ANNUAL REPORT
ON COMPETITION LAW AND POLICY DEVELOPMENTS IN HUNGARY

(January 1996 June 1997)

Gazdasági Versenyhivatal
(the Hungarian competition authority)
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Contents

I. Changes to competition law and policy proposed or envisaged

1. Summary of new legal provisions of competition law

1. A new Competition Act, namely "Act No. LVII/1996 on the Prohibition of Unfair and Restrictive Market Practices" entered into force on 1 January 1997 replacing the previous "Act No. LXXXVI/1990 on the Prohibition of Unfair Market Practices".

2. The most important new elements of the Act to be applied for proceedings commenced from 1 January 1997 are as follows:

- the ***scope*** of the new act [Art. 1] covers market practices carried out on the territory of Hungary by natural and legal persons and companies without legal personality. The new wording cuts out the definition of 'economic activity' of the previous act, in this way extending its scope for example to investorial activities i.e. a field which was not covered by the old legislation. The extension of the scope to market activities of foreign undertakings in respect of anticompetitive practices is another new feature;

- the new act has kept the basic structure of the previous one and apart from anticompetitive practices contains provisions relating to 'consumer fraud' and other 'unfair market practices';

- the new law extends the ***prohibition on agreements*** to all kinds of vertical-type agreements [Art. 11]. (The previous Act covered horizontal agreements and of vertical restrictions it was only resale price maintenance which was prohibited.) Another extension is that the new act also covers „decisions by social organisations of undertakings, public corporations and other similar organisations ... ". The scope of the prohibition has been extended also from an additional point of view, the new prohibition covers „prevention, restriction and ***distortion*** of competition". The provision about the automatic voidness of agreements infringing the prohibition is also a new element of the regulation;

- in the field of abusive control the new act has an entirely new concept for ***defining dominant positions*** [Art. 22]. Contrary to the previous one, this definition does not contain market share thresholds, but is built on the ability of the undertakings to act independently to a great extent from other market participants. Costs and risks of market entry and exit, financial strength of the undertakings, the structure of the relevant market and market shares are among the factors to be taken into account assessing the existence of dominance in a particular case;

- the new act has kept the spirit of the old one and contains a general ***prohibition of abuse*** [Art. 21]. However there are some new elements put into the illustrative list of particular state of affairs of abuses, such as tying, withholding of goods, discrimination and predatory pricing;

- in respect of ***M&As*** the new act modified the notification thresholds. The turnover thresholds of the old act has been amended - HUF 10 billion (USD 50 million) joint net turnover, in the case of financial institutions, ten per cent of their total assets is considered in place of net turnover. The market share will not be a threshold any more - the previous Act contained an alternative threshold of 30 per cent market share. There are some new elements in the definition

of concentrations, e.g. /1/ acquisition of parts of undertakings, /2/ creation of concentrative-type JVs, /3/ acquisition of majority voting rights and /4/ acquisition of the right to appoint the majority of executive officials [Art. 23]. In difference to the previous competition act the new legislation explicitly defines that temporary acquisitions by financial institutions do not fall under the scope of M&A control [Art. 25];

- although with different wording but in close harmony with the European Merger Regulation the criteria of the assessment of M&A transactions have been reworded [Art. 30];

- the Hungarian competition authority may decide about separation or divestiture of the merged undertakings if the parties failed to apply for authorisation and the authority may not have been authorised the transaction [Art. 31].

2. New guidelines

3. The OEC is not empowered to issue implementing rules or guidelines to the Competition Act. However, the OEC published its new notification forms for agreements and mergers in harmony with the provisions of the new Competition Act.

3. Government proposals for new legislation

4. The 1996 Competition Act empowers the Government to adopt regulations about group exemption of agreements. In March 1997 the Government adopted three block exemption regulations, namely, for

- exclusive distribution agreements;

- exclusive purchasing agreements; and

- agreements in the insurance sector.

Other regulations (for motor vehicle distribution agreements, franchise agreements) are under drafting, it can be expected that these will be adopted before the end of 1997.

5. Both the March 1997 regulations and those under elaboration in their draft forms represent simplified versions of the relevant EC regulations.

II. Enforcement under the 1990 Competition Act

7. One of the characteristics of the Hungarian Competition Act is that it regulates both unfair market practices and deception of consumers. Whilst rules relating to unfair market practices fall within the exclusive competence of the civil courts, the second area belongs to OEC competence. A substantial part of the workload of the Office stems from the law enforcement in this latter field, nearly half of the Competition Council decisions belongs to this category.

1. Actions against restrictive agreements and abuses of dominant positions

8. This paper reports the law enforcement experience of the Office of Economic Competition (OEC) gained in the period between January 1996 and June 1997. Since the new Competition Act stipulated that all the cases commenced in 1996 have to be assessed under the provisions of the 1990 Competition Act, in the first half of 1997 the majority of the OEC decisions were made under the 'old' Competition Act.

9. The total staff of the OEC numbered 104 persons at the end of 1996. The OEC has no regional offices.

a) Restrictive agreements

10. The 1990 Competition Act prohibited restrictive agreements or practices between competitors (horizontal cartels) or the fixing of restrictive resale prices (as one form of vertical restraints). Pursuant to the cartel regulation the prohibition applies to actual restrictions as well as agreements potentially leading to restrictions.

11. During the reported period two comprehensive ex officio examinations were conducted concerning the anti-competitive agreements on the beer distribution market. This product commands special attention because the situation on the market (oligopolistic market structure, stagnant or declining demand, minimal imports) objectively creates incentives for restrictive agreements. In one of these specific cases the subject of the examination was the joint distribution network of five regional companies of the *Kobanya Brewery and Kanizsa Brewery*, which breweries are under the same ownership. The other case concerned the activity of the joint wholesaler of the *Sopron Brewery and Martfu Brewery*, which also have the same owner. (The extensive nature of the examination is indicated by the fact that a total of 240 undertakings were parties to the cases, and the four breweries met 58.6% of Hungarian beer sales.) The wholesalers concluded agreements with other wholesalers and large retailers. The Competition Council decided that the provision of these contracts preventing resellers from selling beer at a price below a definite price was a violation of the cartel prohibition. In their form the agreements constituted RPM, but they can also be considered horizontal price fixing between wholesalers as competitors. Due to the immediate action against the cartel the Competition Council considered that the actual anti-competitive effect of the price fixing could not be exploited. Therefore the Competition Council prohibited such anti-competitive practices and imposed only symbolic fines amounting to 3 million 240 thousand HUF (ca. USD 16.200). These decisions have not been challenged, and most of the fines have been paid.

12. In the process of elaborating new regulations for professions like doctors, engineers, architects, patent officers, auditors, lawyers, etc., the OEC advocated the creation or increasing the scope for fair

competition. Sometimes these endeavours of the OEC have proved to be successful. (eg. the draft bill on 'Professional Chambers of Designing and Expert Engineers and Architects' intended to exclude from the market the designers with secondary level qualifications who used to be able to do simple planning work. As a result of an OEC opposition a three year period is granted by the ultimate version of the Act for these designers to obtain a special qualification for pursuing planning activities under this Act.)

13. In the period concerned two applications for exemption from the cartel prohibition were received. The Competition Council denied the exemption in one case, and in the other case the agreement had no restrictive character at all.

14. In one of the cases the *Chamber of Commerce of Hajdu-Bihar County* applied for an exemption concerning the minimum fees for driving instruction proposed by the Chamber. The Competition Council refused to grant the exemption because of two reasons. First, the Chamber cannot be qualified as an entrepreneur entitled to ask for exemption. Second, the majority of entrepreneurs affected did not want to accept the Chamber's recommendation. The decision has not been appealed. This case raised several theoretical problems. Some of these are solved in the 1996 Competition Act (extending the scope of the Competition Act to associations and chambers), but they also indicate that chambers may act even against the intention of some of their members - note that the membership is obligatory - and they have some role in attempts to restrict competition among their members. Various interest representation bodies and trade associations also show an inclination to restrict competition.

b) Abuse of dominant positions

15. The Competition Council made 69 decisions concerning the abuse of dominance. Out of these, the respondent was condemned in 12 cases, while the procedure was terminated due to the revocation of the claim in 7 cases. In 50 cases the Competition Council either found no violation due to the absence of dominance, therefore its abuse is excluded by definition, or, in ten cases the dominant position was established, but its abuse could not be substantiated.

16. In abusive-type cases the high proportion of rejections is primarily attributable to the fact that the applicants assume the existence of dominance in cases when one party is indeed highly dependent on the other - for instance, because it based its business on one supplier or customer and thus assumed excessive risk -, but the other party is not dominant as defined in the Competition Act. Such cases often simply revolve around some contractual dispute.

17. Four out of the 12 condemning Competition Council decisions (on grounds of abuse of dominance) were related to the conduct of the *National Savings Bank plc. (OTP Rt.)* in the area of mortgage lending:

- the increase of service charges was publicised three months after they became effective;

- during the negotiation of the contracts for mortgages the bank created the impression that the purchase of an insurance service from OTP-Garancia Insurance Co. was a precondition for concluding a mortgage agreement; furthermore, the unilateral but lawful changes in the general terms of the mortgage were not based on objective criteria and were implemented in an non-transparent manner;

- the amount of government subsidy for the consumers available for long term subsidised mortgages was calculated with a technique disadvantageous to the consumer, thus reducing the amount of available subsidy;

– they unreasonable refrained from concluding contract facilitating the use of government mortgage subsidies.

In analysing how much the complaints about mortgage lending were justified, the fact could not be neglected that OTP had market power due to its 90% market share and the commitments arising from the long term contracts. Furthermore there was no market pressure on OTP, and presumably there would not be any market pressure for quite some time that would encourage it to make its business practices more customer friendly. The market is open to competitors, but no other banks have entered this market to an appreciable extent.(All four decisions have been challenged before the Court.)

18. Two condemning decisions were adopted against *Kabeltel Budapest Ltd*. Both of them found a section of the general terms of contract applied by the service provider illegal and detrimental to the consumer. The anomalies present on the cable television market highlight the fact that on this market, where the service provider enjoys natural monopoly after the installation of the network, regulation is called for, an institutionalised opportunity for protecting the interests of consumers is absent, and at this time the only possibility for law enforcement is that of the competition law. Both decisions were challenged before the Court.

19. The *Metropolitan Public Maintenance Co*. (Fovarosi Kozterulet-fenntarto Vallalat) was also condemned. Upon the introduction of the garbage collection charge, the firm failed to change its garbage collection system in time in accordance with the consumer demand, and charged the consumers for undemanded services. The fine imposed was a token amount but it influenced the behaviour of the company. (However, the OEC decision was challenged by the defendant.) In the second half of 1996, in an investigation started upon a similar complaint, the Competition Council of the OEC established that relatively fast reaction was made after the consumer complaint has been received to eliminate the unlawful situation. The infringement, though apparently of minor importance, is a warning sign that, when the regulation is changed in a manner detrimental to the consumer, the regulator and the undertaking concerned have the common obligation of acting with the greatest care in respect of the technique, substance and implementation of the regulation.

20. The Competition Council condemned the *Debrecen Waterworks Co*. (Debreceni Vizmu Rt.) because it was willing to invoice on the basis of the measured consumption only if one of two types of water meters identified by the firm were installed out of the approximately 80 types licensed by the authorities. With this conduct it excluded the distributors and manufacturers of the other brands from the market without any reasonable justification. Unfortunately this phenomenon is not unique, and even though such behaviour has lost its legal basis as a result of legislative changes of recent years, certain service providers (in the case of gas and water pipelines, electricity grids and other areas where the installation of certain fittings, instruments etc. and the commissioning of the system is subject to regulatory licenses) follow discriminating business policy which constitutes barriers to entry. (Debrecen Waterworks challenged the decision of the Competition Council.)

2. Mergers and acquisitions

21. The Competition Council adopted decisions on 30 cases; in 22 cases it permitted the concentration, while in the remaining cases it declared the absence of obligation for authorisation.

22. In some significant cases the market participants purchased their competitors or other undertakings on their vertically connected markets. Instance for such subject-matters are the Hungarian Oil/Nitrogenworks (MOL-Nitrogenmuvek), the Dunapack/Halaspack, the Graboplast/Keszta-Dunawall, the National Savings Bank/Merkantil Bank (OTP-Merkantil Bank), the Agrana/Hungarian Sugar (Agrana-Magyar Cukor) and the Siemens-Erokar acquisitions. All of these transactions were authorised by the Competition Council for certain reasons, among which the role of import competition can be mentioned in the first place, or in some cases detrimental effects stemming from the decrease in the number of market participants or from the higher level of concentration were outweighed by advantageous economic effects.

23. Several privatisation decisions resulted in transactions falling under the competence of the Competition Act. Examples include the acquisition of Hungarhotels plc by Danubius plc. In this particular case the merger of the capacities of the Danubius and Hungarhotels plc. was examined in four regions (geographic market) and concerning three, four and five star hotel accommodation (product market). Any appreciable increase in market share was noticeable only in the category of four star accommodation in Budapest region. However, the Competition Council considered that there is a considerable fluctuation of consumers and of the hotels themselves in Budapest between the three and four star, and the four and five star categories. Thus the market power of the applicant following the acquisition of control is better described by its joint share on the three-four or four-five star hotel accommodation market (relevant market) than its share on the market of four star hotels alone. Having considered the possibility of market entry and exit, the Competition Council estimated that the market share of the applicant that reflects its real market power on the Budapest hotel market was approximately 35 %, and considered that the proposed acquisition would not prevent the development of competition on that market. Accordingly, the acquisition of control was authorised.

24. In most concentration cases subsidiaries were merged or amalgamated into the parent company. This is a typical trend, adjusting in accordance with market consideration the situation that arose as a result of the decentralisation wave of transformation and privatisation. Such cases included the merger into the parent companies of the subsidiaries of OMV, Danone, Messer Griesheim, Porsche Hungary, Balatonboglar Vineyard, Sarvar Poultry Processing plc, and Vertes Power Plant. [These kinds of concentration do not constitute transactions to be authorised according to the provisions of the new Competition Act anymore.]

25. The Ciba-Geigy/Sandoz case was an interesting example of the merger of subsidiaries that also had international relevance. The foreign parents that owned various subsidiaries in Hungary merged, and requested authorisation for their merger in Hungary because of the effects of the deal in this country. However, the scope of the Competition Act effective until 31 December 1996 did not cover undertakings operating abroad or concentrations emerging in this manner.

3. Experience related to court reviews

26 Cases investigated by the experts of the OEC were (and are also, under the new Act) decided by the Office's Competition Council, a decision-making body comprised of seven staff members (five lawyers and two economists). Each case was decided by a minimum group of three out of the seven members with a lawyer as chairman. Decisions of the Competition Council can be challenged before the Metropolitan Court of Budapest, with possible subsequent appeal to the Supreme Court.

27. In 1996 final judgements of the Supreme Court altered OEC decision on legal grounds in three cases, while in two other cases the Metropolitan Court reversed the decision of the Competition Council.

However, only 7 out of the 127 court decisions reversed the OEC decisions which fact indicates that the conceptual basis for the decisions is largely identical during the 6 and a half year practice of law enforcement.

28. With one exception, the decisions altered in 1996/1997 do not entail any difference in the interpretation of law between the OEC and the courts. The reversal is primarily because discretionary elements frequently play a significant part in competition law proceedings.

29. In one case, however, there was a fundamental difference of principle. Subsequent to a Metropolitan Court decision upholding the decision of the OEC, the Supreme Court did not consider the conduct of Hungarian Railways (MAV Rt.) illegal because it acted in the capacity of customer, which, according to the court, does not constitute an economic activity (production or service provision for consideration) under the scope of the Competition Act. The OEC protested against this interpretation at the court of appeal (at a special College of the Supreme Court, where Supreme Court decisions may be appealed for last resort), but this special College of the Supreme Court (as the court of review) upheld the above view. In the future this dispute will not reoccur because the new Competition Act defines the scope of the Act in such a way that it indisputably covers any practices committed by customers.

30. The procedure for competition cases at the Metropolitan Court takes one-one and a half years, while, if the ruling is appealed to the Supreme Court, this last phase takes an average of three years. This is shown by the fact that the court review of the Competition Council decisions made in 1991-93 have been completed, with a few exceptions. Decisions which have not been yet finalised relate mainly to significant cartel and abuse of dominance cases or the illegal advertising of tobacco and alcohol products. As far as cartel cases are concerned, the sugar cartel decisions of 1993 was upheld by the Metropolitan Court, but the Supreme Court will hold the first hearing only in the autumn of 1997. In the coffee cartel case of 1994 the Metropolitan Court has not made its decisions yet. Of the dominance cases, the court review of an OEC decision from 1991 stating the excessive pricing of number plates and a dismissing decision from 1993 on the excessively low purchase price of sunflower seed have not been concluded yet.

III. OEC participation in the formulation and implementation of other policies

31. According to the provisions of the 1990 Competition Act, ministers are obliged to solicit the opinion of the Office of Economic Competition on every draft bill that would have a restrictive effect on competition, including, in particular, market access, exclusive rights or price regulations. The OEC received about two hundred drafts last year, of which only a smaller part had the effects listed above.

32. In 1996 there were no major changes in the regulation of public services; the relevant laws were adopted previously and some of them had been in operation in prior years (for instance, price controls in telecommunication). Part of the regulation of the energy sector came into effect in 1996. The experience with the operation of regulatory systems confirmed the concerns and doubts that the OEC had at the time when the rules were formulated, and raised new ones. Regulations do not adequately fulfil their competition policy function; they contain numerous details which are not in line with the original theoretical models they were moulded after. The principles are not carried through all the details, which hinders or prevents the implementation of the original intentions.

33. The price regulation of telecommunications is one example for unsound solution; it is a price cap type system, which is considered modern, but the actual parameters have been defined loosely, therefore there is no pressure for efficiency. This has resulted in the situation that the price increase introduced by Hungarian Telecommunications plc (MATAV) in 1997 was smaller than what would be possible under the price control system. The government has given up the right to revise the price control system that was established in the concession agreement in 1993.

34. Another deficiency in the system is that although the concession agreement requires MATAV to record the costs of the activities performed under exclusive rights separately, i.e., as a monopoly, this has not been done so far. Even if it were to happen in the future, it would promote the competition policy objectives adequately only if the network and other expenses were separated, and the various activities were fully segregated in the accounts. This is also a precondition for the effective operation of the regulation and the enforcement of public consumer interests.

35. The price control system does not cover the full range of concession activities, and the company, which also engages in non-concession businesses, can engage in cross subsidisation in a manner not transparent to the regulators or the OEC.

36. The price regulation of electricity also raises problems. The system is a mix of several regulatory models (price cap, cost based, rate of return based). As a result, the benefits of none of the models are present. In the price cap system the average allowed price level is set for a relatively long period (3-5-10 years) on the basis of an automatic adjustment mechanism ("indexation"). In this model the regulated firms are interested in more efficient operation, there is no need for permanent cost analysis (it is needed only at the introduction of the system and upon its adjustment). The presence of the principles of the other regulatory models and the most recent developments (quarterly review) eliminate the essence and the benefits of the price cap system.

37. In the energy sector the vertical levels have been partially separated. However, the regulation should serve the purpose of the separation of infrastructures and of activities that constitute a natural monopoly from the areas and activities suitable for competition, and the introduction of competition in the latter field. In our view the separation in practice does not go hand in hand with the introduction of

competition in this area. The separation itself has remained partial because some natural monopoly activities are mingled with others, while the problems of cross subsidisation have not been resolved satisfactorily.

38. There are some competition law enforcement experiences in some other areas related to regulation or the absence thereof affecting competition:

- some local utilities supervised by local governments can also be considered as natural monopolies (communal services, local transportation etc.). However, local regulations are not supported by uniform principles and solutions; as a result, either the local by-laws appropriate for the new situation have not been issued, or there are great differences regarding the content of the rules. This is one of the reasons why there are many anomalies on these markets. Since the boundaries of mandatory state responsibilities and the market are continually changing in the case of these services, while the defencelessness of the consumers does not necessarily lessen as a result of the appearance of competition, it would be necessary to define in law the minimum requirements, regulatory principles or potentially applicable solutions that the local governments' by-laws must be in line with.

- in many instances the public administrative-, ownership- or entrepreneurial-type decisions of local governments take the same legal form, i.e. they are considered as public administrative resolutions. As a result, the ownership- or entrepreneurial-type decisions can be challenged only in a procedure used for decisions made in the capacity of public administration (administrative lawsuit, petition to the Constitutional Court). This may mean for the competition supervision that any elements of the decisions made by local governments in their entrepreneurial capacity but clad in the legal form of public administrative decision that violate competition law can only be challenged in a lengthy administrative lawsuit, while other undertakings can be subject to competition supervision proceedings for the same offence. Such a distinction is not justified.

39. Realising these anomalies the OEC drew the attention of the Parliament to the circumstance that regulations were needed in the areas where market failures were present, and regulations would have important competition policy functions. Therefore neither the situation of lacking regulation nor the situation of regulation that does not fulfil its competition policy functions in these areas is desirable. Both types of shortcomings exist in Hungary.

40. For the request of the Economic Committee of the Parliament the OEC prepared a detailed submission in June of 1997 summarising the most important competition policy aspects of the regulations in the different specific sectors.

IV. Publications on competition law and policy

In the period between January 1996 and June 1997 surveys and reports relating to competition law and policy were published as follows:

VISSI, Approximation to the Competition Policy of the European Union
Study prepared for the "Conference on Competition Policies in the Countries in Transition" Florence, 7/8 June 1996

VISSI, The Competition Act and the Economic Policy Background of Its Amendments
Study prepared for the Third Hungarian Lawyer's Assembly
published in: 'Gazdasag es Jog' 7-8/1996

VISSI, Market Infrastructure, Competition Policy, Accession to the Union
Study prepared for the "XXXIVth Assembly of Economists",
Gyor, 22 May, 1996
published in: 'Kozgazdasagi Szemle' September/1996

VÖRÖS: Handbook of European Competition Laws
2nd edition, LOGOD, Budapest, 1996

TOTH, Competiton Law of the European Community
JATE, Szeged, 1996

Sarai-TOTH, EC Competition Law
ITD Hungary, Budapest, 1997

Kaszaine-MISKOLCZI, Handbook on Competition Law
HVG-ORAC, Budapest, 1997

V. Statistical information on the application of the 1990 Competition Act in the period from January 1996 till June 1997

1) Types of Cases concluded by the Decisions of the Competition Council:

Blanket Clause	32
Unfair Market Practices	-
Consumer Fraud	82
Restrictive Agreements	8
Cartel Notification	2
Abuse of Dominant Position	69
Merger	30
Case Transferred by Court for Imposing Fine	1
Sum total	**224**

2) Types of the Decisions of the Competition Council 224

Establishing the Violation of Law	**64**
under Article 3 (Blanket Clause)	4
under Article 11 (Consumer Fraud)	50
under Article 14 (Concerted Practices)	7
under Article 20 (Dominant Position)	12
imposing fine based on a court decision	1
Authorisation	**22**
of Merger or Acquisition	22
Refusal of Approval	**1**
for Exemption of Cartel	1
Termination of Proceedings	**56**
Refusal of Complaint	**81**

3) Imposed Fines (in thousand HUF)[*]

Type of Case	**1996**	**1997 Ist half**	**Total**
Blanket Clause	5400	-	5400
Unfair Competition	100	-	100
Consumer Fraud	40236	12210	52446
Cartel	3240	30000	33240
Abuse of Dominant Position	62507	6800	69307
Total	111483	49010	160493
Average Sum per Case	2477	2580	2508

[*] Exchange rates:

1996: 1 USD ≈ 160 HUF

1997: 1 USD ≈ 200 HUF