from 1991 by replacing features designed to correct monopolised market structures with basic elements of EU law. One such change was to replace a rule targeting anti-competitive actions by government-related entities with one that parallels the EC Treaty in applying competition law to providers of public services.

The second major revision accompanied the Czech Republic’s accession to the EU in 2004. Enforcement practice now conforms to new EU methods and ÚOHS no longer deals with applications for individual exemption. Block exemption regulations under EU law are automatically incorporated into Czech law. The standard for mergers is now the same in Czech law and the EU merger regulation. Czech law empowers ÚOHS to apply EU law as well as national law. The first case under the EC treaty, concerning abuse of dominance in telecoms, was opened in 2004, and ÚOHS has now completed three enforcement matters applying the EC Treaty.

The judiciary has treated this concurrent jurisdiction with scepticism. Court rulings have held that ÚOHS could not decide that conduct infringed both the national competition law and the EC treaty, and that parallel proceedings at ÚOHS and other EU enforcement bodies would violate civil law principles. ÚOHS has appealed these rulings to the Supreme Administrative Court.

Figure 1.
FEWER MERGER REVIEWS
Merger proceedings initiated



Source: ÚOHS

What are the competition issues in network industries?

The substantive test for approving a merger was amended in order to follow the revision of the EU merger regulation. The merger-review docket has shrunk since entry into the EU. The threshold for notification now incorporates a “local nexus” test, which has reduced the number of filings. ■

Competitive concerns are common in the network sectors. Competition law enforcement has supplemented regulation, sometimes through simultaneous action with the regulators. Fines against competition infringements can be much larger than the sanctions for violating sectoral regulations. Nonetheless, the functions are distinct. 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. ÚOHS acts *ex post*, to protect competition by correcting and deterring conduct that undermines or restrains it.

Restructuring and privatising the electricity and natural gas sectors were the most important and difficult merger decisions ÚOHS addressed.

Electricity

Electricity 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. During the deliberations over the restructuring plan, ÚOHS objected to re-establishing a monopoly through the distribution level. Despite government backing for the overall plan, ÚOHS imposed some conditions when ČEZ, the successor of the historic monopoly, moved to acquire most of the regional electricity distribution companies. One condition was a divestiture, so that ČEZ would end up with four of the eight regional distributors. This divestiture was not carried out immediately, however, and the Parliament amended the Czech Competition Act to permit reconsideration. In 2005, ÚOHS cancelled the divestiture order and instead required ČEZ to make power available, at auction, to competing distributors.

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 it was then re-integrated through acquisition. ÚOHS approved the merger of RWE Gas AG with Transgas, which combined the monopoly importer and transmission system with six of the eight regional distribution companies. The ÚOHS decision observed that the energy sector regulator would prevent exploitation of market power, while the merged company’s larger scope of operation would offer better customer service and products. ÚOHS also anticipated that competitors would enter the market once the European industry was liberalised. ÚOHS did not anticipate the measures that the incumbent could take to prevent that competition from being effective.

The principal condition of approval was that the new firm could not acquire the country's only gas producer, whose gas field could be used for storage. In addition, the new firm was barred from the electric power and heating sectors 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 ÚOHS's expectations about how formal liberalisation would lead to real competition may have been unrealistic.

Competition law enforcement has reinforced sector regulation here. An action in 2006 led to the largest fine ÚOHS had issued by that date, CZK 370 million, for violations of both the Competition Act and Article 82 of the EC Treaty. The infringements listed included discriminatory contracts, territorial constraints and discriminatory terms that denied competitors access to storage. In addition to the fine, ÚOHS issued an order to reform the contracts to end discrimination against non-group distributors and to remove barriers. ÚOHS and the energy regulator are still working on ways to deal with the storage problems.

Telecommunications

ÚOHS had been very active in enforcing the Competition Act to support liberalisation. In 2002, ÚOHS fined the two principal mobile phone operators for discriminatory pricing. In September 2004, ÚOHS fined all three mobile operators for agreements on interconnection practices. Two months later, ÚOHS fined Czech Telecom for abusing its fixed-line dominance in ADSL. In 2006, ÚOHS fined Czech Telecom for another aspect of its efforts to discourage competitive entry into broadband service. And at the end of 2006, ÚOHS fined Czech Telecom because the "loyalty" feature of its pricing plans discouraged competitive entry. This decision was taken under Article 82 of the EC Treaty.

That active enforcement may have prompted the industry to ask Parliament for an exemption. The Parliament excluded the telecoms sector from the jurisdiction of the Czech competition law in 2005. ÚOHS 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 infringement proceedings against the Czech Republic. In the face of this opposition, Parliament repealed this exclusion in 2007. ■

How does ÚOHS encourage compliance?

Measures other than formal decisions and orders are now commonly used to encourage compliance with competition law. ÚOHS has the power to accept commitments proposed by the parties and to terminate an investigation without making a finding about liability. In addition, ÚOHS has actively promoted disposing of relatively minor complaints about vertical restraints through negotiated resolution of problems, without opening formal proceedings at all. ÚOHS calls this process "advocacy." ÚOHS has prepared guidelines to explain more clearly the kinds of cases for which it will accept commitments or not open proceedings at all.

Correcting and eliminating resale price agreements is now a high priority. ÚOHS finds that the business public still needs to be educated about this issue. Firms behave as though they do not know it is prohibited. ÚOHS has combined enforcement with willingness to accept commitments when firms reform offending contracts. For example, 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.

Fines, rather than commitments, are preferred in hard-core cases. Until 2005, ÚOHS 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, ÚOHS 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. ■

Should competition law tackle pricing and contract disputes?

ÚOHS believes that a law is needed to deal with firms that unilaterally extract favourable business terms in contracts, even though they do not have a dominant position in a market. ÚOHS claims that abuse of contract partners' economic dependence may lead to serious distortions of competition. ÚOHS proposed a law incorporating this principle, but it withdrew its support after Parliament moved to expand the scope of liability. ÚOHS objected to creating a new ban on sales below cost, since that issue was already covered by other law. 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.

To avoid conflicting goals, keep bargaining-power disputes out of 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. 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.

To avoid conflicting outcomes, eliminate the Price Law rule about pricing below cost.

Under the Competition Act, the “consistent offer and sale of goods for unfairly low prices” is an abuse if it “results or may result in distortion of competition.” In addition, the Price Law also bans sales below cost. It is enforced by the Ministry of Finance, but it resembles a competition law. It

would be better to eliminate the overlap by eliminating the Price Law rule. It 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. ■

Can enforcement against cartels be strengthened?

Enforcement experience against hard-core price fixing has been limited. The most prominent recent case, announced in April 2007, was the Czech contribution to multi-jurisdiction enforcement against an international bid-rigging cartel, for gas-insulated electrical switchgear. This was an important opportunity for ÚOHS to show how clandestine international cartels operate and how leniency can be used to uncover them. The outcome also showed how fines, even higher than the parties' total gain from the infringement, can be used to further increase deterrence. The 16 firms were fined a total of CZK 941.9 million. The total fine takes back significantly more than the firms' profits from their violation, and thus it includes a factor adjusting for the unlikelihood of detection.

As part of its moves to adopt EU enforcement methods, in 2007 ÚOHS replaced its original 2001 leniency program, which had not produced many results. The new Czech program follows the European Competition Network model. It promises greater legal certainty to applicants who qualify. The leniency policy now applies only to horizontal agreements. For the 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 its existence 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 reveal the case.

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. 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. Enforcement would be handled by police and prosecutors. 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 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 actual beneficiaries of the restraint on competition, i.e., the members of the association, would lead to more effective deterrence.

Make investigative powers more effective.

The Competition Act authorises ÚOHS to engage in dawn raids. This power would be more effective if ÚOHS could rely on support from law enforcement bodies when businesses resist granting access or hinder ÚOHS's investigators. ÚOHS has found that police have not been able to help out in these situations. 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. ■

How has ÚOHS operation improved?

Since 2005, new leadership at ÚOHS has promoted some new approaches. One result is a sharp decline in the high rate of staff turnover that had been reported in the 2001 review. The staff have 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.

The new leadership has made clear that ÚOHS 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 ÚOHS's enforcement resources on more serious problems. ■

For further information

More information about this *Policy Brief* can be obtained from Michael Wise: e-mail: michael.wise@oecd.org, tel.: +33 1 45 24 89 78. Or visit the website: www.oecd.org/competition



For further reading

OECD (2001), **Regulatory Reform in the Czech Republic**, ISBN 978-92-64-19481-6, 360 pages, € 61.

OECD (2008), **Economic Survey of the Czech Republic**. Available at: www.oecd.org/eco

OECD (2005), **Competition Law and Policy in the European Union**. Available at www.oecd.org/competition

OECD (2008), **A Motor for Positive Change: Competition Committee Policy Roundtables, Executive Summaries (1998-2007)**, Vol. 1, Law Enforcement, & Vol. 2, Economic Regulation. Available at: www.oecd.org/competition

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