Organisation de Coopération et de Développement Économiques
Organisation for Economic Co-operation and Development

08-Feb-2011

English - Or. English

DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS
COMPETITION COMMITTEE

DAF/COMP/WP2/WD(2011)18
For Official Use

Working Party No. 2 on Competition and Regulation

THE REGULATED CONDUCT DEFENCE

-- Hungary --

14 February 2011

The attached document is submitted to Working Party No. 2 of the Competition Committee FOR DISCUSSION under item III of the agenda at its forthcoming meeting on 14 February 2011.

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JT03296114

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1. One of the first steps that must be taken when making a legal assessment under the competition enforcement procedure of the Hungarian Competition Authority is an assessment of the scope and applicability of the Competition Act, given that Article 1(1) of the Competition Act applies to the market behaviour of businesses, conducting their behaviour or having their impact on the territory of Hungary, except where otherwise regulated by statute. The question of the applicability of the Competition Act is particularly important in regulated industries. Many of the sectors that are highly important to the national economy are regulated by specific legislation (as well). These sector-specific regulations aim to solve and prevent market failures. Since these sector-specific regulations sometimes cover anticompetitive conduct (or conduct that may be caught by the Competition Act), it is essential to clarify whether the Competition Act can also be applied to such behaviour in practice.

1. Conditions for the use of the regulatory conduct defence in abuse of dominance and horizontal agreement cases

1.1 General principles

2. Abuse of dominance cases are by far the most common type of cases that the regulated conduct defence has been attempted in. The way in which this defence is considered by the Competition Authority is quite similar in horizontal agreement cases; therefore in the forthcoming section we present the principles of our approach as laid down in relevant abuse or cartel cases together.

3. In light of what we have said about the conditions of applicability of the Competition Act in the first paragraph, the regulated conduct defence may be based on one or both of the two following arguments: the conduct cannot be judged within the ambit of the Competition Act as a) it is provided otherwise by law or b) the conduct was not autonomous as a result of sector-specific regulation that is in force.

4. One situation where other laws prevent the application of the Competition Act is when its application is explicitly prohibited by the law in question. E.g. “the guiding price and quantitative restrictions are exempted from Article 11 of the Competition Act on restrictive practices.” Act No. XVI. of 2003 on the Agricultural Regime contains such an exemption but it is a very rare example. In case a restriction on the application of the Competition Act does not explicitly appear in the law, the intention of the legislator needs to be looked at. An exemption is justified only if it is established beyond reasonable doubt that the legislator authorised the given conduct on the market with the express aim of excluding the conduct from the ambit of the Competition Act. That is, the legislator wanted to exempt the given economic sector from the application of the Competition Act. However, this is to be carefully assessed on a case by case basis – as it is laid down in the relevant position statement of the Competition Commission.

5. In this given case on funeral services, in addition to the exemption spelled out in a sector specific regulation, the Competition Council considered it necessary to examine the existence of an additional condition. Namely, a condition that insures that competition is restricted only to the extent that is necessary in order to reach the desired aim, and that the interest of consumers is not hampered. In this particular case, the legislature imposed a wholesale contract obligation on the undertaking with regard to all of the services covered with the exclusivity granted by the law. The wholesale services were to be offered on the ground of necessary and reasonable costs, and the charges were to be calculated on the basis of the given service. This stipulation was to guarantee specific capacity needs, and to prevent the exclusion of undertakings from adjacent markets.

6. As the provision in Article 1 of the Competition Act that states “except where otherwise regulated by statute” is an exception under the general proposition, it is to be narrowly interpreted. This corresponds to the legislator’s intention of sector neutral competition law. Accordingly, any statutory

authorisation for anti-competitive conduct shall be regulated in (or clearly deducible from) an act. Furthermore, the intention of the legislature needs to be undoubtedly spelled out in the act. As a result, in the absence of the clear intention of the legislature, no legislation should be interpreted in such a way that certain anti-competitive practices would be authorised. It is also noted that in general, pro-competitive principles in sector-specific regulations supporting liberalisation (e.g. in electronic communications or in energy) cannot be interpreted in such a manner that would narrow down the applicability of the Competition Act or that would deprive the competition authority of its powers.

7. What conditions shall be considered if parties claim that allegedly anticompetitive behaviour is not autonomous? In general, the prohibitions contained in the Competition Act may not be invoked if the conduct is a direct consequence of state action, that is, in case the undertaking is engaged in the conduct without acting on its own initiative. In the event that the state measure influencing market behaviour leaves room for some freedom in decision-making, then the Competition Act is applicable. However, in case it is justifiable, state intervention can be taken into account as a mitigating factor in calculating the fine to be imposed on the undertaking for the violation of competition rules.

8. The lack of applicability of the Competition Act in this situation is not based on the superiority of other legislation, nor can it be explained by explicit limiting terms in laws, but is due to a criterion spelled out in the Competition Act: the market behaviour of the company is not based on its own autonomous decision. That is, in this case it is not the existence of legislation limiting the applicability of the Competition Act that explains the exceptions (conduct where the Competition Act is not invoked), but the market situation in which the behaviour of the undertaking lacks discretion due to state intervention.

9. This type of defence is acceptable in two situations. First, when the law obliges the undertaking to adopt certain conduct; second, when the law explicitly authorises conduct which goes against the rules of the Competition Act.

10. The mere fact that the conduct may violate other laws cannot preclude the possibility of assessing the very same conduct under the Competition Act. The Competition Act contains general provisions aimed at protecting competition in the whole economy, while other legislation may contain provisions on a particular market or on a particular behaviour. Consequently, in certain cases, it can occur that another administrative body may be entitled or obliged to act under the very same circumstances of a given market behaviour. However, a procedure carried out by another authority based on a specific law does not preclude the initiation of competition proceedings. Proceedings by another authority for the breach of another law may strengthen the grounding of the decision of the Competition Council. However, facts and changes on the market resulting from another authority's proceedings shall be taken into account in the proceedings of the GVH.

11. This particular situation may occur when liberalisation rules prevail. The sector-specific economic regulations supporting liberalisation usually conform to the regulatory principles found competition law. This is because the aim of liberalisation is consistent with the interests protected by the Competition Act: the main objectives of all of these types of regulations are the protection of consumer interests and the creation and strengthening of competition. These are in line with the Competition Act's aim to preserve competition, and to protect consumers' interests. Like elsewhere in Europe, the application of competition law and the regulatory regimes of liberalisation in Hungary are looked upon as interventions existing alongside each other, in complementary ways. Neither the existence of regulatory authorities, nor that of competition based sectoral-regulation automatically prevent the application of competition law in the markets and for the market players concerned. The assessment of a given behaviour on a regulated market always takes into account an analysis of the specific conduct, the regulatory environment, primarily through an assessment of the scope for autonomous action on the side of the undertaking.

12. All of the above is supported by our experiences. In the vast majority of the cases in the telecommunications, postal, energy, rail and financial sectors between 2000 and 2010, the GVH applied the Competition Act, even in cases where the relevant sectoral legislation contained provisions against behaviour that may be found to be illegal by competition law (such as providing anti-competitive discounts, the restriction of carrier selection). Similarly, the GVH did not consider the Competition Act inapplicable if a condition – being incidentally anti-competitive – had been approved by the industry regulator given that the latter did not/could not assess behaviour according to the criteria of competition law due to lack of competence. This approach of the Competition Council was either not disputed by national courts or was positively approved.

13. It might be worth mentioning the approach towards price cap regulation at this point, as the Competition Council has dealt with the issue of the regulated conduct defence in several of such cases where price cap regulation in force had an impact on the pricing of undertakings being investigated. In connection to the price cap regulation common in electronic communications markets, it laid down that this regulation did not preclude the autonomous market behaviour of the undertakings. Accordingly, the applicability of the Competition Act was not called into question. The Competition Council held that the full exploitation of a price cap did not automatically exclude the possibility of a violation of the Competition Act, as the price cap regulation usually leaves room for manoeuvre in setting the price for products and services (provided that the regulation concerns ranges of products/services and not individual ones).

14. As far as the concerted action of setting price levels just below the regulated maximum price, or increasing it to reach the maximum considered, it also does not fall outside of the application of the Competition Act. This conduct can fall foul of the rules on anticompetitive restrictive agreements. At the same time, however, this behaviour cannot constitute an abuse of a dominant position in the form of excessive pricing, if the method used in the price regulation employs the same competition assessment that would be employed by the GVH. In this case the regulated price can be excessively high only if the regulator would have set it contrary to the legal provisions. However, this question cannot be dealt with under the Competition Act. In case the price is regulated by law, then the review falls within the competence of the Constitutional Court, if the price is regulated in an administrative decision, then the national court is the competent forum. Nevertheless, the scenario is different if trade between Member States is affected – then the conduct can be assessed under Community Law. This is the case when the hierarchy of norms is important.

1.2 Hierarchy of norms

15. A national competition authority of an EU Member State, such as the GVH, may initiate a competition enforcement procedure against an undertaking – provided that trade between Member States is affected – if it violates EU competition rules, even if it does not violate the national competition rules. In the CIF decision[1] the ECJ established that based on joint application of the principle of primacy of Community Law and Article 10 of the Treaty, there is an obligation on the side of the Member States to disapply national legislation that contravenes Community law. In line with the ruling in the CIF case, however, the national competition authority has to take into account that a national law contributed to the unlawful conduct of the undertaking when setting the fine for the illegal action. With regard to the liberalisation of the electronic communications sector, in the Guidelines[2] and the in the Access Notice of the European Union, the Commission spelled out that it regards competition law and its application as entirely part of the overall approach in telecommunications. It emphasised that the liberalisation and

1 See Case C-198/01 Consorzio Industrie Fiammiferi (CIF) [2003] ECR I-8055, [2003] 5 CMLR 829.

2 Commission guidelines on market analysis and the assessment of significant market power under the Community regulatory framework for electronic communications networks and services.

harmonisation of telecommunications markets should be implemented in line with EC competition rules. The Commission is of the view that the direct applicability of competition rules (Articles 101 and 102 of the TFEU) shall continue to apply in cases where other provisions of the Treaty or secondary legislation aim, in particular, to stimulate competition. These are both important and mutually contribute to the proper functioning of the markets. The Commission has adhered to this approach in specific cases (such as Deutsche Telekom and Telefónica), and established their anticompetitive practice in spite of the sector-specific competition rules.[3] In analogy to the foregoing – as a consequence of the direct applicability of the provisions of the Treaty and the primacy of Community law – we are of the opinion that competition proceedings would be/are possible in other liberalised sectors despite the existence of similar sector-specific regulations.

1.3 Other issues

16. It is possible that the existence of regulation does not prevent the application of the Competition Act, however, it prevents the establishment of the infringement.

17. One example of this was the case against the Hungarian Chamber of Pharmacists (hereinafter 'Chamber'). In this case, the GVH examined the agreement between the Chamber and the pharmaceutical producers based on which the Chamber published the wholesale and retail prices of drugs not subsidised. As a result, this information was freely accessible to all producers, wholesalers and retailers. The GVH could not establish that the agreement had the objective of restricting competition, as stipulated in Article 101 of the TFEU. Therefore, it examined whether it restricted competition by effect. A recommended price by an association of undertakings may restrict competition by providing the competitors on the market with an opportunity to get to know each other's pricing policies, and to take this into account in their own policies regarding their future price setting. In the course of assessing the condition of anticompetitive effect, the GVH attached high importance to the fact that the Chamber had made available the recommended prices only whilst the wholesale and retail margins were set in the relevant Act. This of course points to the direction of a single retail price on the market. The Competition Council found no evidence (although it could not rule it out either) that the publication of the recommended retail prices by the Chamber would have significantly strengthened the coordinated effects, the existence of which arose from the price cap anyway. In the evaluation of the effect of the recommended prices on competition, the other factor that could not be overlooked was that they were made available by the Chamber for only a relatively short period of time (just over one year).

18. This is of importance because it is likely that during this period memories of the earlier practice still subsisted. Earlier, the Ministry of Health published in its official journal the actual retail prices,

[3] Based on the data from the ECN case statistics, national competition authorities in the EU follow a similar approach to that of the Commission. A number of national competition authorities have initiated proceedings against market players of the electronic communications sector for abusing their dominant positions. These cases were started in spite of the fact that the primary goal of the European regulatory framework for the electronic communications sector is sustainable (and preferably "automatically" workable) competition. Additionally, the instrument provided for the attainment of this goal, the imposition (and checking) of obligations on dominant firms with substantial market power – based on the principles of competition law. Indeed, relying upon the data from the ECN Interactive, exactly these types of cases are in an overwhelming majority. For the suspected violation of the competition provisions of the Treaty in the electronic communications sector, between May 2004 and March 2010, only 20 cases out of 103 were about anti-competitive agreements or concerted practices (2 cases before the Commission, while 18 before national competition authorities). All of the other proceedings concerned abuse of dominant position cases (of which 9 before the Commission and 74 before national competition authorities). The latter ones were initiated typically for price abuse practices, despite the fact that regulatory authorities have broad powers in price regulation.

calculated on the basis of producer prices taking into account the maximum mark-ups. These retail prices were automatically applied by the pharmacies. As a consequence of this practice, the vast majority of pharmacies, in November 2005, would most likely not have been prepared to set the prices for thousands of individual products. Therefore, it can be reasonably assumed that, even in the absence of the Chamber's practice, retail prices would have been set in the same way (based on the maximum mark-ups) by the majority of the pharmacies. Therefore, the Competition Council held that the publication of prices by the Chamber, in itself, did not restrict competition.

19. Another situation was when the GVH terminated its proceeding – initiated on the suspicion of abuse of a dominant position – because, during the proceeding, the conduct became the subject of a regulation that excluded the applicability of the Competition Act. In other words, a new circumstance came about in the course of the investigation, which would have prevented the initiation of the proceeding from the outset. In such a case, the proceeding has to be terminated, because the continuation is not justified by public interest.

20. In certain cases the GVH pointed out the weaknesses in the sector regulation, emphasising that the licensing and control powers transferred to market players did not, in themselves, (on account of the public power aspect) exempt their conduct from the application of the competition rules, if an essential condition, such as a legal remedy, is lacking.[4]

21. Concerning the discretionary power of the regulatory authorities, an interesting jurisdictional question arises, namely, where the regulator has discretion to initiate proceedings. The Competition Council has repeatedly held that the GVH has powers to initiate proceedings in cases where another regulatory authority has already initiated proceedings or could have done so. If the regulatory authority did not challenge a given behaviour, although it could have done so, then the applicability of the Competition Act might exist, as the undertaking cannot use as a defence the argument that the competent authority did not initiate a proceeding. The fact that the legislator and enforcer of sectoral legislation did not act – implicitly approving the behaviour – can be taken into account only in the calculation of the fine.

2. Conditions for the use of the regulatory conduct defence in merger cases

22. In merger cases we can cite one relevant example when the parties claimed that sectoral regulation underway would properly guarantee that merging parties cannot abuse their market power and

[4] A similar problem ("quasi regulatory powers") came before the Competition Commission in two cases concerning the energy market. In these cases, the Competition Commission – on top of the condition of the availability of a legal remedy, referred to above – tied in other conditions as well to the public power "status"; e.g. the express authorisation for judging eligibility, and codification of the underlying aspects. However, in a case about student loans, proceedings against a financial service provider were terminated by the Competition Council – in part – with regard to a lack of business-type activity. The Competition Council concluded in its assessment that the purpose of granting student loans (equal opportunities for higher education in society as a whole) is the responsibility of the state, belonging to the category of public interest. And the mere fact that the organisation responsible for the implementation of this programme seeks some kind of return does not mean that it qualifies as a market activity, especially if ultimately the state can collect it via authorities (e.g. tax authority) and coercive measures. The exact the opposite situation exists if the conduct of a public body affects the market, though the conduct does not belong to the public sphere. This may be the case if a municipality exercises its ownership rights. In such a case, the Competition Act may be applicable. Decisions of public authorities are characterised by unilateralism, and establish rights for the client/party (or deprives it). Furthermore, these decisions are enforceable by public authorities. However, if the decision is not taken in the sphere of public power (that is, when the activity is not connected with the exercise of the power of the public authority), then an agreement concluded based on such a decision is characterised by a co-ordinate relation, and not that of a subordinate one. Consequently, such an agreement can be subject to competition supervision proceedings.

cannot deny access to their broadband Internet infrastructures. Nevertheless, the GVH stated that competition law based merger control prevails in regulated markets as well. Being preventive by nature one very important function of this structural control is to hinder the emergence of market situations that need to be cured by regulatory measures. This is particularly the case in electronic communications markets where it is a European regulatory principle that sectoral regulation and competition law complement each other and it is essential that ex ante regulatory obligations should only be imposed where there is no effective competition and where national and Community competition law remedies are not sufficient to address the problem.

3. Role of competition authorities in regulation and its consequences

23. Another important feature of economic regulation prevailing in the electronic communications sector in the EU is that where appropriate, sectoral regulators and competition authorities are in close collaboration with each other during the market regulation process, i.e. in the SMP designation procedures. In Hungary this is one of the examples of the direct involvement of the competition authority in the design of regulatory remedies. The other example is the regulation of electricity and natural gas markets where similar a regulatory solution applies. The Act on Electronic Communications states that the national regulatory authority of electronic communications and the competition authority shall cooperate closely to enforce the protection of competition under uniform principles in the electronic communications market and to apply a uniform approach in the justice system, such as in procedures:

- for defining the relevant markets of the electronic communications sector;
- for analysing competition in the relevant markets;
- for the identification of service providers with significant market power and for defining the obligations conferred upon these service providers;
- for drawing up a methodology for the examination of price squeeze and for the examination of price squeeze.

24. In the process of defining the relevant markets of the electronic communications sector, analysing the competition on the relevant markets and identifying service providers with significant market power, the regulatory authority shall pay special attention to the opinion of the GVH and shall inform it if deviating from its opinion, along with the reasons indicated.

25. There are very similar provisions in the Electricity Act and in the Natural Gas Act. However, we have to point out, first, that the opinions of the competition authority are not binding, they focus more on the market definition and SMP designation carried out by the sectoral regulators and less on the remedies planned. Second, there is always a disclaimer included in the formal document containing the GVH's opinion that the statements made there are not binding on the decisions of the Competition Council. Consequently, the prior involvement of the competition authority in establishing these regulatory decisions neither immunises conduct nor adds strength to the regulated conduct defence. This is also true for those cases when there is no direct involvement but the competition authority comments on regulations

exercising its general competition advocacy role and the specific authorisations of the Competition Act for that[5].

[5] The President of the Hungarian Competition Authority (…) shall be solicited for his opinion concerning all planned measures and draft legislation that have a bearing on the responsibilities of the Authority, in particular if such planned measures or legislation restrict competition (performance of some activity or entry into the market), grant exclusive rights or contain provisions pertaining to prices or terms of sale. The notary of a municipality may solicit the President of the Hungarian Competition Authority for his opinion concerning draft municipality regulations which have, as set out above, a bearing on the responsibilities of the Hungarian Competition Authority.