

The Art of Supervision

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Liber amicorum
Pieter Kalbfleisch

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The Art of Supervision

*Ars longa,
vita brevis,
occasio praeceps,
experimentum periculosum,
iudicium difficile.*

The full text is often rendered in English as:

*Art is long,
life is short,
opportunity fleeting,
experiment dangerous,
judgment difficult.*

Introduction

What is typical of the way in which Pieter Kalbfleisch has led the Netherlands Competition Authority (NMa) over the past eight years is the fact that he regards supervision of competition as an art. As the Latin translation of Hippocrates' famous saying imparts, this art will survive long after the drudgery of the everyday is gone. *Ars longa vita brevis* is a Latin translation of the original Greek text which in fact gives more the sense that the speaker was not referring to the fine arts, but rather to the art of living. Apart from the fact that supervision is a craft, it also involves difficult judgments: *iudicium difficile*.

For Pieter, a number of starting points are important with regard to his work for the NMa, specifically 1) the enforcement of the Competition Act and 2) the optimal regulation of the energy and transport sector, taking into account the public interests and economic arguments. Decisions must, in his view, be properly substantiated (in both economic and legal terms) and the broadly defined consumer welfare must play a leading role.

Under his leadership of the NMa, the Office of the Chief Economist was set up, merger control and competition enforcement were forged together in a new department, the Competition Department (DM), and the regulatory offices were merged to create the Department of Energy and Transport Regulation (DREV). Since his appointment, the NMa has pub-

lished annually the yields of competition enforcement, merger control and sectoral regulation estimated in money terms: the outcome. At the same time Pieter believes international cooperation is a must in order to learn from and emulate others. He has always been very active internationally and made great efforts to bring the International Competition Network's 2011 conference to the Netherlands in honour of the network's 10-year anniversary.

Pieter's social commitment is evidenced by his activities for the Residentie Orkest (The Hague Philharmonic Orchestra) and his interest in sports in general and football in particular.

The editors tried to ensure that all these facets of Pieter are expressed in this book. That is why both national and international colleagues and friends were invited to contribute to this *Liber Amicorum*. Attention is also devoted to themes that are not often addressed in the competition literature. There is discussion of competition and art and competition and solidarity, for instance. The *Liber Amicorum* is organised into eight themes, which we feel do justice to the aforementioned variety of Pieter's interests. Two subthemes are discussed and commented on per theme by two authors.

The first theme is mentioned in the title of the book: The Art of Supervision. Philip Collins says: "the central role of a competition authority is putting the consumer interest at the heart of its work. The role of an authority goes further than enforcer of the competition law against private businesses but also as an advocate of the benefits of competition and of well-functioning markets." He also argues that those activities with the biggest infringement should be prioritised. He opts for an authority that is socially engaged, emanates independence and remains impartial and accountable. The commentators on this piece, Hans Vijlbrief and Hans Hoogervorst agree that the NMa is "indisputably an independent agency". The line between 'competition policy' and 'competition enforcement' continues to be a source of discussion, according to Vijlbrief. Hoogervorst thinks enforcement is important but also argues for a strong advocacy role. It can be important in this respect to periodically conduct and communicate a risk analysis.

Pablo Amador Sanchez, Gerard Bakker and Aad Kleijweg write about cooperation with other institutes. Cooperation can serve the public interest well. Cartels are still detected mainly because there are 'whistle-blowers' and leniency programmes. In future the cooperation with national and international institutions to obtain tip-offs on suspected anti-competitive behaviour will become increasingly important however. As an

example of national cooperation the authors cite the relationship with the FIOD in investigating construction industry cartel cases (false invoices; telephone taps). The international cooperation with other authorities, such as the German, Danish and the Belgian authorities in the case of the shrimp fishers and in the flour cartel case, also makes it clear that this kind of cooperation is developing positively. The authors point out that regular meetings are important in this cooperation: “face to face contact is necessary”. In their commentaries, Alexander Italianer and Jacques Steenbergen primarily discuss the role that Pieter Kalbfleisch played in this international cooperation. Under his leadership, the NMa has become increasingly active in working groups in the European and International Network of Competition Authorities (the ECN and ICN, respectively). This international orientation ultimately resulted in the NMa’s organisation of the 10th ICN Annual Conference in 2011. Steenbergen also emphasises the good cooperation between the Belgian competition authority and the NMa, as stated in the main article.

The second theme of the book goes into the public interests in more depth. Coen Teulings and Paul de Bijl write about ‘The political economy of deregulation’. They discuss how the public interest in regulatory reform can be managed in the face of vested interests or high transaction costs. One theoretical model shows how product market deregulation can support labour market reform. A second model illustrates that a properly functioning financial market is important for the acceptance of product market deregulation. If inefficient companies cannot be easily taken over by more efficient ones after deregulation, this will complicate deregulation. Chris Buijink emphasises in his comments that in the case of reforms that “will raise welfare standards for society as a whole, but may have a negative effect on certain groups, all the interests must be taken into account, particularly during the transition period.” Bernhard Wientjes stresses that further reforms of markets are necessary to increase productivity growth. The warnings and advice from Teulings and De Bijl can further support the implementation of such a process.

Henk Don claims that, in principle, the legal framework allows all public interests to be taken into account in competition cases. He explains that the definition of public interests is not straightforward and briefly reviews the recent debate on this issue in the Netherlands. Don concludes that the identification of a public interest and its proper weight ultimately require a political decision. Yet, the application of Article 101(3) TFEU in practice tends to avoid a real balancing of interests, by relying on the requirement that a sufficient degree of competition will remain in the

market which will keep it sufficiently self-policing. As a result, it is often sufficient to check the legitimacy of the public interest at stake, without invoking a weight factor. This also avoids weighing uncertain efficiencies and finds confirmation in the NMa practice of recent years. Elco Brinkman concentrates in his comments on the public tendering of large construction projects. He feels that as a result of too strong a government orientation towards prices, excessively low prices are sometimes quoted. The question is whether the public interests are properly served this way, since quality is also an essential component on which the government should focus. Chris Fonteijn addresses weighing public interests more from the perspective of regulation. Public interests play a prominent role in regulation, and are likely to gain in importance. While the regulator needs guidance from the legislator to handle dilemmas, he must ultimately balance all interests in a transparent and independent way.

Part three concerns the international dimension of Pieter's work. Both the established and new authorities are discussed in this section. Philip Lowe discusses an important development in implementation of the competition rules, specifically the 'private enforcement' in the EU. In his view it is evident that 'public enforcement' is in many cases the appropriate manner for enforcing the competition rules (there is a general interest; the consumers are benefited), but at the same time it has its limits. After all, public enforcement focuses mainly on 'deterrence' and less on 'compensation'. It is in his opinion obvious that it is mainly compensation that is emphasised in private enforcement. There is no room in this for 'punitive such as double or treble damages' as is customary in the US. At the same time, it is important to guarantee the attractiveness of leniency programmes. In their commentaries, both Floris Vogelaar and René Smits discuss the relationship between public and private enforcement. They claim that the two complement each other, but public enforcement will be leading. Vogelaar defends the assertion that both are intended primarily to deter: "Compensation of damage is the outcome, not the goal". He also argues for a more uniform approach to the sanction policy within Europe to reduce the "helpless diversity of (total absence in) laws regarding damage redress as was laid bare in the Ashurst Report". Smits also sees public enforcement as leading in both forms of enforcement. He detects the risk that a claimant in private procedures will obtain confidential information from the competition authorities in order to determine the damage. Because of this risk the leniency instrument could be at stake, which should not occur in the opinion of Smits. That is why he supports European rules to avoid this risk.

In addition to a contribution on the old world, the essay from Peter van Bergeijk and Pierrette Gaasbeek also addresses the emerging world. Strengthening of the competition policy can be seen as one of the pillars of a 'structural adjustment' policy. The gradations differ per country. China is an example of a gradual turnaround towards a market economy. China's entrance to the WTO in 2001 forced the country to accept international imports. China's competition legislation followed rather than led the economic turnaround however. As long as the economy is growing, there will not be a tendency to change direction in this respect. It is doubtful whether the market dominated (neoclassical) economic model will continue to be a guiding principle if countries like China and India take on an increasingly prominent role in the world economy. The authors state however that pressure on emerging economies to further implement the market model of the Western shape is "not sensible". Carl Baudenbacher agrees with this in his commentary. He does point out that not only the Chinese economy is in flux, but also its competition legislation. To date, merger control in China has been much more important than anti-trust policies. Added to this is the fact that the legal enforcer can apply criminal law in the case of serious abuse of power. Whether this will actually happen is doubtful. For the time being, "changes in competition policy will likely be geared towards national interests rather than specific ideological dogma". Peter Freeman also ascertains that the competition policy in China has to date been creatively applied. He has high expectations for (silent) diplomacy and cooperation. The UK's Office of Fair Trading signed a Memorandum of Understanding with China's National Development and Reform Commission to promote cooperation between the two authorities. The NMa too has many informal contacts that are useful and in which Pieter Kalbfleisch's international orientation has proved invaluable.

The transition to the court room is made in part four of this Liber Amicorum. Monique van Oers and Anke Prompers entitle their contribution: "*The courts and the art of concentration*". There is one specialised district court, the district court of Rotterdam, where appeal cases against the NMa's decisions are heard, with the possibility of further appeal to the 'Appeals Tribunal'. It was decided to have this concentration in 1998 with the introduction of the Competition Act in the Netherlands because a) it was thought the number of appeal cases would be limited, b) it requires special expertise that can better be concentrated and c) it would promote consistency in decisions. In practice, the number of appeal cases is now on the rise, but the authors do not feel this is any reason to reverse the

concentration of jurisdiction. They do believe that the competence of the district court of Rotterdam needs to be expanded “so as to include disputes on preparatory and actual conduct of the NMa”. Erik van den Emster endorses this assertion in his commentary. He stresses the need to invest in the development of knowledge on the level of appeal cases within competition law. The economic importance of a sound legal infrastructure must not be underestimated. It is of the utmost importance that the course of proceedings in competition cases is sound, fair and of the highest standard. Mark Biesheuvel doubts the correctness of the idea of Van Oers and Prompers to place civil appeals against the NMa concerning, for example, its investigation methods with the district court of Rotterdam. The fact that the NMa is inconvenienced by the rulings of civil courts in this area does not in his view constitute a good argument. It is also highly questionable whether, in these kinds of cases, the district court of Rotterdam is in “a better position to value the merits of the case and the direct consequences of its ruling” than other district courts.

In Berend Jan Drijber’s essay, economics enters the court room when he states that “Competition law is economic law. Yet, for a long time competition law has virtually been monopolised by lawyers”. It is only the past 10 years that economists have become increasingly involved. In his opinion, this is mainly due to the developments in ‘merger control’. Economics is essential in assessing mergers. The approach has therefore partly evolved into a more ‘effect-based approach’. Still, the European Court of Justice only calls on economic experts to a limited degree. The experts usually come from the parties who put a great deal of energy into their cases against the experts from the Directorate General for Competition. Often that is pointless, according to Drijber, especially “if the Commission’s findings are based on documentary evidence”. Economic analysis has also become more important at the NMa, as evidenced by its staff and organisation. He cites three concentration cases in which the NMa’s decisions based on economic argumentation were in some cases seen as controversial. Annetje Ottow and Loes Brekhof believe that the economic analysis is important also in cartel cases. How matters stand in both a legal and an economic context must be considered on a case-by-case. Although a case by case approach can hinder a more general economic approach the “intrinsic link between competition law and economics shows itself in both approaches”. In their commentary on Berend Jan Drijber’s essay, Esther Lamboo and Milou Dijkman state that, in their view, according a more economic dimension of competition law makes it possible to take public interests into account in decisions. They see this as

a benefit of including the economic dimension in a more explicit way. One of the disadvantages they identify in this regard, however, is the multiplicity of opinions in proceedings, as a result of which one statement contradicts another (arm wrestling between conflicting teams of economists). In such cases, the court must itself assess the value of the economic reports. It is clear that the economic evidence must also always be supported by sufficient factual evidence. According to Lamboo and Dijkman, this makes it possible for the court to identify the essence of the matter (the so-called “sniff test”) and take it into account in its assessment.

Part five discusses the two faces of the NMa: competition and regulation. In this section the unique character of the NMa is expressed, specifically the fact that the NMa both implements the Competition Act and is a regulator for the energy sector and part of the public transport sector. Price regulation can be given form in various ways (including cost-plus, rate of return, price-cap, benchmarking). In all these forms of regulation, it is prescribed in one way or another that the efficient costs may be passed on in the tariff. Some of these efficient costs consist of capital costs. The importance of these costs varies according to the capital intensity of the particular regulated sector. In the regulatory framework, the shadow price of the capital costs is calculated via the so-called WACC (the Weighted Average Costs of Capital). In their article *What rate of return to allow? Do we truly understand it?* Arnoud Boot and Jeroen Ligterink are surprised that this WACC plays such a dominant role in the regulation while, theoretically, but also practically, much can be said against it. For instance, long-term considerations play a role in investment decisions while a maximum of one regulatory period (at most 5 years) can be taken into account in the WACC calculations. Partly for this reason it is important in discussions on the WACC to keep the relativity of this concept in mind. In his commentary, Winfred Knibbeler addresses the NMa’s reticence with respect to intervening in the matter of excessive prices. Intervention with respect to prices only becomes unavoidable in sector-specific cases. The WACC is truly necessary in such cases. The NMa therefore uses the WACC in some sectors. Understandably, however, it does not do so wholeheartedly, since the WACC is based on a number of assumptions that also make it difficult for a court to estimate the exact scope of this concept. It is therefore understandable that a court requires that “methods are consistent, based on up to date numbers and commonly accepted according to general economic principles”. Independent experts are virtually unavoidable due to the complexity of the subject mat-

ter. In their commentary, Peter Plug, Machiel Mulder and Luuk Spee refute a number of points of criticism made by Boot and Ligterink with respect to the WACC. For example, they explain why, when using the WACC, the NMa opts for an optimal ratio between financing by debt and equity. This relates to both taxes and the aim of achieving a cost structure that is as efficient as possible. The same applies to choices concerning the decision not to compensate for non-systematic risks.

In the article *Is cost benefit analyses a tool for decision making between free competition and regulation?* Jaap de Keijzer asserts that regulation is actually only appropriate if there is a case of a natural monopoly and a public interest is at stake. Temporary regulation can also play a role in the transition from a collectively financed activity to market-orientation. Jaap de Keijzer echoes the SER's conclusion that a cost-benefit analysis can play an important role in whether or not to privatise. At the same time, he makes clear that the somewhat negative connotation surrounding the notion of regulation (except in the word 'deregulation') is unfounded. Regulation can in many cases be a good alternative for guaranteeing efficiency in certain markets and for in fact promoting competition in market segments. Maarten Pieter Schinkel states in his comments that in the merged competition authority, which includes - besides the NMa - OPTA and the Consumer Authority, competition policy and regulation should be well defined in their own context. He does not agree with Jaap de Keijzer's opinion that regulation is frequently more beneficial than competition policy because it allegedly provides greater certainty. In his view, regulation is extremely information-intensive, especially in rapidly developing markets, and he therefore hopes that the new NMa will not acquire a regulatory bias. "Shifting the emphasis from competition policy to regulation in the new NMa will burden the agency with asymmetric information problems, not alleviate it." Drawing on experiences at the Dutch Healthcare Authority (NZa), Cathy van Beek and Rein Halbersma address two additional points that arise when doing cost benefit analyses in practice. First, as was hinted by Jaap de Keijzer, prospective analyses as required for regulation and merger control are inherently more difficult than retrospective analyses as required for cartels and abuse of dominance. Second, in prospective analyses one could argue for a bias for Type I errors over Type II errors, especially in markets in transition where anticompetitive mergers can block competition before it has even started.

In the first article of part 6 of this book 'Competition and moral sentiment', in his article *Competition vs. cooperation: Between the Devil and the Deep Blue Sea*, Tom Ottervanger sets regulation and competition against

each other and not alongside each other, as Jaap de Keijzer does. Although competition is the cornerstone of our economic system, cooperation sometimes offers benefits that can exceed the yields of free competition. This can involve aspects like solidarity and morality, which are difficult to incorporate economically. Not so long ago, cartels were not regarded as reprehensible in our national cartel paradise, on the contrary. Whence this turnaround in the moral view on cartels then? Added to this is the fact that an exception is often made for agricultural policy. It may not be efficient, but is it amoral or antisocial? Ottervanger does not always agree with the NMa's decisions that sometimes lead to monopoly via concentration, while the NMa says it takes public interests into consideration. It is important for the NMa to clarify further how it takes these interests into consideration. The decisions and annual reports from the NMa do not give a definite answer on this in any case, according to the author. Other authorities wrestle with the same dilemma. Perhaps cooperation between them can offer a solution. In his commentary, Kees Hellingman takes the position of the sceptical regulator. He sees an inclination on the part of many individuals towards a sort of cartel paradise. In the view of many individuals, cartels are illegal but certainly not immoral. Nevertheless, he believes that there are also moral arguments against cartels. Competition is a fundamental right that guarantees individual freedom, just as democracy guarantees political freedom. It is therefore the responsibility of those in politics to defend both forms of freedom. In his commentary, M.R. Mok expresses doubt as to whether the relationship between competition and democracy can be defined in such unambiguous terms. Although he sees competition developing in China, democracy in that country is a different story altogether. The opposite can also be the case, i.e. democracy without competition. The EU described examples of such situations in Article 101(3) of its Treaty on the Functioning of the European Union (TFEU). Indeed, such situations may even be amplified. Especially when public interests are at stake, government intervention is justifiable, not only in cases of sustainability in an environmental sense but also in order to guarantee quality with respect to consumers. Mok mentions the Dutch postal services as a poor example of the latter category.

In his essay, Johan Graafland talks about "consumer welfare versus sustainability in competition policy". He ascertains that material prosperity has increased dramatically but that the ecological effects of this are not taken into account. In that context it is important to keep in mind that the European treaties also identify sustainability as an important objective. Many companies pursue sustainable enterprise without jeopardising com-

petition. Green can also be a good competitive slogan. “Obviously, the two policy goals – a competitive market and sustainable growth – can easily collide.” But not all the studies are unequivocal on this point. Especially the first mover often has to compete against the companies who do not participate. An agreement on the sector level can offer a solution for this. It is important to keep in mind, Graafland says, that man is supposed to act responsibly as a steward of creation. That can in some cases mean that the consumer interest should not be assigned quite so high a priority. It is important that in cases where sustainability and competition could come in conflict, the NMa opts for a socially responsible line. In his comments, Nout Wellink supports the view that sustainability must be an important objective. It is important to make it possible also for future consumers to share in our prosperity. The government is making this possible in financial and economic terms by reducing the budget deficit and public debt. This intergenerational solidarity also applies to pensions. The matter is more complicated with respect to the environment. In Wellink’s view, a sensible course of action would be to carefully consider actions in the field of corporate social responsibility through which companies would strive to combine the environment and competition. At the end of his commentary, Wellink addresses the problem as to whether competition in the banking system must be strengthened. He sees both benefits and drawbacks with respect to greater competition. It is clear that a competitive system will always be necessary. He notes, however, that in the case of mergers in the financial world, DNB and the NMa sometimes serve different consumer interests. In such cases, DNB often focuses on existing savers, whereas the NMa focuses on the future situation. For the NMa, competition is the primary consideration.

In parts seven and eight of the book, we enter areas in which the NMa is not traditionally very active: ‘competition and arts’ (part seven) and ‘competition and sports’ (part eight). In his contribution titled *La maladie Imaginaire*, Jules Theeuwes shows that with regard to the performing arts, economists still sometimes have the misperception that Baumol’s law applies: because of the labour intensity of an orchestra, it becomes prohibitively expensive to perform Mozart because there has been no growth in the labour productivity of performing since the year 1750. Whatever the truth of this premise, Theeuwes claims this is a misinterpretation of Baumol’s law. After all, advancing technology makes it possible to enable many people to enjoy the performance at the same time. Competition is in the way in which orchestras compete – on the business side therefore and not so much on the performance side. Successful, profitable art also

exists – low art – and is not subsidised. High art is often loss-making and is indeed subsidised. The question is to what extent this is desirable. Baumol cannot help with this in any event. In his commentary on this article, René Jansen states with respect to his time at the NMa that he can remember the discussions with Pieter Kalbfleisch about competition and art well, but never in combination. His main conclusion remains that “art and (economic) competition have had only a marginal significance to each other.” He therefore interprets the contribution of Jules Theeuwes mainly as a business approach of art’s performance side. This is of importance to the consumer. Regarding the art itself, he believes that Pieter Kalbfleisch’s approach is worthy of emulation: “participate instead of regulate!” In his comments on the contribution of Jules Theeuwes, Paul Glazener does not ask “whether the performing arts are suffering from a disease” but, rather, whether the application of the Competition Act to the performing arts is beneficial. Like René Jansen, he does believe that it is not. Orchestras may indeed make agreements to reduce costs, for example, but ultimately “they will compete on the artistic quality of their performances, which is left untouched by cooperative agreements”.

In her article *Are less government support and more competition a threat to diversity in the supply of arts?* Barbara Baarsma sees positive external effects as an argument for supporting art. “People who consume more cultural goods do better at school, are healthier, and less likely to engage in criminal behaviour.” According to Baarsma, it is first of all important to boost per capita income because increased prosperity is the best guarantee for high art consumption. By raising GDP, more competition will also stimulate the arts. Weijer Verloren van Themaat also believes that there is little risk of artists exchanging information without proper authorisation or concluding agreements that are detrimental to consumers. The Competition Act only applies when a company is involved. This is sometimes the case. Like Paul Glazener, he refers in his commentary to the Unitel case concerning exclusive broadcasting rights of Don Carlos from Salzburg against which Unitel protested. The matter concerns not only art but the commercialisation of art. “The artistic process itself remains something very special. Artists are extremely unwilling to make concessions that would compromise their art.” In his commentary, Tjark Tjin-a-Tsoi adheres to the idea that artists compete with each other through their art. It is primarily new ideas and innovations that prompt also artists to break new ground. This constitutes the similarity with economic development, where creativity is also essential. He therefore agrees with Baarsma that economic growth is essential to enable art to flourish. This is possible

through civil society funds or through the government. The yields of government subsidies are usually low: “the golden ages of art are not created by government subsidies. They are created by golden ages in thought and economic activity.”

The articles in the “Competition and Sports” section tie in with the discussion about art and competition. In his commentary in the “Competition and Arts” section, Weijer Verloren van Themaat states the following in this regard: “We may need to distinguish between the creative process itself and the act of asking money (...). The same issue arises in sporting activities.” Rein Wesseling’s article is the first in part eight that deals with “Competition and Sports”. He argues that football clubs should not be seen as undertakings in the sense of the Competition Act, since football clubs “are not (rational) economic actors at all, and (...) their activities should not be considered economic activities”. By taking this approach to football clubs, it is not likely that the European Commission will have to intervene, although arguments can be found for this in a number of cases, partly in view of the international effects from a competitive perspective. Wesseling nevertheless states that “The Commission Directorate General for Competition had better devote its scarce resources to cases which are more relevant for competition and for consumer welfare within the Union.” In his commentary on Wesseling’s article, Piet Jan Slot expresses the view that the objective of not intervening does not in this case justify the means. Placing football clubs outside the definition of undertakings reopens a difficult discussion from the past. “It should be borne in mind that that this definition is the result of a long string of judgments of the court of Justice”. He considers this undesirable, certainly if one takes broadcasting rights of football matches and Formula 1 races into account. The solution identified by Slot is to apply the so-called “market economy investor principle”. Considering the low standards for return on investment applied by private investors in football clubs, this would provide a rather generous exemption for local aid. Although Ewoud Sakkers acknowledges Wesseling’s point that state aid frequently comes down to messing around at the periphery of what are often marginal football clubs, he disagrees with Wesseling’s assertion that local support as a whole does not have any consequences for the sport. According to Sakkers, it is precisely the middle-ranking teams that are at times capable of challenging the top teams, something that can patently affect the competition. He believes that it would be beneficial if the European Commission devoted somewhat more attention to the expenditure of tax money on local football clubs.

The article of Jarig van Sinderen and Rob Vossen deals with professional football. The authors wonder why so much public money is sluiced into professional football in the Netherlands. One argument for this may be that the government considers its external effects of eminent importance. “Also the EU in various documents pinpoints the public interests involved with sports in general and football in particular.” This means the use of public funds for clubs can be justified. Whether this kind of sponsoring improves the competitive strength of Dutch clubs is questionable however. The Netherlands performs modestly on the international club level. Moreover, many clubs are facing financial difficulties while players earn exorbitant salaries. According to the authors, there is good reason therefore to reduce the subsidies, and this does not necessarily have to result in performance suffering. There is also good reason not to sell media rights in packages as is customary in the EU, but on a more individual basis, so that the best performing clubs can also profit the most. In his commentary on this article, Christof Swaak concentrates on the recent decisions of the General Court concerning the exclusivity of the broadcasting rights of matches. The General Court decided to define some broadcasts of a member state’s national team as items of public interest and therefore prohibited these broadcasts disappear behind a decoder. Watching matches through foreign broadcasters at lower rates was also permitted. These judgments will foster competition between a range of authorised broadcasters in various EU countries, which will benefit consumers. The last commentary in this book is written by Gerard van de Wal. He is of the opinion that Van Sinderen and Vossen do not make a clear distinction between state aid and the application of Articles 101 and 102 of the Treaty on the Functioning of the European Union, something that he believes to be essential. State aid is not a matter that is dealt with by national authorities. It is dealt with by the EU. In his view, articles governing subsidies may be applied, avoiding the rules pertaining to state aid. This was successfully done also in the provision of subsidies to stadiums.

This brings us back to the essence of the objective of competition policy, as taken as a starting point by Pieter Kalbfleisch in the eight years he has headed the NMa, namely to properly apply the rules governing competition as laid down in the Competition Act in order to improve consumer welfare. Considering the many cartel cases, concentrations and regulatory decisions taken under his leadership, he has kept an extraordinarily clear view of this starting point. Supervision remains an art, or as he himself said it, “supervision is more an art than a craft”. Whether it belongs to high art or low art is up to the reader to decide. In any event, the

INTRODUCTION BY THE EDITORS

authors have contributed to a tangible document that also contains a number of wise life lessons for the future: *Ars longa vita brevis*.

The Editors,

Henk Don

Jaap de Keijzer

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PART 1

The art of supervision

The role of the competition authority in policy debate and public society

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Introduction

Over the last fifteen to twenty years, the role of a competition authority has changed and developed considerably as the scope of its activities has broadened and deepened, and the impact of those activities on consumers, businesses and the economy has grown. Those activities have also become more diverse and more complex, and have involved greater engagement in and positive contribution to policy debates and public society. The NMa, under Pieter's inspired leadership first as Director-General and then, from 2005, as Chairman, and with the mission 'making markets work' provides a fine example of the expanded and enhanced role of the modern competition authority.

This evolution has occurred at a time when markets have become more international and dynamic and subject to rapid, and sometimes profound, change, especially as a result of the impact of technology and new business models. Also during this period, former state-run utilities have been liberalised and opened up to competition for the first time, and state-owned businesses have been privatised. Moreover, there has been increased opening up to competition of public services, such as hospitals, prisons, waste collection and treatment, and social services.

Against this background, politicians and legislators have also come to recognise the value of a competition authority acting not only as an enforcer of the competition laws against private businesses, but also as an advocate of the benefits of competition and of well-functioning markets in promoting growth and prosperity generally across the economy. The central role of a competition authority in putting the consumer interest at the heart of its work, and in promoting growth and productivity in the economy, has become well established. Pieter has been a firm, clear advocate of putting the consumer's interest at the heart of the NMa's work.¹

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Thus, the broader mandate of the competition authority is concerned not only with private restrictions of competition, but with public restrictions, such as those that flow from regulation or the interactions of government with markets and with both the private and the public sectors.

This has emphasised the need for a competition authority to be politically independent, whilst appropriately governed and properly accountable for its activities. With such independence, governance and accountability, a competition authority is able to set its own agenda and priorities, and to engage actively in and contribute its perspective on competition issues in relevant policy debates for the benefit of society in the modern free-market economy.

So, while enforcement through casework involving the activities of private businesses rightly remains, and will always remain, at the centre of a competition authority's functions, its role now extends beyond casework in the traditional fields of antitrust and mergers, and into advocacy, influence, education and guidance. It can, and must, play an active role, within its mandate, in relevant policy debates contributing from its skills and experience in competition and markets to help shape policy decisions.

Case openings: obligation or opportunity?

It is self-evident that the main role for a competition authority is to bring cases which enforce the law and sanction the infringers as well as to deter others, whether in the same sector or in other sectors, or indeed across the whole economy. An active and effective enforcement policy remains the cornerstone of an authority's work. By any standards, the NMa during Pieter's tenure has become an active and effective enforcer, bringing cases successfully across a wide range of sectors.

But what should that active and effective enforcement policy lead to in terms of the portfolio of cases? Does society expect a competition authority to investigate every case or issue brought to it? Resources are limited and have to be focussed, and enforcement is only one part of the broader mandate described above. Some competition authorities (such as in France) are required by law to investigate every case; others (such as in the UK²) have considerable freedom to choose what cases they do and, acting within the boundaries of the relevant national administrative law, how they dispose of them. The NMa has sought to focus its enforcement interventions on sectors that are of particular importance to the economy of the Netherlands, such as (in 2010/2011) healthcare, processing industries, financial and business services, energy and transport.³

A competition authority now has to focus on case selection and on evaluating the impact of its casework. Numbers of cases started, closed or fought successfully, and levels of fines recovered are only crude measures of enforcement activity. They do not allow a competition authority to demonstrate to society generally, and in the context of wider policy debates, the value of an effective competition regime in terms of the benefits it delivers to consumers and the economy.⁴

Hence, if a competition authority has a legal obligation to investigate every case, it must do so, but it may have to find innovative ways of dealing with those that are less strong or less important and to be prepared to defend its position in court. A competition authority, especially if it has no obligation to investigate every case, will need to find effective ways to screen cases, prioritising those that are the most important in terms of impact, significance and precedent as well as inherent strength of evidence, as well as innovative ways of resolving cases, where possible, other than by taking every case through to the full process to an infringement decision. The NMa has taken an innovative approach to resolving cases, notably in the construction industry with its fast-lane procedure⁵ and in the remedies that it adopted in the KPN/Reggefiber joint venture.⁶

So the role of the competition authority has become not just to enforce the law by bringing cases, but by bringing the right cases and dealing with them in the best way.

A balanced portfolio

For the same reasons, the mix of the case portfolio is important. Most competition authorities could probably devote a major part, or even most, of their resources to detecting and sanctioning cartels and other hardcore infringements. This can be challenging work from the fact-finding and evidential perspectives, especially when the activity is sophisticated, for instance, requiring the painstaking analysis of many thousands of documents and other records, and the reconstruction of events from diverse sources. As business activities change, new business models emerge, and new kinds of business relationship develop: exploring the boundaries of cartels and hardcore infringements is a continual, but important, challenge.

Uncovering cartels is not easy, but the development of leniency policies and whistleblowing programmes have helped,⁷ and a competition authority must ensure that it keeps those policies effective and up-to-date, so that they are well understood by businesses and by practitioners when they

need them. This requires careful identification of the key drivers that encourage leniency applications and the practical issues that have to be covered to ensure that it works in practice.⁸ But, as Pieter has rightly pointed out, it is important not to be reliant on leniency and to find other ways to find leads to potentially successful cases.⁹

Rule of reason and abuse/monopolisation cases may also raise challenges in terms of fact-finding and evidence, but the legal and economic issues that such cases raise are often complex, involving careful development of theories of harm, and they are typically heavily contested. Competition authorities must take these cases not only to enforce the law, but to develop the application and interpretation of the law in the interests of society. In doing so, they provide clarity and certainty to business and consumers, especially as markets evolve and new business models and practices develop. It is vitally important that the law can be, and is applied, to deal with new issues and with changes in the way that businesses operate and consumers behave when considering and making purchases.

The workload of competition agencies in mergers is outside their control, being dependent on the levels of M&A activity and the economic cycle. Here, the role of the competition authority is to protect consumers by ensuring that transactions which raise potential competition issues are carefully examined and, if necessary, prohibited while mergers that do not raise such concerns are able to proceed without undue delay. Often, this may require a careful balancing of opposing arguments and weighing of the available evidence. Particular mergers can raise other issues of concern to different parts of society. It is essential here that a competition authority confines itself to addressing the competition aspects of the merger, and leaves matters that may raise other policy issues to be dealt with by government or other parts of the public administration.

In connection with both antitrust and mergers, competition authorities also have an important role to play in providing guidance to business on competition law. There was a view in some quarters when guidance was first introduced that either it did little more than state the bare bones of the law or that it was designed to implement the competition authority's view of what they wished the application of the law to be or to achieve, even in the absence of case precedents, a form of 'soft law'.

We have moved a long way from those days, notably following the move in many competition law regimes from notification to self-assessment systems and from form-based to effects-based analysis of competition issues. Guidance is now developed on the basis of careful initial preparation of the issues within the agency often benefiting at that

stage from specialist input to ensure that it captures the right issues, leading to the development of draft guidance. This is followed by debate and consultation within and between the various interests in the legal, economic, business and other communities. Guidance can make use of practical examples or case studies which are not just mere replications of decided cases, to illustrate the principles that it sets out. The NMa has been an active developer and promoter of guidance, for instance, with its recently revised guidelines for the healthcare sector and its new guidelines, drawn up jointly with the Dutch Healthcare Authority, for health care groups.

Guidance in relation to mergers, too, now forms an important part of a competition authority's role in ensuring that business is aware of the authority's approach to the issues that typically arise in mergers and of the kinds of analysis and evidence that may be anticipated. In this way, businesses are better able to judge for themselves whether or not a merger is likely to raise concerns and, if so, how it may be able to address them.

The role of the competition authority in relation to compliance with competition law has also developed significantly. Whilst responsibility for compliance with the law rests with business who have access to specialist advice applicable to their own business structures, practices and commercial arrangements, there is increasing interest in, first, what actions by a competition authority have the greatest impact in stopping and deterring infringements¹⁰ and, second, how a competition culture can be cultivated and embedded in business organisations so that the risk of infringement is reduced.¹¹ Work in both areas benefits society by enabling the competition authority to focus its resources on cases and on issues that are likely to have the greatest impact; and they provide a valuable interaction with business and business advisers in supporting the promotion of competition in markets. Under Pieter's direction, the NMa has been an active promoter of the compliance message to business in the Netherlands as well as developing key tools to assist in uncovering infringements, such as its guidance on detecting and preventing bid-rigging.

In addition to traditional antitrust and mergers casework, competition authorities now have a broader role in examining markets. They can carry out studies, investigations and research projects in relation to competition and markets. These projects may examine whether particular markets are functioning well and, if not, reporting on what can be done to address the causes as well as researching and reporting on thematic issues that are relevant to competition and markets across several sectors or in the economy generally. They can examine the potential impact of new

developments that are affecting markets or are on or just ‘over the horizon’. These reports can also inform the evolution of competition policy as well as its application to novel situations. They may also help identify issues that can inform or lead to future casework in antitrust and mergers.

The importance of competition advocacy

Beyond casework and related activities, competition authorities have taken on an increasingly important role in the public debate and in society through competition advocacy. Competition advocacy describes the activities of competition authorities related to the promotion of a competitive environment for economic activities other than through casework, mainly through interaction with other parts of government and by raising public awareness of the benefits of competition.

In this role, competition authorities raise awareness of competition issues among policymakers in government and advise them where wider government policies affect competition and markets. This can be achieved in a variety of ways. In some cases, there is a formal role for the competition authority, requiring it to be consulted or to give an opinion on new legislation or regulation. In most cases, the engagement is less formal, with the competition authority being asked to assist the policymakers in developing proposals which are consistent with competition law, but run with the grain of developing well-functioning markets.

This work can be challenging for competition authorities, given the need to ensure that the competition issues are addressed with in-depth understanding of the specific sectoral issues and the overall policy context. Whilst this has some parallels to some of the challenges of competition casework in terms of understanding the complexities of individual markets, the range of sectors and issues that have to be considered is much larger and more diverse. It is critical to be able to engage with policymakers in a way that demonstrates technical expertise as well as well-informed and well-researched advice that is based on both theoretical and empirical considerations. Timing is also important: advocacy will be most effective if it is provided early in the policy-making process, rather than late on when the policy approach has been well developed. Competition advocacy may be high-profile because of the nature of the issues or the size of the market involved. Here, the independence and objectivity of the competition authority is vital. Under Pieter’s direction, the NMa has recognised the importance of this advocacy role, not least in reminding businesses that the economic crisis is not an excuse for concluding illegal agreements as well as in guiding other policymakers.¹²

Notwithstanding its advocacy function, it is important to the success of a competition authority to recognise the boundaries of its role so as to avoid straying beyond markets and competition into other policy areas that fall within the proper remit of politicians, the legislature or other public institutions. A competition agency can input its views and expertise on competition to the policy debates, but should be mindful of overextending its reach by taking decisions in other areas that are best left to others, albeit others who are (hopefully) well informed about the competition implications.

In order to be best informed and equipped to take part in public debate and public society, a competition authority has to be well informed. It can do this through engagement with policymakers, politicians, legislators, business and all aspects of public society at national level.

But in order to deliver on its national role, a competition authority needs also to be active internationally, following and understanding the activities and interests of other competition authorities and learning from them while also educating them about its own activities and interests. While national competition regimes and legal systems may differ, the core issues that arise are relatively common even if they have to be tackled in different ways and subject to particular national sensitivities. Sharing experiences internationally, through bodies such as ICN, OECD and bilateral/multilateral arrangements enables a competition authority to engage more effectively at the national level in public debate and public society.

Concluding remarks

A competition authority needs to engage in public society at the relevant levels and through a variety of routes, including both the media and civil organisations, to explain what it is doing, why it is doing it and what outcomes are intended or have been achieved as well as the broader benefits of well-functioning markets to consumers. This is more than just fulfilling a perceived need to justify its existence as a body. It is to ensure, through such engagement, that society can contribute to the choices that it makes and understands the benefits that it delivers.

In doing this, the competition authority must exhibit three attributes. First, it is crucial that the competition authority is *independent* from government and free to make decisions *impartially*, unhindered by political or other pressures. The NMa itself became an autonomous non-departmental public body in 2005 having previously fallen under the

responsibility of the Minister for Economic Affairs. Pieter himself has stressed the importance of this independence.¹³ As with the rule of law generally, confidence in competition enforcement requires transparent and well-reasoned decision-making that enables market participants to understand and anticipate how the authority is likely to act in the future. If it is necessary for other public policy concerns, such as national security for example, to be invoked in a given case, this should be the responsibility of government policymakers and not the competition authority.

Similarly, competition authorities must be, and be seen to be, impartial. By their nature, and in particular where investigations originate from complaints, antitrust cases will usually meet with opposition and efforts to use them to pursue vested commercial or other interests, whichever way they are decided. Likewise, the clearance or prohibition of a merger transaction. The maxim of protecting competition, not competitors is a familiar one here. The need for such impartiality is particularly relevant when a competition authority is investigating incumbents in some industries and where the risk of regulatory capture is real.

Second, with independence comes *accountability*. Competition authorities need to regularly report on their actions, for example through publishing annual reports and consulting on their prospective plans. In addition, being answerable to policymakers, for example through appearing before parliamentary committees, will strengthen that accountability and transparency. The NMa has, under Pieter's leadership, demonstrated the importance of accountability and transparency.

Third, the competition authority's accountability should be supported by suitable *governance* mechanisms. Competition authorities have been established with different forms of governance structure and follow different approaches on the range of skills and experience considered desirable to ensure robust governance. In some, legal and economic skills predominate; in others the governance structure seeks to ensure broader representation from society or to follow the private sector model. Whatever structure is adopted, it is important to ensure that the competition authority does not function in an ivory tower, but is in touch with the society in whose interests it acts.

With the transition from being part of a government department to an autonomous public body, operating under a Board, which Pieter has chaired with great skill for the past six years, the NMa and Pieter have been at the forefront of developments in the modern competition agency and its role in policy debate and public society.

COMMENT**HANS VIJLBRIEF*****The NMa as advocate of well-functioning markets**

Philip Collins argues that the role of competition authorities has expanded in the last decade: from an ‘enforcer’ to an ‘advocate’ of well-functioning markets across the board. In his view, competition authorities should be politically independent, well run and accountable for their actions, so they can set their own agendas and priorities, and contribute actively to the public debate on competition issues. I share Mr Collins’s view on these points. Although the enforcement of competition law must always remain the primary duty of the Netherlands Competition Authority (NMa), the NMa can only practise effective and vigorous enforcement in a society that recognises the importance of well-functioning markets to the economy and to consumer welfare. I see the NMa, along with the Ministry of Economic Affairs, Agriculture and Innovation, as the foremost advocate of this message. In the current climate, in which competition and market forces cannot be taken for granted, that role is only likely to increase.

Prerequisites: autonomy, good governance and accountability

I am convinced that the Dutch situation largely embodies Collins’s prerequisites. The NMa is indisputably an independent agency. The boundary between competition policy, for which the Minister of Economic Affairs, Agriculture and Innovation is responsible, and competition oversight, for which the NMa is responsible, was recently defined even more stringently. This move underscores once again the principle that politicians should have no influence over individual competition law cases. Thanks to that independence, the NMa can function effectively and vigorously. Indeed, it was for the express purpose of safeguarding this independence that the NMa’s executive board under Pieter Kalbfleisch was made an autonomous administrative authority (ZBO) on 1 July 2005. Under the Competition Act, the NMa’s staff are accountable solely to the executive board.

At the same time, the independence of ZBOs is not unlimited. The NMa must comply with the provisions of the Autonomous Administrative

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Authorities Framework Act. The organisation is accountable to both the government and society at large. Not for decisions in individual cases – which are subject to review only by the courts – but for the effectiveness and efficiency of its operations generally. The first way the NMa renders account is by publishing an annual report. ‘By the rules of ministerial accountability, the Minister of Economic Affairs, Agriculture and Innovation submits that annual report to Parliament, and he is politically accountable for the actions of the NMa. In addition, every five years, the NMa’s performance is evaluated at the request of the Minister of Economic Affairs, Agriculture and Innovation. The 2010 evaluation, for which ‘independence’ was one of the criteria, was very positive about the authority’s performance during the past five years under the leadership of Pieter Kalbfleisch.

NMa as advocate

It is to Mr Kalbfleisch’s credit that the NMa fulfils its role as an advocate of well-functioning markets with such enthusiasm. This is done with the help of various instruments, which fall under the categories of advocacy and guidance. As an advocate of well-functioning markets, the NMa advises ministries on policymaking, thereby ensuring that competition issues are properly addressed. Formally speaking, the NMa does this by conducting feasibility and enforceability reviews of legislative bills. These reviews assess the potential effect of proposed policy on competition in sectors of the Dutch economy and on competition oversight. Along with this, the NMa employs its knowledge of competition to ensure a well-balanced policy. It does so both on its own initiative and at the request of outside parties.

As used by the NMa, the term ‘guidance’ refers to efforts to give the business community a better sense of what is and is not permitted under competition law. This guidance takes the form of guidelines, informal recommendations, and a bi-annual agenda that sets out the organisation’s priorities. This agenda plays a major role in the public debate, because the NMa actively solicits the opinions of the business community prior to publication. Despite this transparency, the 2010 evaluation of the NMa revealed that the business community feels a need for even more guidance. For its part, the NMa must continually reflect on how to put its (finite) resources to optimal use. This means that there are limits to the amount of guidance that can be provided. I therefore welcome the NMa’s initiative to deliver a more customised service in the future. Its aim is to focus prima-

rily on industries in transition, such as health care. It has also announced its intention to hold roundtable meetings with the business community to discuss sector-specific market problems. I expect the NMa to strike the right balance between its role as guide and its role as enforcer.

Looking ahead

In March, the Cabinet agreed to the proposal of the Minister of Economic Affairs, Agriculture and Innovation to combine the NMa, the Independent Post and Telecommunications Authority, and the Netherlands Consumer Authority into a single new regulatory agency. This decision is not only in keeping with the government's effort to achieve a more compact and dynamic public administration; it will also bring about more effective and efficient market oversight. Obviously, the competition authority will be given an identifiable position in the new organisation. Certain changes will be inevitable, but the role that the NMa has played for the past several years as an advocate of well-functioning markets will remain the same. The new regulatory agency will also be given the scope to fulfil that role suitably.

COMMENT

HANS HOOGERVORST*

Competition and financial supervisory authorities: handling high expectations

A competition authority needs to engage in public society at the relevant levels, and, through a variety of routes, including both the media and civil organizations, needs to explain what it is doing, why it is doing it and what outcomes are intended or have been achieved as well as the broader benefits of well-functioning markets to consumers.' This is one of the key messages of Philip Collins.

From my point of view, as the former Chairman of the Netherlands Authority for the Financial Markets (AFM), I could not agree more. Reading Mr Collins' contribution is in some ways like looking into a mirror. It

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seems that the issues a competition authority faces are often similar to ours. In my comments, I would like to highlight some of our experiences with issues that fuel debate in both our worlds.

Mission

One of the major challenges of a supervisory authority is to state a clear mission statement. ‘Making markets work’, says the mission statement of the Netherlands Competition Authority. ‘Making markets work well for consumers’, is what the Office of Fair Trading promises to achieve. ‘The AFM promotes fairness and transparency within financial markets’, is what we say.

And we add: ‘We are the independent supervisory authority for the savings, lending, investment and insurance markets. The AFM promotes the conscientious provision of financial services to consumers, and oversees the fair and efficient operation of the capital markets. Our aim is to improve consumer and business confidence in the financial markets, both in the Netherlands and abroad. In performing this task, the AFM contributes to the prosperity and economic reputation of the Netherlands.’

Naturally, there are differences, but they should not be overstated. Although our perspectives may be different, in the end, both competition and financial supervisory authorities are in the business of *business conduct* supervising, to benefit the interests of consumers and investors.

Regulatory craft

Our mission statements do not clarify *how* we intend to achieve our goals. The ‘regulatory craft’ is, as Malcolm Sparrow says, about identifying problems, solving them and telling everyone about it.

Risk analysis is the basis on which we ground our activities. Our primary attention should go to behavior that is not only illegal but also damaging. Also, for reasons of accountability the AFM has developed a *risk statement*. In our annual plans and reports, we write down the risks we see. Most risks lead to action, some lead to a call for new legislation.

The AFM does receive indications, and will act on them if necessary and possible. The AFM can fine a company, but cannot settle private complaints of individual consumers. Given the need to set priorities, it is even more necessary to manage expectations.

In order to achieve our goals we cannot rely on fines and other formal measures alone. We have learned that ‘supervision by speech’ can be

effective as well. And just like competition authorities like OFT and NMa, we have developed *guidance*, being an important tool to promote compliance.

Guidance also leads to legal debates that touch upon the distinction and division of powers, at least in the Netherlands. It is not without meaning that there is no Dutch translation of ‘regulator’. Supervisory bodies like NMa and AFM are independent institutions, established to *enforce* law. Critics say that, in practice, these supervisory authorities are making law, thus doing the work that should be done by the legislator. At the same time, businesses and consumers demand interpretations of *open* rules in our legislation. And the AFM has made a claim for strengthening regulating powers, to be able to enhance effective supervision. All this illustrates a certain tension, between legal and political restrictions on the one hand and expectations and ambitions on the other.

Among competition authorities, the advocacy issue has been broadly debated, less among their financial counterparts. Still, we also should raise awareness of certain issues among policymakers in government. The risk statement mentioned before can be considered to be a – rather new – advocacy tool. The AFM does not have a formal role here, but experience shows that both ministers and members of parliament, possibly for various reasons, tend to listen carefully whenever we are consulted.

Concluding remarks

I fully agree with Philip Collins’s concluding remarks on independence, accountability and suitable governance mechanisms. It is important to ensure that any authority is in touch with the society in whose interests it acts. The good news is that we will not be allowed not to be in touch, nowadays even less than before. Society does not accept us not to listen. Social media make this very clear: we can tell anything to businesses and consumers, but they will actually talk back...

The mirror Philip Collins has put in front of us shows that competition and financial supervisory authorities may differ in many ways, but the issues he has raised are familiar in the land of financial supervision. This only underlines the benefits of looking in mirrors, to share our knowledge and experiences. The AFM will welcome every opportunity to do so, both in the Netherlands and on a European and international level. After all, we both have to take our responsibility in handling high expectations.

Notes

- 1 See, for instance, Challenge 1 in Pieter's speech in New Delhi, 24 October 2010.
- 2 Although even in the UK that discretion may be curtailed: for example, the OFT must publish a response within 90 days of receipt of a 'super-complaint'.
- 3 See NMA 2010 Annual Bulletin.
- 4 In the UK, the OFT published a report providing the annual estimates for direct financial benefits to consumers from its work on competition enforcement, consumer protection, mergers and markets work over the period 2007-2010: see *Positive Impact 09/10* (July 2010, OFT1251) available at www.of.gov.uk.
- 5 See, for instance Pieter's speech 'Antitrust settlements and leniency: effectiveness, interaction, conclusions for the future'.
- 6 See Annual Bulletin 2009 and Pieter's speech 'Consumer welfare, innovation and competition' (Innsbruck 2009) where he discusses the trade-off between intervention to keep prices low for the short-term benefit of consumers and non-intervention to preserve long-term consumer welfare'.
- 7 Between 2005 and 2009, leniency played a role in approximately 40% of the cartel cases investigated by the NMA.
- 8 For example in 2010, the OFT published its report on Drivers of compliance and non-compliance with competition law. Amongst its conclusions, the report identified fear of financial penalties as a key driver of compliance and recognised that a leniency policy is an important ingredient in an optimal enforcement regime: (May 2010, OFT1227) available at www.of.gov.uk.
- 9 See, for example, Challenge 5 in Pieter's speech in New Delhi 24 October 2010.
- 10 For example, in a report prepared for the OFT by Deloitte in 2007, businesses' average ranking of the factors which motivate compliance were: (1) criminal penalties, (2) disqualification of directors, (3) adverse publicity, (4) fines and (5) private damage actions. See *The deterrent effect of competition enforcement by the OFT* (November 2007, OFT962) available at www.of.gov.uk.
- 11 On this, see for example the OFT's report on Drivers of Compliance and Non-compliance with Competition Law referred to above.
- 12 See, for example, Challenge 2 in Pieter's New Delhi speech 24 October 2010.
- 13 See, for instance, Challenge 3 in Pieter's New Delhi speech, 24 October 2010.

The art of enforcement: Cooperation with other institutions, a national competition authority's perspective

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Introduction

Inter-institutional cooperation has developed from being a by-product of agency diplomacy to a central enforcement strategy. This contribution, written from the perspective of the Netherlands Competition Authority (NMa), deals with cooperation between public institutions at the national and the international level. It is structured as follows. The first section describes the features of a competition authority. The second section sets out the various benefits of national and international cooperation from the NMa's enforcement perspective, and describes a number of concrete examples. The third section deals with how institutional relationships are built. It provides a description of the NMa's types of institutional counterparts, the practical dynamics involved in the relationship building process and the current state of affairs. The last section raises some fundamental legal questions which should be duly taken into account in the further development of inter-institutional relationships.

Features of a competition authority

The average competition authority typically consists of a certain number of employees with an academic background. It enjoys certain powers conferred on it by law and its main task is to enforce competition rules. Competition authorities are often known for their power to impose heavy

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finer compared to enforcement agencies in other fields. Competition authorities carry out their enforcement task formally by exercising powers but also by performing all sorts of complementary activities which, while remaining within the boundaries of the law, do not involve the exercise of legal powers in the strict sense. Building inter-institutional relationships is an example of those. By its actions, a competition authority gradually develops a competition policy in its jurisdiction and builds itself a certain reputation.

Competition authorities are generally more accustomed to dealing with international aspects of enforcement than many other enforcement agencies are.

Competition authorities are typical 'learning organisations'. To some extent, they have to try out new policies and tactics and see if they work or not. The more experience they gain, the better and more effective they tend to become. Their staff members must be able, among other things, to analyse complex issues from a legal and economic perspective, whilst at the same time being sufficiently 'streetwise' to seek actively and recognise competition law violations in the outside world. They must also show sufficient stamina to carry out investigations which, depending on the circumstances, may take years to complete. As this contribution will illustrate, they increasingly also need to have good personal networking skills.

The above shows that, even if a competition authority must carefully act within the boundaries of the law, it has a large area to manoeuvre in. This leaves ample room for human creativity. Where there is room for human creativity, an art may develop.

Benefits of inter-institutional cooperation

Enforcement agencies have a lot to gain from cooperating with each other. Below, we describe a number of different benefits, followed by a number of real-life examples of inter-institutional cooperation.

Tip-offs

For any enforcement agency, the most tangible benefit of cooperating with a fellow regulator is receiving a good tip-off. A competition authority may receive tip-offs from various sources, such as the public at large, other national enforcement agencies, and international fellow authorities.

A tip-off consists of information which, directly or indirectly, relates to illegal conduct. Such information may in and of itself create a reasonable

suspicion of an infringement with the receiving authority and allow it to start a fresh investigation. Alternatively, the transmitted information may add to or corroborate pre-existing information on certain conduct, which was already in the possession of the receiving authority. Such 'extra' information may in turn either allow the receiving authority to start an investigation which it was unable to start before the receipt, or it may add to its evidentiary position during the course of an ongoing investigation.

As regards tip-offs, the NMa is in a fortunate position. The NMa is widely known among the general public in the Netherlands, and, as a consequence, receives a lot of information from the public. Moreover, as will be set out in more detail below, the Dutch Public Prosecution Service operates a considerable number of wiretaps in The Netherlands and has proved willing to cooperate with the NMa in cases.

Contextual information

In addition to tip-offs, information which does not relate to illegal conduct but rather to certain subjects or objects of an investigation may also be useful for an authority. This may include information on certain previous conduct of people, on their current whereabouts or on certain characteristics of companies or individuals. This may help to detect illegal conduct or to find relevant evidence, in particular if combined with other information already at the disposal of the receiving authority.

Working methods

Apart from sharing tip-offs and contextual information, which both relate to concrete investigations, agencies may also usefully share operational working methods. Examples include methods of information-gathering during investigations (in writing, through inspections, through interrogations, etc.) and tactical methods applied during investigations or ways of looking at certain illegal phenomena from a more strategic perspective. Another interesting topic of shared interest concerns communicative strategies in order to promote compliant behaviour.

Other benefits

The above list of benefits is not exhaustive. For competition authorities, another particular benefit of cooperation at the national and the international level is that, insofar as the cooperation strengthens the ability to

start *ex officio* cartel cases, it may help to ensure that competition authorities do not become overly dependent on their leniency programmes. Finally, enforcement agencies may also cooperate in various ways on policy-related issues.

Examples

The benefits of cooperation set out above are reflected in the following examples. These are illustrative of the benefits that the NMa has reaped from cooperation with national and international enforcement organisations.

In November 2007, the NMa imposed fines on companies that operated a cartel in the tree nursery sector. The NMa's investigation was triggered by information provided to it by the Fiscal Information and Investigation Service ('*FIOD/ECD*').¹ The information included fake invoices which were used by the cartel members to cover up mutual compensation payments.

In October 2010, the NMa imposed fines for cartel conduct in the road construction sector.² The investigation started on the basis of wiretaps which were transmitted to the NMa by the Public Prosecution Service. The Public Prosecution Service had installed the taps on the telephone lines of various employees of a single construction company to investigate bribery and corruption of local public employees during tenders. The taps unintentionally also revealed bid-rigging conduct of the relevant construction company with a competitor and led the Public Prosecution Service to transfer the relevant taps to the NMa.³ This led to simultaneous inspections coordinated between the NMa and the Public Prosecution Service in private homes and company premises. The case turned out to be the first where the NMa imposed personal fines on individuals for cartel conduct. It did so in respect of three individuals for amounts of €10,000, €100,000 and €250,000, respectively. In the 'parallel' criminal case, the latter two individuals were shortly afterwards convicted to six and fourteen months imprisonment, respectively, by the criminal court on the count of bribery of public employees.

In one of its earlier cartel cases, the NMa imposed fines for cartel conduct on wholesalers and fishery organisations of North Sea shrimps (January 2003).⁴ The investigation which led to this decision was conducted in close cooperation with the Danish and German competition authorities, and also led to Dutch fines on Danish and German fishery organisations. In effect, it proved an example of European Competition

Network (ECN) cooperation *avant la lettre*, since the latter did not exist at the time.⁵

In one of its latest cartel cases, the NMa punished a cartel which was operated in the Netherlands between fifteen undertakings from Belgium, Germany and the Netherlands in the Dutch flour mill industry (December 2010).⁶ The case was exemplary of current ECN cooperation in cartel cases. The investigation involved leniency applicants from various countries who confessed the cartel to the NMa, including a first (Type B) leniency applicant from Germany. It involved coordinated inspections by several national competition authorities which carried out parallel investigations into similar cartels in their respective territories. Also, several national competition authorities transmitted documents to each other under Regulation 1/2003,⁷ and case teams travelled to other competition authorities in order to be present during interrogations of cartel members performed by fellow competition authorities on their behalf.

The above sets out a number of older and more recent examples of inter-institutional cooperation in cartel cases which have been taken from the NMa's daily enforcement practice. The NMa expects to be able to publish more examples of cooperation in cases in the future.

Building institutional relationships

National and international counterparts

At the international level, the NMa's counterparts consist of other competition authorities. Although these vary in terms of staffing and the legal systems in which they operate, they all have common basic characteristics. Within the EU in particular, the differences are not so large, and insofar that differences exist, the ECN has created a valuable platform for an increasingly intense and smooth cooperation between its members.

At the national level, the NMa's institutional counterparts consist of a highly diverse set of public institutions. One may broadly distinguish between two groups. The first group consists of the independent regulators in the field of telecoms and health care, which have sector-specific regulatory tasks in the area of competition. These are closely related to the NMa.⁸ The second group consists of a large and very diverse set of institutions which includes, *inter alia*, the Tax Administration, the Police, the Public Prosecution Service and criminal investigation services in the fields of environment, social benefits fraud, tax crimes, and food, which operate under the Public Prosecution Service's responsibility, a media authority, a consumer authority, the central bank, and a regulator of mining activities.

Universal dynamics

The NMa has learnt that, in building successful institutional relationships, it is useful to take the following into account.

First, institutional relationships depend on human relationships. People need to physically see each other on a sufficiently regular basis to build and maintain good relationships, to think about each other at crucial moments, and make telephone calls. It is more effective to build relationships through visits and secondments than to build them via letters, emails, and protocols.

Second, as in any marriage, a good relationship between institutions requires the counterparts to be willing to 'give and take', make compromises and listen to each other's interests. In engaging in any type of cooperative relationship one must be willing to give up a certain degree of autonomy. This also requires trust in each other, which in the case of enforcement agencies includes trust in each other's discretion where appropriate.

Third, relationships between enforcement agencies become 'alive' on the back of cases. As soon as a certain cooperative relationship provides an institutional counterpart with a new case or significantly helps an existing case forward, this tends to unleash a strong enthusiasm on the side of both the receiver and the provider of assistance or information. This dynamic has been particularly apparent for the NMa in its contacts within the ECN and is increasingly also visible in its relationships with enforcers at the national level.

National dynamics

In addition to the universal dynamics set out above, the NMa faces the following specific circumstances in its dealings with other Dutch regulators.

First, a competition authority's main goal in relation to its national counterpart institutions should be to focus on sensitising them to competition law infringements. In view of the specific nature of competition law infringements, this should be done in plain terms to ensure that, as much as possible, fellow public employees are able to recognise an infringement if they stumble across it. In practice, this presents a number of challenges. First, it is often not easy to reach all the relevant staff at the counterpart regulator, especially if one takes into account the significant number of public employees at some of the national agencies concerned. Second, it is

often not evident to explain the gravity of competition law infringements to people who deal on a day-to-day basis with, say, violent crime.

In view of the notoriously covert nature of cartel conduct, wiretaps are an investigatory instrument with very significant potential. In The Netherlands, large numbers of wiretaps are operated under criminal procedure outside the area of competition law. In 2009, for example, 26,425 wire taps were installed by the Public Prosecution Service (In contrast, the number of wiretaps in the US was reportedly 2,376 that year).⁹ Moreover, the length of time for which a wiretap is installed may be considerable and, once installed, both incoming and outgoing calls are recorded. Therefore, the total number of recorded conversations as well as the number of participants to those, is likely to significantly outnumber the annual figure of 26,425 mentioned above. Consequently, from a purely statistical point of view, the chances that the ears of a Dutch justice official will catch a national or international cartel in action are significant. The usefulness of this phenomenon for the NMa depends on whether the people who deal with wiretaps in the criminal field recognise possible evidence of cartel behaviour on a tap and on whether they are subsequently willing to explore the possibility to lawfully transmit the information to the NMa.

Second, in building national relationships with other institutions it is necessary to keep an eye on the possibilities of establishing reciprocal benefits. If information cannot be reciprocally exchanged or shared, one should look for other ways of ensuring a minimum of reciprocity.

Third, entering into cooperation protocols may serve a useful purpose in building national institutional relationships. The NMa has established such protocols with several national agencies.¹⁰ Although the contents of the NMa's cooperation protocols vary considerably, typical features include provisions on the practical dimensions of information exchange, on referrals of certain applications made by undertakings at different institutions, or on mutual consultations. As indicated above, in the NMa's experience one should not overestimate the importance of protocols in building relationships. In practice, most enforcement institutions in The Netherlands appear to be perfectly able to develop a world of relationships among themselves, regardless of the existence of protocols. Conversely, if a cooperation protocol has been concluded with another institution, this protocol in itself will not guarantee any success as long as the counterparts do not invest in their relationship and keep it alive by, in particular, developing sufficient mutual human relationships.

Cross-fertilisation between national and international levels

Both in respect of the development of relationships and in respect of enjoying the fruits of cooperation, the national and the international levels of a competition authority's institutional relationships reinforce each other. To a large extent, the same dynamics apply in establishing the contacts at both levels. Internationally, competition authorities inspire each other on how successfully to establish useful national relations with other agencies. For example, the NMa may learn from experiences of the Antitrust Division of the US Department of Justice in establishing the latter's relationships with other US institutions outside the area of antitrust. Conversely, the NMa may, at the national level, bring useful experience to its national counterparts, gained from international contacts in ECN or its global counterpart the International Competition Network (ICN). Moreover, a reinforcement of the relationships with other national enforcers which comes to fruition will also enhance the strength and the benefits of the international networks. After all, a Dutch criminal wiretap might, for example, uncover a cartel in the UK.

Current state of affairs

The NMa has increasingly become aware of the significant potential of inter-institutional cooperation for its own level of enforcement. This development and its corresponding benefits for competition law enforcement, has recently been recognised by the Minister of Economic Affairs who, in a letter to the Dutch Parliament, has expressed its willingness to explore the possibility of broadening the NMa's statutory possibilities to share information with other public enforcement agencies in The Netherlands.¹¹

Fundamental questions

Aside from the practical challenges in building institutional relationships that have been set out above, the process towards a strengthening of inter-institutional relationships also raises a number of fundamental questions on the limitations to the freedom of public bodies to engage in the exchange of information and the use thereof in evidence.

It is beyond the scope of this contribution to analyse all the implications for the NMa in the development of its relationships with other agencies in detail. We will limit ourselves to pointing out a number of fundamental issues that should be duly considered.

The main caveat to the development of inter-institutional contacts as described above, is that which relates to the respect of fundamental rights.

It is clear that an information exchange between authorities with different powers should on no account lead to a situation where one authority without a certain power were to *de facto* instruct another authority who has such power, to use it on behalf of the former (*détournement de pouvoir*).

Institutions should carefully consider if and to what extent the purpose for which information has been gathered or obtained by one or the other authority, has an impact on their ability to transfer the information to other institutions. A related question which arises if the information may be transferred, is whether the receiving institution is bound to limitations on the use in evidence of that information.¹² Also, the question may arise whether the possible existence of differences in the legal regimes and their safeguards in the light of the rights of the defence may have an impact on the possibilities to exchange information or use exchanged information. Finally, the nature of the sanctions to which an exchange of information may expose certain subjects (individuals and/or companies) may also be a relevant factor in assessing the limits to exchanges of information between institutions.

An equally important question is whether inter-institutional information exchanges may harm the institution's effectiveness because of the possible repercussions on their capability to receive information from other sources than institutional ones. In the case of competition authorities, an obvious example is the need to protect the confidentiality of the information provided to them by leniency applicants. The NMA will always want to guarantee as much as possible that information provided to it by leniency applicants or informants will not be shared with other institutions.¹³

In this respect, another relevant matter to take into account is the interplay between prohibitions, powers and obligations for authorities to transfer information to others. This might create questions on possible conflicts between different sets of rules and their different normative hierarchies.

Where certain limitations exist to the inter-institutional exchange of information, interesting further questions arise as to the existence of possible exceptions, for example, due to issues of public interest. These issues became particularly apparent in the case referred to above on the wiretaps which had been placed by the Public Prosecution Service in the criminal investigation into bribery and corruption in the road construction sector.

Under the relevant legislation, the Public Prosecution Service is entitled to pass on information that has been gathered in the context of a criminal investigation if it is necessary in view of a substantial public interest. The undertaking concerned sought an injunction in summary proceedings against the NMa in which it claimed the violation of its right to privacy under Article 8 of the European Convention on Human Rights (ECHR). The judge, however, agreed with the NMa and the Public Prosecution Service that there was no legal impediment for the exchange of information between the two enforcement agencies, and that Article 8 ECHR was not at stake. An important issue was that there was no interference of the NMa in the investigation of the Public Prosecution Service. The NMa was neither involved in the wiretap search itself, nor in the decision to start the wiretapping. The judge stated that the concept of 'substantial public interest' also includes the economic welfare of a country, and the enforcement by the NMa of the Dutch Competition Act.¹⁴

The legal questions set out above also translate into a question of a more political nature. One may wonder to what extent the government considers that public employees who serve the same government but work in different areas of law enforcement should seek efficiencies.

It is submitted that authorities should at least endeavour to be aware of each other's existence and each other's fields of work. After all, institutions all work for the public good, and the public deserves at least that no unavoidable losses occur merely because public employees have accidentally been too narrowly focused in their activities thereby forgetting other publicly relevant issues. The organisational efficiencies of having relationships among regulators are significant. Also, at the level of cases, regulators should be creative and not be afraid to transfer information to each other, as long as no compromises are made in relation to the respect of fundamental rights.

Conclusion

Building relationships with other enforcement agencies is a powerful means to enhance the effects of enforcement. Contacts and cooperation with other public bodies are in itself a source of knowledge and inspiration. In addition, it generates cases, which in turn multiplies the learning effect and the corresponding strength of the organisations which cooperate as 'combined' agencies. In developing these relationships, one should duly take into account the legal boundaries so as not to infringe fundamental rights.

As mentioned at the beginning of this contribution, in view of the developments towards more cooperation between institutions, the NMa's staff members increasingly need to use their networking skills with the outside world. In doing so, they may in the future take their former chairman Kalbfleisch' personal networking skills and drive towards innovative approaches of enforcement as an inspiring example.

COMMENT

ALEXANDER ITALIANER*

No art without an artist

The contribution by Pablo Amador Sánchez, Gerard Bakker and Aad Kleijweg on collaboration with other institutions finishes where I would like to start: the inspirational manner in which Pieter Kalbfleisch has built relationships and has fostered co-operation between agencies, both domestically and internationally.

If enforcement is something of an art – and all of us involved in the trade know this to be true – then Pieter should be qualified as an artist. Whether playing on home stages or performing on international podia, Pieter has demonstrated an immense drive for fostering collaboration between institutions. His ability to interact well with his peers, counterparts, and other stakeholders has been appreciated by us all. But, apart from being a social grace, it has been a means to an end. The goal has always been to improve the institutional ability to deliver better market outcomes for the consumer. From that perspective, the announcement that the Dutch Consumer Authority will be merged with the NMa could be an appealing prospect to Pieter, even though it is likely to take place only after his departure from the NMa.

The authors describe well the benefits of, and conditions for, successful inter-institutional co-operation. At the European Commission, we interact with non-competition institutions in exchanging best investigative practices and considering leads for cases, for instance with the anti-fraud services of the Commission (OLAF). However, I would like to

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focus on inter-institutional co-operation between competition agencies, in Europe and internationally. The attitude of the NMa, from its inception, has been most collaborative in that respect, and Pieter has given this a further impetus by providing the ‘tone from the top’. The cross-fertilisation that is the result of such international collaboration overall has ensured a much better harvest for sister agencies across Europe and the globe.

The participation of the NMa as a constructive partner in Europe and beyond has manifested itself in many forms and on many occasions. I would like to raise a few examples of its willingness to commit, no doubt omitting plenty of other examples. In 2006, the NMa took upon itself the organisation of the ICN Cartel Workshop, bringing together over 200 cartel experts from across the planet. Furthermore, for the Cartel Working Group, the NMa contributed very extensively to the drafting of the enforcement manual. In the area of applying forensic information technology, the NMa has been a pioneer both in terms of technological development and in creating an appropriate legal framework for this kind of investigations. The manner in which this has been shared with other agencies and institutions has helped them to make strides forward and ensure convergence. My own agency was one of the beneficiaries of that experience. The contributions of the NMa to the ECN working groups and sectoral subgroups have been multiple. It is at that stage, as the authors have rightly signaled, that relationships ‘come to life on the back of cases’; on case coordination, too, the NMa has been one of the agencies ensuring that the potential of ECN partners to collaborate and exchange information has been maximised. It is notable that a few of the main cases that have resulted in fines, such the *Flat Glass* cartel case, have resulted from Member States comparing notes, and coordinating an investigation with the Commission. Also, we are grateful for the excellent manner in which the NMa has supported our investigations and on-site inspections, becoming through their assistance a true part of the exercise (I would not like to say ‘partner in crime’). To be mentioned further is the informed way in which the NMa takes part in considering proposed Commission decisions and policy proposals in meetings of the Advisory Committee. The critical yet practical input has only helped to ensure more robust outcomes. Then, last but not least, and underscoring its commitment to multilateral collaboration, the NMa under Pieter’s inspiring leadership is organising the global Annual Conference of the International Competition Network in 2011.

To conclude, and citing from its public website, the NMa is *convinced that international collaboration will help to achieve a permanent improvement to the execution of its task: making markets work*. It has done so, under Pieter's guidance, stimulating creativity and developing its skills, thereby mastering the art of enforcement. Whilst working towards the goal of institutional co-operation, namely ensuring that markets function better, Pieter can be commended to have done justice to the Chinese proverb that the 'journey is the reward'.

COMMENT

JACQUES STEENBERGEN *

The NMa: a leading neighbour in an ever more important cooperation

Inter-institutional co-operation has indeed developed into a central enforcement strategy. This is partly a consequence of the decentralisation of enforcement adopted with Regulation 1/2003. It is also indirect evidence that the internal market really works. An increasing number of distribution networks and geographic relevant markets do, at least in the Benelux countries, no longer stop at national borders, managers do not always live in the member state of employment, etc.

The everyday reality of the cooperation between NCAs is well illustrated by the flower mill case referred to by Pablo, Gerard and Aad. I could also refer to the radiator case decided by the Belgian Competition Council on 20 May 2010. In both cases, dawn raids took place at both sides of the border.

The framework for the cooperation between NCAs

The cooperation between NCAs is in the first place structured within the ECN and the merger control working group. Discussions in DG meetings, ECN plenaries and cooperation working group meetings on information exchange protocols, the development of IT platforms etc. increasingly focus on cooperation between NCAs.

Pieter and the NMa play a key role in the development of bilateral relations between neighbouring NCAs. These contacts range from occasional

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get-to-know-each-other-better meetings, to briefings for dawn raids or more multilateral ‘neighbours’ or ‘leads’ seminars and intensive know-how sharing projects. And although the Commission may at some time have been somewhat uncomfortable with the idea that clusters of national authorities sit together and discuss common issues, it is to my knowledge no longer questioned by anyone that these forms of cooperation greatly contribute to the common enforcement efforts. Bilateral and neighbour’s meetings support decentralised enforcement, and thus to the promotion of a culture of competition. And I am equally convinced that enforcement is not a goal unto itself. Enforcement only contributes to the sustainable development based on balanced economic growth and price stability, referred to in Article 3(3) of the TEU, to the extent that it fosters such culture of competition.

I also fully agree with Pablo, Gerard and Aad that institutional relationships depend on human relationships. People indeed need to meet on a sufficiently regular basis to build and maintain good relationships in order to think of each other at crucial moments. Meetings on common issues foster human relations, and human relations fuel further cooperation on cases or issues. It is therefore important to find the right balance between a core team of people who really get to know each other, and the (more occasional) involvement of a sufficiently large number in order to broaden the scope of the cooperation.

Basic features of a competition authority

Few NCAs differ more in size and structure than the NMA and the Belgian Competition Authority with its dual structure and a total staff of approximately 60. But I can confirm that, from our perspective, too, the fact that authorities have the same mission, attract the same kind of people, and – perhaps most important – use similar methods in order to enforce similar policies, is far more important than any differences in the structural make-up of authorities.

Benefits of co-operation

Tip-offs

Competition authorities tend to be uncomfortably dependent on leniency for the fight against cartels. Tip-offs, leads seminars, contextual information etc. are therefore most welcome.

Working methods

The Belgian Competition Authority benefits greatly from the generous support of the NMa in the key area of forensic ICT. And learning from each other does not only enable us to achieve better results faster and at a lower cost. Using similar methods is also increasingly important when NCAs conduct inspections for each other and relevant data need to be collected and sorted in a way that is compatible with the methods of the receiving authority.

The exchange of information

It is telling that when Pablo, Gerard and Aad discuss the exchange of information and legal obstacles to cooperation between institutions, they refer mainly to issues on the national level. One would normally expect cross-border cooperation to be more difficult than domestic cooperation. The fact that this is not the case in the field of competition law enforcement shows to what extent the ECN has really developed into a 'network industry'.

But this does not mean that everything is perfect. The EU system would e.g. benefit from an improved legal framework for the exchange of information in cases under domestic competition law. And the trickiest issues remain concerned with the sharing of information related to leniency applications and envisaged dawn raids.

Pieter: many thanks and very best wishes!

Notes

- 1 Decision of 13 November, 2007, Case 5211, see http://www.nmanet.nl/Images/5211BLD_tcm16-109974.pdf.
- 2 Decisions of 29 October, 2010, in Cases 6494 and 6836, see http://www.nmanet.nl/Images/6494BLD_1_tcm16-141474.pdf.
- 3 In application of the Judicial Data and Criminal Records Act ('Wet strafvorderlijke en justitiële gegevens').
- 4 Decision of 14 January, 2003, Case 2269, see http://www.nmanet.nl/Images/2269BLD_tcm16-47110.pdf.
- 5 The ECN is the framework for cooperation of the 27 member states and the European Commission established by Regulation 1/2003 and the Commission Notice on cooperation within the Network of Competition Authorities, OJ [2004] C 101, p 43.
- 6 Decision of 16 December, 2010, Case 6306, see http://www.nmanet.nl/Images/6306BLD_tcm16-142318.pdf.
- 7 Council Regulation 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty. OJ [2003] L1, p. 1.

- 8 After all, the national energy and transport regulators are integrated in the NMa.
- 9 Wiretap Report 2009 of the US Federal and State Courts. <http://www.uscourts.gov/Statistics/WiretapReports.aspx>.
- 10 The NMa has entered into national protocols with the Public Prosecution Service, the Tax Administration, the Independent Postal and Telecommunications Authority, the Social and Economic Council, the Dutch Central Bank, the State Supervision of Mines, the Dutch Healthcare Authority and the Consumer Authority.
See for the reference documents: http://www.nmanet.nl/nederlands/home/Wet_en_regelgeving/70_Samenwerking_met_andere_toezichhouders/Index.asp.
- 11 Letter of 7 October 2010 of the Minister of Economic Affairs to the Dutch Parliament, reference ETM/MC/10138454.
- 12 ECJ, Judgment of 16 July 1992, Dirección General de Defensa de la Competencia v Asociación Española de Banca Privada and others, Case C-67/91, [1992] ECR – I-4785.
- 13 ECJ, Opinion of Advocate General Mazák, 16 December 2010, Pfeleiderer, Case C-360/09, not yet published.
- 14 Judgment of 26 June, 2009, District Court of The Hague, KG ZA 09-616. LJN: BJ0047.

PART **2**

Public interest

The political economy of deregulation

PAUL W.J. DE BIJL AND COEN TEULINGS*

Introduction

In the 1980s and 1990s, several deregulation operations were initiated in a number of European countries, leading to a wave of privatizations and liberalizations. Many economists and think-tanks agree that further reforms are needed. In the Netherlands, improvements are possible in, for instance, the labor market, the housing market, and the long-term care sector. In such sectors, deregulation may help firms to increase output or quality, and support governments to reduce subsidies or unemployment. The end goal may be clear, but implementing transitions tends to be difficult. At least in the short run, deregulation typically implies a redistribution of rents. Such redistributions start having effects before the benefits of reform can be reaped. If deregulation leads to layoffs, unemployment will increase before gains in dynamic efficiency lead to new jobs. Moreover, it may be the case that these new jobs are created elsewhere in the economy, unattainable to people that have just lost their jobs due to deregulation. This makes it hard to gain political support for market reform, since the implementation is constrained by the distribution of gains and losses. Consequently, ‘political economy’, which takes private interests (e.g. interests of politicians and incumbent firms) into account, matters for deregulation.

This paper discusses an interesting idea from economic literature. The point is that by simultaneously analyzing different markets, one can demonstrate how policymakers can take vested interests into account to make a reform work. The relevance of this idea is illustrated by a recent advisory report by the SER (the main advisory body to the Dutch government and parliament on social and economic policy) on deregulation,

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liberalization and safeguarding public interests.¹ The report calls for acknowledging the interests of various stakeholders in deregulation processes. Our discussion of this idea is brief – for a richer explanation, we refer to the underlying articles (see below). We are not aware of any policy applications (e.g. in the form of applied models that are richer than those in the articles).

Obviously, there are different ways to implement reform. The most straightforward way is to simply exercise power. Another way is to give the parties involved a say through democracy. There is an interesting strand of the literature on institutional reform that focuses on the effects of institutions on cooperative behavior. An interesting result in this literature is that involvement (e.g. democratic participation) induces cooperation.² In this paper, we discuss another branch of the literature, which explores general equilibrium models of deregulation, which provide interesting ideas on the design of reform. A relevant empirical observation is that there is a correlation between the presence of product market regulations and labor market regulations.³ This may be due to the fact that employees will lobby harder for protection in the labor market if there are more rents to be distributed – rents that accrue from product market regulation.⁴ Hence, it is interesting to simultaneously look at regulation in product markets and labor markets, that is, in a ‘general equilibrium’ context.

It has happened too often that political economy constraints were ignored in the design phase of reforms. In such cases, one can expect either a stalemate (the reform is blocked by vested interests) or a flawed design leading to problems later on (potential losers undermine the transition as much as possible). The first outcome can be observed on a regular basis. An example is provided by the fact that reform of the housing market has been a no-go area for several Dutch coalition governments in the recent past. The second outcome is no stranger either – think for instance of the liberalization of the taxi market and the postal market in the Netherlands. The territorial battles that ensued between taxi drivers made it clear that one cannot ignore those who have something to lose. Moreover, design details can have a big impact on behavior, and, thereby, on the outcome. The lessons from such experiences are that the design of the implementation is very important, arguably even more important than the envisioned end situation, and that regulatory reform is a constrained optimization problem.

Teulings and De Bijl (2008), in a survey of Dutch experiences with deregulation and liberalization, and Van Damme and Schinkel (2009), in an essay collection on liberalization and public interests, call for more

research on government failure and political economy as relevant inputs to the economics of liberalization and deregulation. In this paper, we discuss two papers in the literature on the political economy of regulatory reforms, namely Blanchard and Giavazzi (2003) and Caselli and Gennaioli (2008). These papers may form a starting point for new research avenues in economics.⁵ Blanchard and Giavazzi (2003) explore a general equilibrium model in which combining labor and product market deregulation may reduce employees' opposition to deregulation. Hence, governments can use product market deregulation to support reform of the labor market. Caselli and Gennaioli (2008), also in a general equilibrium model, demonstrate that although deregulation reduces the rents of incumbents, financial reform increases the feasibility of compensating some of them. Thus, financial reform can win over some of the incumbents to deregulation, which may create sufficient critical mass to set the transition in motion. Admittedly, these ideas are very stylized – it is not immediately obvious how they can be directly applied. The purpose of this paper, however, is to highlight these ideas that have the potential of opening new avenues for research and policy applications.

The following section discusses the insights developed in Blanchard and Giavazzi (2003) and Caselli and Gennaioli (2008). In the concluding section, we highlight some additional topics that await further research and application.

The political economy of deregulation: two stylized examples

Example 1: using product market deregulation to support reform in the labor market

Blanchard and Giavazzi (2003) construct a model with monopolistic competition in the goods market. By using labor as an input, the firms in the market produce horizontally differentiated goods. The intensity of competition determines the size of rents available for firms and employees. In the short run, the number of firms is assumed to be given. In the long run, entry is endogenous. In addition there is a labor market. The distribution of rents between employees and firms is determined by bargaining. The bargaining process is such that employees with higher bargaining power (defined by the obtained fraction of the 'pie' that is divided in the bargaining process; the determinants of this parameter are not specified) can obtain a higher wage without experiencing more unemployment in the short run. In the model, the distribution of rents between

employees and firms in the short run determines how many firms can be active in the market in the long run.

Note that there are only two markets, the goods market and the labor market. These markets constitute the whole economy. This is an obvious limitation of the model. We will come back to this point below.

The level of product market regulation is supposed to determine the cost of entry into the product market and the degree of competition between firms in the market. The entry cost, for instance, may consist of bureaucratic obligations associated with starting a firm. The degree of competition can be interpreted as the degree of substitutability (unfortunately, the authors do not specify how this parameter can be influenced by policymakers or competition authorities). Deregulation reduces the markup, and thus the rents that are available. The level of labor market regulation determines employees' bargaining power. Deregulation reduces their bargaining power and, thus, their share of the pie. These three parameters – the degree of competition, the entry cost and the bargaining power of employees – jointly determine the size of the available rents and their distribution in the short run. Accordingly, deregulation affects the macroeconomic equilibrium outcome.

In the short run, an increase in employees' bargaining power increases their share of rents, and accordingly their real wage, without affecting the employment level. Vice versa, labor market deregulation (which reduces employees' bargaining power) decreases the real wage. In the short run, employees lose from a deterioration of their bargaining position. An increase in the markup of the relative price over the reservation wage, which is exogenous in the short run, increases the profits of the firm where the employee works.⁶ Thus the employee receives a higher wage, but pays more as a consumer (various assumptions are obviously needed to make this work – see the article). Since employees only get a fraction of the rents, the second effect is stronger, leading to a lower real wage. Through the same mechanism, product market deregulation, which decreases the markup, leads to a higher real wage. Accordingly, the short-term effect of a change in the relative bargaining power only redistributes rents between firms and employees.

In the long run, a change in bargaining power affects profits and the number of firms in the market. Through these effects, it influences the unemployment level. To see this, note that the number of firms is determined by an entry condition specifying that entry costs are covered by profits. A stronger bargaining position for employees (which reduces the rents for firms) and an increase in the entry cost now have the same

effect. The reason is that, in both cases, a higher markup is needed for recovery of entry costs, which reduces the equilibrium reservation wage. Consequently, in equilibrium, unemployment goes up. Labor market deregulation, which decreases employees' bargaining power, reduces unemployment. Product market deregulation, through a decrease of the cost of entry, has the same effect.⁷ The results suggest that policymakers may use product market deregulation to support reform of the labor market: reducing monopoly rents in the product market makes employees less eager to fight for their share of the rents.

Obviously, this type of insight is not immediately applicable. For instance, it is unlikely that cheaper stamps will convince postmen to accept a lower wage. Nevertheless, it is definitely worthwhile to pursue this line of research further. Another limitation of the model is that the whole economy consists of only two markets. For policy applications, a richer model may be desirable. For example, one may explore a model with more than two markets, allowing employees to switch jobs from one sector to another. A related shortcoming is that, in reality, it seems unlikely that the price reduction induced by a deregulation of a specific goods market will be sufficient to compensate workers for a lower share of rents. For that to happen, the net utility that consumers derive in the goods market has to be sufficiently large compared to the rents they gain as employees. Nevertheless, the underlying mechanism may be relevant for reform of large sectors of the economy, or for a simultaneous set of reforms in various markets.

Example 2: using financial reform to gain support for product market deregulation

Caselli and Gennaioli (2008) explore a model in which regulatory reforms have general equilibrium implications through the market on which firms are traded. In their model, incumbents are active on a market protected by legal entry barriers. Entrants can become active in two ways. First, by setting up a new firm, which involves a setup cost. This cost is to a large extent determined by the government, through administrative requirements and necessary licenses. The second way to enter is by taking over an existing firm on the market for control rights for firms (the 'market for control'). Think of this as the market for licenses, property rights, and so on, depending on the context. Takeovers, which involve the transfer of licenses from incumbents to newcomers, typically feature (relatively) inefficient incumbents and efficient entrants. Entrants have to borrow funds

for the setup cost or the price of a firm they purchase. If an entrant defaults on its debt, a creditor can only recover a fraction of the profits. The interpretation is that this fraction captures the quality of the financial system. In particular, this parameter may reflect the enforcement of financial market regulation. If there is less risk of hold-up in the credit market, it will be easier to borrow money to open a business.

In the model, deregulation reduces the extent of regulatory entry restrictions. Financial reform stands for an increase of the fraction of profits that creditors can recover from entrants that default on their debt. An important distinction is that deregulation directly stimulates entry, while financial reform improves the ability of newcomers to finance the acquisition of less efficient incumbents.

The presence of a market for control makes a crucial difference. Without such a market, incumbents will oppose both deregulation and financial reform, as it reduces their value through more intense competition. If there is a market for control, financial reform may allow incumbents to sell their firms at a higher price. The reason is twofold. First, the possibilities for financial contracting ameliorate. Second, in equilibrium, the average efficiency level increases as less efficient incumbents are taken over by more efficient entrants. This makes entry more difficult, so that incumbents are shielded from increased competition. Thus, whereas deregulation reduces the rents of all incumbents, financial reform endogenously compensates some incumbents. Therefore, financial reform can win over (at least some) incumbents to deregulation. This implies that there will be fewer incumbents that will oppose, through the political process, deregulation.

In an extension of the model, the authors explore the timing and sequence of reforms. They show that inefficient incumbents are more likely to support a joint package of financial reform and deregulation if the latter process is postponed. The reason is that through financial reform, they are more likely to be able to sell their firms before the market gets more competitive through deregulation. To achieve this result, however, one has to assume that policymakers can commit to sticking to the announced sequence of reforms. Without any commitment, a new government could reverse a decision made by its predecessor.

A central result is that deregulation can be made easier to digest, even though it will lead to an increase in competition. The crux of the underlying idea lies in the connection with the associated market for control. This link creates a lever to reduce resistance among players with vested interests. The amount of compensation is endogenously determined

through negotiations between incumbents and entrants. In this way, the government avoids the problem that it is difficult and expensive for a government to determine appropriate compensation, while the result often lacks credibility.

Just as the first model that was discussed, this one is also quite stylized. Direct application may not be feasible, unfortunately. Nevertheless, the type of mechanism that the authors lay bare may generate ideas for deregulation processes. Just as in the previous example, it is definitely worthwhile to explore this type of idea further. One can easily imagine that the deregulation of the Dutch taxi market would have benefited from more attention to ways for incumbents to gradually adapt to more competition.

Concluding remarks

We have discussed two models that view regulatory reform as an optimization problem that is constrained by political economy. The innovative ideas generate useful insights for the design of market transitions. Taking into account the fact that some parties lose from deregulation, and that compensation may be necessary, supports the feasibility of reforms. Paying due respect to potential losers contributes to the credibility of the government as a bargaining partner (note that the design of compensation schemes may be complex in practice). Although during the design phase, such ideas make reform problems more complex, one benefit is that a successful completion of an awkward, lengthy reform process provides credibility for governments. This gives a welcome bonus at a time when confidence in governments appears under pressure as expectations are rising, ranging from the quality of public services to safeguarding public interests in health care and keeping the financial sector afloat. Note, however, that more work is needed before these ideas can be applied in specific situations.

Teulings et al. (2005) discuss the management of public interests in a broader context. They point out that the government faces a tradeoff between flexibility and commitment. By promising to compensate involved parties that lose from reform, the government trades in some flexibility. This will be paid off in the future, if the government sticks to its promise. However, if a promise is not credible, potential losers will fight against a proposed change. Thus, it is important that the government aims at consistency of policies over time, in order to build up and maintain a reputation. Moreover, incorporating compensation in the implementation

design forces the government to take into account all costs and benefits of a reform. This will, in general, lead to a more efficient outcome overall.

An interesting application of the type of ideas discussed here is to consider situations with different generations of economic agents. If incumbents successfully lobby for product market regulation, they will receive a stream of rents (now and in the future) that is effectively financed by future generations of entrants and consumers. For instance, in the Dutch taxi market in the past, entrants had to purchase expensive licenses from incumbents to enter the market and consumers faced large tariffs for taxi rides. Typically, these future generations are seriously disadvantaged during the lobbying stage – perhaps they are not even born yet. Think of, for instance, restructuring pensions and fiscal arrangements for mortgages, issues that are highly relevant in the Netherlands.⁸

Another avenue for further research is to analyze the links between crises and reforms. Does a crisis induce reform? Looking at the recent turmoil in the financial sector, this is not obvious. In order to develop a good theory on this issue, one needs to consider the forces of lobbying by parties with vested interests. See Drazen (2009) for an interesting discussion on this topic.

At a more general level, there is another contribution of models that we discussed. ‘Partial equilibrium’ models, which are typically used to study deregulation and entry in the Industrial Organization literature, are useful to expose the potential efficiency gains of reform and competition, but only go so far in guiding policymakers in designing transitions. In addition, general equilibrium models of reform can be used to explore the macroeconomic implications of deregulation, for instance, with respect to equilibrium unemployment.⁹ For specific ideas on how political economy issues may reduce the prospects for job creation in the future, see for instance Bovenberg and Teulings (2008). A research agenda, with relevance at both the microeconomic as well as the macroeconomic level, is waiting to be addressed in depth by economists.

COMMENT**CHRIS BUIJINK*****Policy lessons learnt from political economy**

Sound economic analyses are no guarantee for successful reforms – a very true observation by Paul de Bijl and Coen Teulings. Radical reforms involve many parties, each with their own interests and each affected differently over time. Besides a sound economic analysis, reforms must be viewed from a political economic perspective.

Without a proven approach to reforms, policymakers must rely on and learn from theory and practice. De Bijl and Teulings present an interesting contribution to our thinking about reforms. The models they describe show the interaction between deregulation of product markets and labour market reforms and between deregulation of financial markets and product markets. A central insight of this approach is the notion that the actual transition route determines the success of a reform. They also discuss the importance of attention to (compensation for) parties who may not benefit from the reform. De Bijl en Teulings point out several themes to be explored in further research. Outcomes must be made more concrete before policymakers can fully benefit.

Much research has already been done in the area of political economy and reform. For instance, the OECD carried out a detailed empiric analysis into different types of reform in Member States (OECD, 2010). Despite the many differences between the countries and the reforms, the OECD presented a number of general observations. Aspects that help create conditions for successful reform are effective communication underpinned by solid research, creating solid support in society, and having an eye for those who do not benefit. The OECD also stresses the importance of timing and sequencing.

Proper supervision is crucial for the well-functioning of markets, particularly for markets in transition. Supervision is about credibility and reputation, which rests on a range of sound decisions. Reliability of supervisory institutions very much depends on the quality of the people who work there. Sound supervision may even be more important in developing markets, with market parties exploring the boundaries of new laws. It is here that supervisors should inspire parties to take up their new role promptly, without stretching responsibilities. Over the past eight years,

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Pieter Kalbfleisch has turned the Netherlands Competition Authority (NMa), whose role includes enforcement of the Dutch Competition Act, into a strong supervisory body, as evidenced by a range of evaluations and international comparisons (see for instance Global Competition Review, 2010).

There have been plenty of successful reforms in the Netherlands. Take for instance the competitive reforms in the Netherlands of the 1990s: the introduction of the Competitive Trading Act ended the Netherlands' reputation as a cartel haven and the opening of the energy market. The Netherlands is one of only a handful of countries that recently did *not* receive recommendations on strengthening competitive power and improving product market regulation by the OECD (OECD, 2011). Moreover, several other countries look to the Netherlands for policy preparation, and how the input and consultations between employees and employers is organised.

Still, the Netherlands can benefit from insights from political economy. Maxime Verhagen, Minister of Economic Affairs, Agriculture and Innovation, recently presented the government's view on the roles of government and the market (Tweede Kamer, 2011). The cabinet takes a practical approach: it looks at what works and what not. There is no point in starting an ideological discussion about market versus government, as both the market and government play a role in all industries. The cabinet aims to specify the roles between government and market that are most beneficial to citizens and firms. For reforms that will raise welfare standards for society as a whole, but may have a negative effect on certain groups, the point is not *if* the measure is taken, but *how*. Obviously, all of the interests must be taken into account, particularly during the transition period. This means that expectations on how the system is to develop must be mapped out carefully, as well as the relevant anticipated effects, and how various groups are affected. A thorough impact assessment is a very valuable instrument for this purpose. At the same time, we must realise that an impact assessment is no miracle cure, and that policies may need to be adjusted. Reforms cannot be lab-tested as they are often breaking new ground.

Clearly, there is no manual for reform. However, some items keep cropping up, such as the importance of sufficient attention for the transition period, transparency about the effects and taking into account all relevant interests. Reliable institutions help create support for policy. After all, it is easier to convince people with information they trust.

COMMENT**BERNARD WIENTJES*****On the limits of regulation**

From an academic perspective, ‘the political economy of deregulation’ makes an important contribution to the planning of reforms: what is the best way for a government to approach the liberalisation and deregulation of markets in order to enhance their feasibility, particularly in political terms? When it comes to the complex process of decision-making, planning and introducing reforms, Teulings and De Bijl offer some pointers to governments and politicians for achieving a good outcome. They describe how resistance from insiders who have something to lose if competition increases can be overcome by cleverly combining different reforms. This approach appeals to me. Reforms engender a win-win situation, if we focus more on the pragmatic approach rather than getting bogged down in an ideological debate.

Reforms are and will always be necessary if we are to raise productivity growth in the Dutch economy to a higher level. Whereas in the last few decades the rising participation was the engine of growth, including the increase in women’s labour force participation, in the future it will cease to be such an influential factor due to the ageing population. We will have to rely instead on improving the production capacity of the private sector to boost our economic growth. The government uses effective free-market policies to stimulate growth in productivity and enables businesses to exploit every opportunity to achieve productivity gains. On the other hand, innovation and renewal regularly require cooperation between firms, in particular in the chain. In the next few years, it is necessary to discuss whether the existing (strict) exception clause in the Competition Act meets this need for cooperation, and to find, at national and European levels, the right turning point to make cooperation for innovation possible, but not affect the heart of the competition legislation.

Competition can drive costs down, give rise to products that better reflect the needs of consumers, and stimulate the design of new products and production methods. Greater competitive pressure – brought about by the liberalisation of markets and globalisation – forces companies to adapt quickly to change. A flexible labour market is part of this. Teulings and De

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Bijl also refer to the combination of more competition between companies and reform of the labour market as an opportunity to enhance the feasibility of reforms.

In its advisory report entitled *Overheid en markt. Het resultaat telt* ('Government and market. The result counts'), the SER (Social and Economic Council of the Netherlands) argues that the debate about the free market must be purged of ideology and that we must adopt a pragmatic approach to regulatory issues. (The result counts!) Like Teulings and De Bijl, the report alludes to the importance of the planning of the government's regulatory policy. The SER recommends devoting more attention to policy preparation, partly to avoid problems during the transitional phase by ascertaining the major implications for specific groups (employees) and softening the blow if appropriate. Changes to the way the sector is regulated can leave citizens (as customers or taxpayers) better off while squeezing workers' pay because, in the new market, pay and productivity are no longer in proportion. In its response to the SER's advisory report, the cabinet rightly states that, in such situations, the question is not *whether* the measure has to be implemented, but *how* it is going to be introduced. Teulings and De Bijl make an important contribution to answering that question.

Reform of the role of the government is also needed if we are to make the Netherlands more competitive. The quality of government policy is an important prerequisite for exploiting the growth potential of the economy. Government policy often makes it difficult for companies to adapt and compete, because of 'regulatory pressure'. Easing the pressure of regulations and bureaucracy leads to economic growth and improves the competitiveness of Dutch companies. As well as the administrative burden, which incurs additional costs for companies, it is first and foremost the rules that restrict the scope and flexibility to do business and innovate. There is no doubt that this situation must drastically change. In this respect too, the planning phase is crucial. A quantitative target for reducing regulation, a freeze on new rules and the introduction of an impact assessment for new laws and regulations are the means to actually achieve fewer rules. At the same time, the number of regulatory bodies and their often extensive powers of inspection and sanction must be restricted – otherwise, we will simply be replacing legal rules with regulation imposed by the regulatory authorities, and we will not achieve the aim of greater entrepreneurial scope. Regulators would have to set themselves the aim of imposing as few sanctions as possible. This means that a regulatory authority such as the NMa must act as a facilitator of business

and, through better information, make clear the boundaries of competition law, as well as the scope for innovative cooperation. Compliance assistance often prevents violation of the law. Even more important, however, is political restraint. All too often, politicians and government resort to the tool of regulation to promote the desired behaviour or in response to incidents. The high expectations that citizens (and politicians) have of government to solve problems – but which cannot usually be met – are the source of many unnecessary rules that have the power to obstruct policy.

In what areas are there further opportunities for the Netherlands to increase productivity through reform? I will single out two. First, health care. Rising costs and growing demand for health care services are impelling us to find new ways of making the provision of care more productive. This calls for product innovation and, above all, organisational innovation. At the moment, the system of funding and the lack of competition and entrepreneurship often stand in the way of innovation. On a positive note, the path to regulated competition, with more opportunities for bold entrepreneurship and greater choice for consumers, is being resolutely and energetically adopted. Resistance from potential losers – vested interests – now appears to have been overcome, as the necessity is apparent to everyone. It is, however, the consistent and bold attitude displayed by the various members of government that has been most instrumental in overcoming this resistance. Opponents see that there is no sense in opposing the measures and are trying to soften their impact through lobbying. Teulings and De Bijl point out that, in order for reforms to be successful, government policy must be credible and consistent.

Education is another area in need of major reform. More scope in higher education for differentiation and selection and courses that are better tailored to the labour market are important steps towards improving the availability of well-qualified personnel for the Dutch business sector. The knowledge infrastructure must also be geared more towards contributing to economic growth and higher productivity. The previously adopted policy of focus and quantity in higher education has had too little impact. Evidently, educational establishments lacked the imperative for real change. This manifest resistance from vested interests will have to be taken into account when the new policy is in the planning stage, by seeking clever combinations of reforms which make it attractive to established institutions to climb on board with the changes.

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Notes

- 1 SER (2010).
- 2 See Dal Bó et al. (2010) for references to the literature and an experimental approach to determine the effects of democracy on behavior.
- 3 See Nicoletti et al. (1999).
- 4 See Blanchard and Giavazzi (2003, p. 900).
- 5 See Caselli and Gennaioli (2008) for more references to the political economy of deregulation and reform.
- 6 The relative price is constructed as a markup over the reservation wage. The markup is fixed in the short run. Therefore, the equilibrium reservation wage is equal to the marginal revenue product of labor, with an associated employment level.
- 7 The authors also discuss the case in which the government increases the intensity of competition while keeping the entry cost fixed. In that situation, the beneficial short-term effects vanish in the long run, since profits tend to go back to their initial levels.
- 8 See also Bovenberg and Teulings (2008). For more on mortgages and the housing market, see, e.g., Raad van Economische Adviseurs (2006).
- 9 Blanchard and Giavazzi (2003) use the insights of their analysis to interpret the evolution of the unemployment rate and the share of labor in the business sector in various countries.

Public interests! What public interests? And how to deal with them?

HENK DON*

Introduction

It is almost a tautology that public bodies should promote, or at least not harm, public interests. But, in practice, the implications are not at all straightforward. What are public interests? Who defines them? How much weight should they carry when they are in conflict with other interests, or indeed with each other? What is the legal basis for bringing public interests to bear on actual decisions of public authorities?

These and similar questions have been given different answers in the ongoing debate in the Netherlands on public interests in general, and on their implications for competition and regulation authorities in particular. How can competition in health care be reconciled with the cooperation that is required for delivering high-quality care? How can fishermen safeguard a sustainable fish stock without making arrangements that violate competition law? How can environmental concerns be addressed in the regulation of energy and transport markets? Building on various contributions to the debate, this paper intends to explore the main issues, and outline the approach which appears to be emerging in practice from discussions and decisions inside and outside the NMa. Pieter Kalbfleisch has played an important role in analyzing the legal and economic basis for NMa decisions in this field and, of course, in defining NMa practice. He took the issue of public interests very seriously, as he was convinced that it will play a crucial role for the future of competition policy. It is a pleasure to contribute this short paper on the occasion of his farewell to the NMa.

The first section provides the main points of the legal and economic background. The second section gives an outline of the recent debate in the Netherlands about the definition of public interests. The third section

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focuses on the practice of decision-making inside and outside the NMa. The final section offers some concluding remarks.

The discussion here focuses on cartels. Most of it applies in a similar fashion to abuses of dominant positions, merger control and services of general economic interest, cf. Lavrijssen (2010).

The legal framework and the concept of welfare

In his recent inaugural address at Leiden University, Ottervanger (2010) describes the historical and political background of competition law in relation to public interests. He stresses that EU competition law is just one of the many building blocks to reach the ultimate goals of European cooperation. It cannot claim to be superior. Instead, its application should take into account all the other goals laid down in the EU Treaties. These cover many fields next to consumer welfare, and include public health, environmental protection and sustainable development, animal well-being, security of energy supply, and combating climate change.

In addition, Ottervanger claims that EU competition law is sufficiently flexible to address these goals. Naturally, this flexibility mainly derives from the exceptions to the cartel prohibition in Article 101(3), TFEU. Exceptions are allowed if the restriction of competition (i) contributes to improvements in production or distribution or to promoting technical or economic progress, provided (ii) a fair share of the resulting benefit befalls the consumers, (iii) the restrictions imposed on the undertakings concerned are indispensable for attaining the objectives and (iv) the restriction does not afford such undertakings the possibility of eliminating competition for a substantial part of the products concerned. According to Ottervanger, the guidelines of the European Commission opt for a narrow interpretation of the improvements and progress that can warrant an exception; only efficiency gains that lead to lower costs, better quality or innovations can qualify, which would imply a (political) choice for efficiencies and consumer welfare in a narrow sense.

Lavrijssen (2010) also notes that the European Commission in its guidelines seems to adopt a strict approach with regard to the protection of non-competition interests: ‘Goals pursued by other Treaty provisions can be taken into account to the extent that they can be subsumed under the four conditions of Article 101(3) TFEU (ex Art. 81(3) EC)’.¹ She stresses that the Lisbon Treaty has enhanced the importance of policy-linking clauses, to ensure consistency between the policies and activities of the EU, taking all of its objectives into account. Whatever the true intentions

of the European Commission may be, it does appear to exclude consideration of any public interests which are not covered by the European treaties.

While the choice of examples in the guidelines indeed suggests a narrow interpretation, the broader interpretation pleaded for by Ottervanger is not necessarily ruled out by the guidelines. Economic progress and better quality in themselves are broad concepts. They should include any aspect valued by consumers, and indeed may also cover aspects valued (positively or negatively) by third parties. Economics offers no rationale for a narrow concept of (consumer) welfare. Any restriction applied in economic studies should be understood as reflecting a practical approximation to the broader concept. Hence, I see no reason why the law and the guidelines would not allow for a broad interpretation of improvements and progress, including aspects of public interests, which may warrant a restriction of competition within the limits of Article 101(3).

This is probably the logical position to choose for someone trained as an economist, like myself. At the same time, I am well aware of the limitations of the concept of welfare. First of all, it suffers from a major problem of aggregation. While the welfare function of an individual is conceptually well defined by his or her preferences over alternative states, the aggregation of these into a community welfare function requires some weighting scheme, the choice of which is not neutral but implies some (political) view on distribution. In addition, measurement of welfare is difficult and sometimes impossible, particularly if public interests are involved. It is true that creative economists have come quite a way in estimating actual welfare effects in monetary terms. A nice example is the valuation of noise pollution near Schiphol airport by assessing its impact on prices of residential housing in the area (Lijesen et al., 2006). But such estimates carry a large margin of uncertainty, and useful revealed-preferences are not always available.

What public interests?

The previous section has brought me to the conclusion that, in principle, all public interests can be brought to bear on decisions in competition cases. So it is important to be more specific on what exactly public interests are supposed to be.

In the past decade, the definition of public interests has been the subject of some debate in the Netherlands. I will briefly explain the different positions and make two observations which I think are relevant to the practice of competition and regulation authorities.

The Scientific Council for Government Policy (WRR, 2000) makes a distinction between individual interests, societal interests and public interests. Societal interests are the interests that are valued by society as a whole. They may overlap with individual interests, and they are often served well without collective intervention. The Council then defines a public interest to be a societal interest which has been selected by the government to be looked after in the conviction that it would not be properly served without collective intervention. Next, the bulk of the Report of the Council focuses on how the government can best take care of the public interests that it has chosen. To guide that discussion, it applies five criteria: democratic legitimization, equality of rights, legal security, effectiveness and efficiency.

In a study commissioned by the Ministries of Economic Affairs and Finance, the economists Teulings, Bovenberg and Van Dalen (2003) state that a public interest is present when there is a complex external effect which cannot be realized² because of free-riding behavior. External effects are (positive or negative) effects of a transaction on a party which is not itself involved in the decision about the transaction. These external effects are called complex, if many such third parties are affected. Examples include the well-known reasons for market failure:³ public goods and external effects; increasing returns to scale, which may result in market power; asymmetric and incomplete information; and fundamental uncertainty. Income distribution (and redistribution) is also mentioned as a public interest. On the basis of their definition, Teulings c.s. show that a public interest does not necessarily call for collective action⁴ and, conversely, that democratic decision-making is not necessarily inferior to market transactions even in the absence of public interests. Market and government each have their strengths and weaknesses, generating transaction costs either way. Hence a cost-benefit analysis should guide the choice of procedure. For public interests, this cost-benefit analysis should include the costs and benefits of accepting or redressing the external effects. Obviously, many forms of public intervention may be considered, and making the best choice is the main issue in the study of Teulings c.s. (2003).

Baarsma and Theeuwes (2009) restate the conventional view of welfare economics. Under ideal conditions, voluntary market transactions will lead to a Pareto optimum, i.e. a situation where no individual can be made better off without making another one worse off. Government intervention is required to assure a proper (initial) distribution and to handle violations of the ideal conditions (market failures). Public interests are

societal interests that require some degree of government intervention. Public interests may result from market failure or from political considerations related to distribution (or redistribution) or paternalism. The possibility of government failure is acknowledged and implies that the first best solution may not be attainable. Government intervention to serve the public interest is warranted only when the costs of intervention are outweighed by the benefits (in welfare terms).

Finally, Stam, Stellinga and De Vries (2010) attack both the WRR as well as conventional welfare economics for their lack of realism.⁵ The line taken by the WRR requires a political body which is capable of implementing any public interest it may choose. This is highly questionable in today's complex society marked by individualization and international interdependencies. Conventional welfare economics rests on some heroic assumptions known to be deficient, if not misleading, like rational behavior and an adequate objective measure of aggregate welfare. Actual policy-making is hardly concerned with designing optimal solutions to well-defined problems. Rather, it is a learning process in the course of which public interests are identified and ways to serve them are discovered and tested. This view calls for an interdisciplinary analysis, which brings in lessons from economic sociology, behavioral game theory and public choice.

In its advice on competition and public interests, the Social Economic Council (2010) confirms the primary role of politics in defining the public interests, but also lists three categories of (normatively) valid reasons for government intervention: (risks on) market failures, social considerations, and paternalism. The Council recognizes the dynamic nature of public interests in their political and technological environment and stresses that they should be identified and made operational (measurable) before an intervention policy (or a change thereof) is implemented.

I will not attempt to give a final verdict in this debate. Without choosing one or the other approach to public interests as being superior, I would like to make two observations, which I think provide a proper background for the next section, which looks into the practice of decision-making at competition and regulation authorities.

1 In many instances, competitive markets are more efficient and effective in enhancing welfare in a dynamic environment than alternative arrangements can be. This explains why market solutions tend to be considered as the default option and any intervention requires an explanation in terms of market failures or otherwise.

- 2 Ultimately, any cost-benefit analysis of market interventions or non-market arrangements will have to be decided by politics, as it is bound to involve an assignment of weights to uncertain effects, which affect the welfare of different individuals (or groups thereof).

This does not imply that competition and regulation authorities are paralyzed when confronted with public interests. As we will see, many issues can be decided without having to resort to political guidance, new or existing.

A balancing act?

The exceptions to the cartel prohibition were written to allow some restrictions to competition when they bring welfare gains in excess of costs. So one might think that any application of Article 101(3) TFEU is bound to involve a balancing of interests. But in his contribution to the Festschrift for Carl Baudenbacher, Pieter Kalbfleisch (2007) tries to ‘look through the ‘mystic haze’ that surrounds the concept of balancing interests’ (p. 456). He observes that in practice, the application of Article 101(3) ‘has mainly focused on the following three questions:

- 1 Are the efficiencies that the firms have brought forward plausible enough?
- 2 Are the competition restrictions proportional?
- 3 Will a sufficient degree of competition remain in the market?’

to conclude that ‘(A)n assessment along these lines implies *that a real balancing does not take place*’ (Kalbfleisch, 2007, p. 465, emphasis added).⁶ According to Kalbfleisch, this practical policy in effect can be quite satisfactory, in view of the uncertainties involved in the assessment of various types of efficiencies⁷ and the importance of residual market forces which will ultimately prevent firms and markets from becoming inefficient. So, in his view, ‘in its present state, the task of competition law is twofold: preserving competition in order to keep markets sufficiently self-policing on the one hand, and giving way to obvious efficiency gains (...) on the other’ (op.cit., p. 466).

The fact that a real balancing of interests does not take place when applying Article 101(3) means that it does not require the competition authority to take a political position, one way or another. This continues to hold true when the efficiencies are in the domain of public interests, provided that the public interest which is invoked to legitimize the efficiencies has a proper foundation in the law and/or explicit political

decisions. This is indeed one of the tests that the NMa has applied for accepting efficiencies in the domain of public interests: legal requirements for the proper removal of used batteries (*Stibat*, case 51), for domestic appliances and home electronics (*Wit- en bruingoed*, case 2495), and for other tools, machines and appliances (cases 1751/28, 1753, 1754, 1755/27); Ministerial support⁸ for castration of piglets under anaesthesia (*Gecastreerde varkens*, case 6455); and the minimum quality of health care as defined by the national Health Care Inspectorate (hospital merger *Zeeuwse ziekenhuizen*, case 6424).⁹

In the domain of regulation, there has been some debate on whether NMa price caps in energy markets should allow for as-yet-unspecified costs of innovative investments aimed at sustainable energy solutions. This seemed to be stretching NMa powers too far, as a generic allowance would in effect be more like a tax than a cost-efficient solution to a founded public-interest concern. Upcoming legal changes in the regulatory framework will provide a proper way to handle the sustainable energy issues at hand, by accepting the efficient additional costs of the innovative investments for the tariff calculations.

If, in fact, balancing hardly occurs, there is no need for strong guidance on the relative weights of various public interests. For the EU, Townley (2009) suggests a qualitative weighting of certain public-policy objectives in accordance with the language of the relevant Treaty provisions. Such a qualitative weighting would probably suffice to implement the proportionality test.

While the feasibility of some of the balancing principles proposed by Lavrijssen (2010) may be questioned, they have only limited scope if, in fact, balancing hardly occurs. However, she does point to an important pitfall that should be avoided when deriving public interests from explicit political decisions. In practice, state measures may have been captured by private interests and, if so, they should not play a role in a competition law assessment.

Concluding remarks

Even if true balancing of different interests is rare in applying competition law, and may require political guidance when it is unavoidable, this does not mean that competition authorities can mechanically follow the recipes, and, in doing so, reach the one and only correct decision. Supervision still is an art. It requires sound judgment and a fair assessment of the relevant economic, social and legal environment.¹⁰

To be able to perform this art, the authorities should be truly independent and free from political interference. The high-trust principle, which is applied to undertakings under regulation in the Netherlands, is also a useful concept in the relationship between lawmakers and regulators. Recent contributions of heads of national competition authorities¹¹ have shown that they are well aware of the various interests at stake, and take a position which leaves ample scope for lawmakers to define and implement public interests as they see fit.

COMMENT

ELCO BRINKMAN*

Healthy competition through prudent procurement

Market forces are gaining momentum in the construction industry because clients are increasingly making use of the instrument of procurement. By calling for tenders, the contracting authority introduces competition among the companies that are interested in the project. They are all keen to do the job, and will submit tenders in order to do so.

Since construction firms – apart from the actual developers – are strangers to stock production and accordingly depend on contracts from third parties for their production capacity, it is vitally important for them to maintain continuity in the flow of their orders – to do one job after another.

This risk of discontinuity, a characteristic affecting companies in the construction industry, means that if a client markets a project by calling for tenders, he assumes a superior position in relation to the construction firms that are interested in securing the contract. This is not just because this particular job will only appear on the market once, but also because clients generally encounter a number of construction firms interested in his project. Calling for tenders therefore results in what might be termed an oligopoly: the client creates a temporary niche market for the work he wants done by putting it out to tender.

The overall result of this is that, in certain circumstances (a limited supply of work, the need for jobs among the construction firms, and the

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contract being awarded at the lowest price), there is a chance that companies will submit prices that are commercially and economically unviable.

If companies end up having to work in this way for prolonged periods of time, we should not be surprised if:

- the firms try to limit their losses even further in the event of problems during the work, and
- the innovative potential of the entire construction industry will end up being jeopardised as a result of a general shortage of cash: innovative approaches (usually) cost money.

The tendering process generates competition: in the construction industry, these are two sides of the same coin. The same applies to procurement law and the competition law.

In his contribution to this book, Henk Don shows that the principle of free markets is modified to some extent in competition law, partly as a result of the exceptions to the prohibition of cartels in Article 101(3) of the Treaty on the Functioning of the European Union. Procurement regulations on tenders also contain provisions that impose limits on unbridled markets. For instance, there is Article 55 of Directive 2004/18/EG, which allows a public procurement authority not to award a contract to a company if he considers that it has submitted an unusually low price.

Talking about unbridled markets, I regret to say that construction contracts are awarded, in far too many cases (about 90%), simply on the basis of the lowest price.

I have already referred to some of the undesirable effects that can stem from focussing on price alone. Contracting authorities should be much more prepared to offer businesses the opportunity of standing out from the crowd with their own solutions to the client's predefined needs. This would be in the interest of both parties. It could be achieved if clients who issue tenders were to describe their building needs with functional requirements with which the work has to comply, so not by means of a detailed specification, and by making clear in advance, in the award criteria, that they will highly value different sorts of quality aspects. Contracting authorities who give the businesses some scope in this way are often pleasantly surprised by the ingenuity shown by companies, as well as by the extra quality they can offer. And while this type of procurement may be a bit more laborious for construction firms, it becomes much more of a challenge to them if they have to compete on the basis of clever solutions rather than the lowest price.

There are therefore good reasons for the frequent calls made, on all sides, for those who issue tenders to allow much more scope for an application of the knowledge and creativity available within the construction firms. It are mainly clients at the level of the national government who have been the first to graduate to this method of tendering in recent years, but there is still a great deal to be gained in this field elsewhere, particularly at provincial and local government levels.

As far as the essence of the procurement process is concerned (that it should lead to competition among businesses), it is actually remarkable to note, in practice, that the contracting authorities are mainly responsible, in a large number of instances, for restricting competition among the companies through their own actions. This quite often happens because they impose ridiculously strict financial and technical requirements on the candidates, ruling out companies that would otherwise be excellently placed to bring the contract to a satisfactory conclusion. Another example is making a contract so large, or assembling such widely disparate work in a single contract, that very few businesses will be qualified to compete for it.

Yet another example is the inclusion by the client, in advance, of such oppressive contract conditions for the work that has to be done – a long way from the balanced, standard terms – that they amount to a barrier that prevents even the larger businesses from competing for the contract. Competition in contracting for construction work should be based first and foremost on the ingenuity of the various tendering parties in relation to potential technical solutions and implementation methods, as well as how they individually deal with the risks inherent to undertaking the work, provided that these risks are allocated to them reasonably and they can exert some influence over them. But I regard it as unjust if competition among tendering contractors is based on estimating the prospects of exactly how much pain they will actually experience during the work from unreasonable contract terms.

Returning to the modification to free markets in terms of competition law, as raised by Henk Don, I would conclude by asserting that clients and construction firms undoubtedly benefit from healthy competition. But as far as the construction industry is concerned, it is crucially important that the procurement process should also be characterised by proper business sense.

COMMENT**CHRIS FONTEIJN*****Life of a regulator is one great balancing act**

In his contribution, Henk Don focuses on the role of public interests in competition law. On the one hand, he concludes that public interests (being any aspect valued by consumers) could be included in competition goals. On the other hand, he states (following Pieter Kalbfleisch himself) that a real balancing of interests hardly takes place when applying exceptions to the cartel prohibition. Setting the technicalities of competition law aside, I would like to address public interests more from a regulators' perspective. In many regulated areas, such as energy and telecoms, public interests play – implicitly and explicitly – a major role in the day-to-day practice of the regulator. Inherent to the decisions of the authorities in regulated areas is the need to weigh various competition and public-policy interests against each other.

Within the legal framework, in which the authority is expected to fulfill its tasks, it is necessary to make choices and balance competition, private and public interests. The regulator cannot turn a blind eye to those interests, but is forced to come up with decisions and solutions which take the different, often conflicting, interests into account. When introducing competition in regulated sectors, public or universal interests – such as consumer protection, the availability and affordability of basic services, educational benefits and the protection of scarce resources – do form part of the overall decision. The general rules set by the legislator must be translated and applied into the complicated (and often unpredicted) day-to-day practice. For example, setting tariffs on regulated companies, might have negative consequences for innovation and the development of new services, but may benefit consumer and competition interests. This is, in my view, particularly true in ex ante regulation.

In his book *The regulatory enterprise*, Tony Prosser (2010) points out that, in the future, regulators will be forced more and more to take other interests than pure competition interests into account. This would mean the balancing act for a regulator will become increasingly complex. Important societal interests, such as sustainability, human rights and other forms of social solidarity (public health, education) will have to form an

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integral part of their day-to-day business. In his view, 'The regulatory enterprise is one of collaboration in determining the correct balance of different principles in each social and political context.'

In case of a dilemma, the regulator needs guidance from the legislator. But evidently, rules never match reality completely, particularly not in *ex ante* regulation and certainly not in dynamic and volatile areas such as telecommunications. Consequently, the independence of the regulatory authority is at the same time one of the fundamental building blocks of the regulatory enterprise. Taking all those interests into account, the regulator must weigh them in a transparent, but independent way, not being influenced by short-term political interests or pressure from private parties. This must be done in an independent manner, with the utmost integrity. Correctly, Henk Don point this out in his conclusion, where he states that authorities should be truly independent and free from political interference. This fundamental principle must be safeguarded under all circumstances.

It is expected that NMa, OPTA and the Consumer Authority will be merged into a newly created authority, presently carrying the working title of 'De Nieuwe Autoriteit' or DNA. Indeed, the challenge will be to allow those responsible for the new organization to be able to take account of the various interests in a manner outlined above. Perhaps even more than today, this will require a balancing act. If and when DNA will carry some of the DNA of Pieter Kalbfleisch, I am confident that this will happen. My experience with Pieter has been extremely positive in this respect. Decisions requiring the balancing of interests such as innovation, investor security, consumer and competition interests require courage, creativity and authority but above all an independent state of mind. To me, Pieter has proven to be able to combine these qualities in a pragmatic manner. And, on top of that, he has retained his sense of humor, which has made working with him a real pleasure.

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Notes

- 1 Guidelines on the application of Article 81(3) of the Treaty, par. 42, as quoted in Lavrijssen (2010).
- 2 With 'realized', the authors apparently mean that the external effect is taken into account when the transaction is decided. In the case of positive external effects, this means that the transaction is valued higher than the gain that the deciding parties themselves derive from it, in the case of negative external effects, it is valued less. If somehow the external effects have been made part of the utility functions of the deciding parties, we say that they have been internalized – the result will be optimal from a total welfare point of view. Otherwise, the third parties will reap positive external

- effects without any compensation, thus free-riding on the costs that the parties to the transaction incur. Similarly, they will suffer negative external effects without any part in the benefits that befall the parties to the transaction. In either case, the result is suboptimal.
- 3 To see the element of free-riding in markets with asymmetric information, remember that only those transactions will be concluded for which the private information on one side implies the worst possible conditions for the trade, given public information; the parties to those transactions effectively have a free ride at the expense of all others who now cannot conclude a transaction.
 - 4 They also discuss the proper level of collective action and argue for the principle of subsidiarity.
 - 5 ‘The calculus of the public interest’ of Teulings c.s. (2003) appears vulnerable to both types of criticism they bring forward.
 - 6 Kalbfleisch also quotes Hovenkamp (2006), who made a similar observation for applications of antitrust law in the US and notes that “balancing’ is simply not something the courts can do unless the difference in weights is fairly obvious’. Such an obvious difference can support the proportionality test, which may require some (rough) balancing.
 - 7 In line with my observation (2) in the previous section, I would add the political nature of weighting effects on the welfare of different individuals (or groups thereof).
 - 8 This admittedly weak form of political backing was considered sufficient to support a temporary financial arrangement which did not have evident restrictive effects.
 - 9 It is noteworthy that Article 47 of the Dutch Competition Act allows the Minister of Economic Affairs to clear a merger, overturning a negative decision of the NMa, if he sees important reasons of general interest that carry more weight than the expected impediment to competition. There is no similar provision for cartels or abuse of dominance.
 - 10 As Kalbfleisch put it: ‘a regulator’s work is more of an Art than a Craft’ (Kalbfleisch 2010).
 - 11 Kalbfleisch (2007), Steenbergen (2008), Freeman (2008).

PART

3

Competition policy in an
international setting

Private enforcement and public enforcement of EU antitrust law

PHILIP LOWE AND RAINER BECKER*

Introduction

Since the inception of the European project 50 years ago, fair competition has generated investment, efficiency and innovation in Europe. Both at EU level and at the level of the Member States, the focus has been on enforcement of antitrust law by public authorities. Strong public enforcement is indispensable, of course. But no public enforcer can, or should, take on every case of infringement to EC competition rules. Our work has to be prioritised, limited taxpayers' resources allocated accordingly and the progress of cases speeded up. From this perspective, it is clear that anti-competitive behaviour cannot be fought by public bodies alone.

Furthermore, there are some tasks in the enforcement of competition law for which public competition authorities, regardless of their resources, are ill equipped to deal with. However, high our fines may be, they are paid into the coffers of the European Union. Ultimately, they benefit all European taxpayers. The concrete victims of antitrust infringements do not receive compensation from the European Commission or from the national antitrust authorities. Such compensation can only be achieved through effective civil redress in the courts of the Member States. Another example of what national courts are better equipped to do than the Commission is the granting of interim relief, which might be key – in particular in cases such as an anti-competitive refusal to supply – in order to guarantee an effective enforcement of the EU competition law rules.

Both because the limited resources of competition authorities as well as because of their particular capacity to safeguard individual rights, national courts, increasingly, have an important and active role to play in the enforcement of competition law. The role of national courts has in-

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creased since the modernisation of the application of EC antitrust rules which allowed them to apply Articles 101 and 102 TFEU in their entirety. And we expect the importance of national courts to expand further in the future once the conditions for more effective private actions in antitrust enforcement are put in place.

The Commission's private enforcement policy initiative

In its 2001 *Courage* judgment and its 2007 *Manfredi* judgment, the European Court of Justice has been very clear in recalling that the right of victims to claim damages under civil law is necessary to ensure the effectiveness of the EC antitrust rules. To those who have suffered harm as a result of an infringement of these rules, compensation is guaranteed by the Treaty. The task is to convert that right from being one that exists on paper, to being a right in reality. Although there have recently been some signs of improvement in some Member States, to date in practice victims of EC antitrust infringements still only rarely obtain compensation of the harm suffered.

Over the last 7 years, the European Commission has analysed in depth the issue of private damages actions for infringements of the EU antitrust rules. In 2005, the European Commission published a Green Paper identifying the obstacles standing in the way of compensation for victims of antitrust infringements, and later a White Paper (2008) putting forward concrete measures to overcome such obstacles and attain the objective of full compensation. In the impact assessment study carried out for the Commission's White Paper, it was outlined that foregone compensation is costing consumers and businesses across Europe of up to € 23 billion a year.

The solutions proposed by the Commission are driven by the primary policy objective to achieve effective compensation of victims. Damages in Europe are normally compensatory in nature, not punitive such as double or treble damages applicable in other jurisdictions. Whilst striving for measures that will have a significant impact in terms of more effective regimes for compensation, the Commission is committed to a *balanced* system, which is grounded in European legal traditions, and which avoids the pitfalls of abusive litigation.

In the public consultations that followed the publication of both policy papers, stakeholders welcomed the Commission's objectives and its general approach (focus on compensation). On the various specific measures put forward in the White Paper, views more widely diverged, and some

concerns were voiced as to the need to avoid that effective compensation for victims translates into excessive and abusive litigation, of the kind sometimes experienced in the US.

In its report of March 2009, the European Parliament stressed the need of action in order to make effective compensation a reality for victims of antitrust infringements, and expressed constructive comments on the specific measures suggested by the Commission. Overall, the debate has shown that, in Europe, we have now moved past the question of ‘should we have a more effective system of antitrust damages actions?’ The question rather is how a damages action system can be made effective in an appropriate manner. It is clear that safeguards are needed in order to meet the concerns of risks of an abusive litigation culture.

Among other measures, the White Paper addressed the issue of collective redress. Indeed, in situations where a single infringement causes harm to a large number of parties – which is typical for infringements of competition law – individual damages actions are neither practical nor cost-efficient. Therefore, some form of collective redress is necessary to ensure effective and efficient access to justice and, thus, effective enforcement of competition law. Collective redress can also play an important role also in other areas of EU law – in fact, wherever breaches of substantive EU rights regularly cause harm to large groups of victims.

The Commission strives for a co-ordinated approach and overall consistency in any future proposals for EU legislation containing mechanisms for collective redress. To this end, the various Commission departments concerned are closely working together to draw up some common general principles that should guide any future EU initiatives on collective redress. On the joint initiative of Commissioners Reding, Almunia and Dalli, the Commission in early February 2011 launched a public consultation on such general principles of collective redress.¹ The aim of this consultation is take soundings as to possible common principles of a European way of organising collective redress as a system that ensures effective access to justice for our citizens and businesses, while containing safeguards to avoid abusive litigation.

Once common principles of European collective redress are identified, sector-specific legislative proposals containing *inter alia* collective redress may be considered further. Regarding the field of competition, Commissioner Almunia announced his intention to present to the Commission a legislative proposal on antitrust damages actions during his mandate.

Complementarity of public and private enforcement: likely policy choices in a European context

The role of private enforcement within the wider architecture of antitrust enforcement depends on some important policy choices, in particular, the choice to what extent damages actions should be geared towards deterrence. Across Europe, there is wide agreement that punishment and deterrence of illegal behaviour should be carried out by public bodies, not by private actors. An effective legal framework for private damages actions will, as any rule on civil liability, of course have the welcome side effects of adding to greater compliance with EC antitrust rules. This is however not the primary function of damages regimes as conceived in the EU Member States and the Commission's White Paper.

More effective actions for damages in Europe therefore can and will not replace a strong public enforcement. Private enforcement is therefore a complement, not a substitute, to public enforcement. The European Commission and the Member States will remain fully committed to continue their vigorous and strong enforcement of antitrust rules by public authorities. The role of public authorities will particularly continue to be of crucial importance in detecting anti-competitive practices such as cartels, where the investigation powers of these authorities and the immunity/leniency programmes of these authorities are often indispensable to detect the infringement.

Conversely, no matter how closely public intervention mirrors the concerns of consumers, no matter how effectively the fines that we impose punish and deter unlawful behaviour, the victims of illegal behaviour will still not be compensated for their losses. Public enforcers are simply neither equipped nor authorised to award compensation to individual consumers and businesses. Delivering (corrective) justice in individual cases is the traditional task of civil and commercial courts.

In contrast to the traditional strong emphasis on *public* enforcement in EU Member States and at EU level, the US have always made the policy choice to rely to a greater extent on the initiative of *private* individuals to ensure enforcement of the antitrust rules through civil litigation. Claimants in US actions for damages are often seen as 'private attorneys general' that contribute to the public-interest goal of detecting and punishing infringers of the antitrust rules. Out of all antitrust cases that are tried at US courts, approximately 90-95% are brought by private claimants and only 5-10% by the public enforcement agencies. The US approach can therefore be said to be 'deterrence-driven', whereas the approach to

damages actions in European Member States (and the Commission's White Paper) is 'compensation-driven'. This policy choice regarding the function of antitrust damages actions is anchored in US legal culture and does not seem to be seriously put into question.²

In line with this policy choice, US law contains several incentives for private parties to start an action for damages to ensure the enforcement of the antitrust rules that are, in their combination, not present in the EU Member States. Some of these incentives are antitrust-specific, but they interplay with general features of the US legal system. The combination of these specific and general features creates considerable incentives for claimants to start an action and a significant pressure on defendants to settle cases, sometimes even where they might believe that they could ultimately win the case before court. As a result, observers from inside and outside the US point to a higher readiness to sue than in other parts of the world ('litigation culture'). Others, however, view the current US system and its incentives for claimants in antitrust damages actions as a guarantee for victims of antitrust infringements to obtain access to justice.³

Some specific issues regarding the interplay of public and private enforcement

Private enforcement and leniency

Although, from a European perspective, public and private enforcement thus serve different primary functions, interaction obviously occurs. For instance, an increased level of damages claims may well be one of the aspects the participants in a cartel consider when they contemplate applying for leniency. The measures put forward in the Commission's White Paper are designed to create an effective legal framework for antitrust damages actions that complements, but does not jeopardise public enforcement. A good example of this approach is provided by the suggestions in the White Paper that are aimed at guaranteeing the attractiveness of leniency programmes. Those programmes are beneficial to private enforcement as much as they are to public enforcement.

On the one hand, we must therefore ensure an adequate level of protection of leniency applications in a future context of an enhanced level of actions for damages. On the other hand, we should continue to reflect on the possibility to further incentivise potential immunity applicants. Key in this respect is the suggestion in the White Paper to protect confessions

made by leniency applicants to the public enforcer (the so-called corporate statements) against any kind of disclosure in an antitrust damages action before a Member States' court. In addition to this suggestion regarding *inter partes* disclosure in litigation before courts in the EU Member States, the Commission has also consistently taken the position that the disclosure of such corporate statements in civil proceedings before courts outside the EU would risk jeopardising the Commission's fight against cartels.

A distinct albeit related question is to what extent public enforcers such as the Commission or the NMa should open their files to claimants for damages. Upon referral from a German first instance court (AG Bonn), several questions on this issue have been put before the European Court of Justice.⁴ Its ruling may well provide guidance that goes beyond the specific context in which they have arisen (a particular German rule of procedure). Insofar as access to the Commission's investigative files for damages claimants is concerned, it is regulated by EU Regulation 1049/2001. In some circumstances, EU law requires the Commission to give access, in other circumstances it allows the Commission not to give access. That is particularly the case when the effectiveness of our investigations is at stake or when business secrets of companies have to be protected. Where this is the case, I consider it fully justified that the Commission does not open up its files to claimants of antitrust damages. Although some may consider that to go against the interest of damages claimants, I am convinced that those claimants are far better off by a well functioning public enforcement.

Binding effect of decisions in public enforcement

Another area where the White Paper deals with points of connection between public and private enforcement concerns the effect that the decision taken in public enforcement have in civil actions for damages. When the European Commission finds a breach of competition rules, victims of the infringement can directly rely on this decision as binding proof in civil proceedings for damages. The White Paper proposes a similar rule also for cases when a national competition authority (NCA) finds such a breach: civil courts should, in subsequent antitrust damages cases, accept the findings of the NCA as irrebuttable proof of the infringement. Indeed, such a rule would not only avoid an inconsistent application of competition law and increase legal certainty. It would also prevent infringers from calling into question their own breach of competition law already established in an NCA decision, which would oblige civil courts hearing

damages actions to re-examine the facts and legal issues already investigated and assessed by a specialised public authority (and possibly an appeal court). Such duplication of factual and legal analysis currently leads to considerable extra costs, duration and imponderability for the victim's action for damages. To protect in particular the infringers' rights of defence, the rule on a binding effect of NCA decisions would be limited to *final* decisions of NCAs, i.e. decisions for which all avenues of judicial appeal have been exhausted.

Relationship with level of fines and criminal sanctions

The interrelation between private and public enforcement is too manifold to be duly considered in this paper. For example, it is sometimes argued that compensation payments made (or promised) by infringers should be taken into account when setting the level of fines. It would clearly go beyond the scope of the present paper to discuss the merits of such arguments. In this debate, one should however not lose sight of the different functions of public and private enforcement in Europe: as mentioned above, the main objective of our public enforcement fines is to deter, not only the undertakings concerned but also other undertakings from engaging in, or continuing, behaviour that is contrary to Articles 101 and 102. The main objective of private enforcement is to compensate the victims. Can it be that, simply because infringers are ordered (or voluntarily offer) to compensate the harm they have caused (which is their legal obligation in the first place), they can count on a lenient treatment by the public enforcer? In this context, it is also worth recalling the cautious remarks of the European Parliament in its March 2009 Resolution, when it noted that any interaction between the level of fines and the payment of compensation should neither interfere with the victim's right to full compensation, nor with the need to maintain the deterrent objective of fines.

Similar considerations should be borne in mind when discussing the relation between criminal sanctions for antitrust infringements and actions for damages. Criminal sanctions on involved executives may act as an additional deterrent for potential infringers, thereby limiting the number of victims suffering from breach of EC competition law. However, they will do nothing to repair the harm caused to the victims of these infringements, who will remain uncompensated in the absence of measures ensuring effective redress. So the case for private damages actions remains valid whether or not some Member States chose to apply criminal sanctions.

COMMENT**FLORIS O.W. VOGELAAR** ***Private enforcement: unraveling the Gordian knot?**

In his time in office as Chairman of the Board (earlier: Director-General) of the NMa, Pieter Kalbfleisch had two characteristic *leitmotifs* for which he will be remembered, and rightly so. The first was his stated preference for (in his own words) a ‘robust enforcement’ of competition rules wherever appropriate, and the second, equally important, was ‘to let markets do their work!’ These two leitmotifs are complementary rather than substituting policy views on approaching the complicated labyrinth of antitrust enforcement.

However, in this context, the discussion on ‘private enforcement’ seems to suffer from an undesirable overlap in terminology, from overlaps in objectives, and from a degree of overlap in potential enforcement instruments. Increasingly and ever since the modernization in 2004 when parallel enforcement of the Articles 101 and 102 TFEU within the Network was introduced, it has become a Gordian knot in spite of the efforts of the Courts in Luxembourg and the ensuing consultation documents of the (European) Commission of the last decade in many colors of the rainbow (mainly green, blue and white). In response to these consultation documents, interest groupings are seen to dig in their heels in their overt lobbying efforts to achieve that matters should not be organized as suggested by the Commission. At least, at the moment of writing this contribution, this seems to be the path followed in the context of the most recent effort of the Commission to enhance the issue of a coherent approach towards collective redress¹, notably in the antitrust context. This effort triggers, at least with this author, some comments that by no means should be seen as exhaustive (the permitted length of this contribution unfortunately not allowing much detail and depth). They merely aim at flagging some of the issues.

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What is to be included in the notion of private enforcement?

In general, enforcement of the EU competition rules should be defined as the efforts to avoid restrictions of competition or to bring such restrictions to an expedient end. And this to the benefit of consumer welfare, or economic welfare in general. Under EU law, this can be achieved by either so-called *public enforcement* or *private enforcement*. These two strains of enforcement should be seen as complementary. Public enforcement includes a strong deterrence component in its effort to bring infringements to an expedient end, once these are detected, as the public enforcement authorities (both the Commission and the NCAs) have the power to impose pecuniary sanctions (nowadays often severe ones). Private enforcement, on the contrary, takes place before national courts and seeks to obtain declarations of applicability of the Articles 101 and 102 TFEU² and to bring these to an expedient end. Here, sanctions do not come into play.

However, the term ‘private enforcement’ incorrectly has started to be used so as to include the mechanism of seeking private compensation of damages suffered as a result of the antitrust infringement. Such damage actions should not be seen as a form of ‘private enforcement,’ but rather as the sequel of successful acts of either public or private enforcement. In other words, the ancillary effect of a successfully remedied antitrust infringement would be that consumers, trading partners and even competitors may have suffered damages, which should be compensated because of unlawful market behaviour by the infringing undertakings. Compensation of damages, therefore, cannot be the prime issue of enforcement, but the legal consequence thereof, whether such enforcement was public or private.

Interface between public and private enforcement and damage claims

The above unraveling of the terms as used does not imply that these lead completely separate lives. On the contrary! There is a strong interface between the two, as there also is a strong interface between public enforcement and private damage actions. It is submitted herewith that antitrust infringing undertakings are likely to think twice before they actually indulge in infringing market behaviour when they know or can expect that the damage inflicted upon ‘the market’ may be recouped by the damaged parties concerned without prohibitive effort in terms of cost and time. Looked upon the issue from that angle, one might conclude that relatively

easy damage redress might be part and parcel of the overall deterrence package pursued either in public or in private.

Judgments like *Crehan v. Courage*³ and *Manfredi*⁴ seem to indicate as much, in that Member States should make a realistic effort to put mechanisms in place through which damage claims may be pursued without undue procedural obstacles for the claimants. This is all the more necessary in cases of mass claims, where many petty claimants, each individually, would not have the means to reclaim their damages, but where collective redress might remedy the problem. Such obligation to put some effective mechanisms in place might also be construed in the light of the obligations for Member States deriving from Article 4(3) TEU in conjunction with the Protocol no. 27 on the Internal Market and Competition, i.e. deriving from their Union Loyalty obligations.

What could be the justified and facilitating role of the Union or the Commission?

If the redress of damages could indeed be accepted as an aspect of the general theory of deterrence, it might also successfully be argued that the Union may have jurisdiction to improve (at least) the level playing field within the Union's territory under which such redress practice may fruitfully develop. The principle of subsidiarity probably dictates that top-down harmonization of collective redress claim procedures will be a bridge too far as such claim mechanism will also prevail in other non-competition-related areas of the law (*i.e.* product liability, medical drug liability, health issues, environmental claims). It would impinge on the Member States' freedoms for too large an area of their law (private or common).

On the other hand, Member States should not close their eyes for the unhelpful diversity of (or total absence in) their national laws regarding damage redress as was laid bare by the Ashurst Report in 2004 (and for that matter, neither should interest groupings). It would be for the Union to facilitate a level playing field, some uniformity in at least the basic notions that would play a role in collective redress of antitrust damage.⁵ This would avoid unnecessary or abusive forum shopping and obstructive arguing on basic issues that might prevent claimants to bring their claims to a reasonable end expending proportionate cost and effort. Issues which the Commission might wish to address in this light could be:

- The notion of 'damage'.
- A uniform statute of limitation for antitrust damage actions.

- The Union-wide *erga omnes* effect of public enforcement decisions once these have been upheld on appeal.
- The (civil or common law) evidence issues that come with it.
- The determination of ‘who has standing’ in claims for collective redress.
- Access to the public file for claimants of damages and its relation to aspects of confidentiality and leniency.⁶

It is herewith submitted that such issues should not be slashed down by the principle of subsidiarity. They would be prerequisite for a cost-efficient and successful claim procedure for the redress of damages suffered Union-wide or, at least, in an number of Member States as a result of one and the same antitrust infringement.

How to avoid an emerging claim culture?

Whilst improving the level playing field, the danger of an emerging claim culture should be addressed at the same time. Whenever claiming anti-trust damages will be made more cost-efficient and Union-wide feasible in terms of its underlying terms, it is to be expected that a market for such claims will emerge. Already today, both lawyer and non-lawyer organizations seem to specialize in setting up collective claim mechanisms which might operate effectively throughout Europe. Touting for the business already occurs (the so-called *entrepreneurial lawyering*). Unfortunately, the collective redress consultation paper does not address this issue at all. Securitization of potential claims may then be the unavoidable next step. Non-bona-fide intermediaries may emerge at the expense of petty claimants. This makes the issue of ‘standing’ in collective redress actions a key pin one. Checks and balances should be built into the system. The Commission should be wary of a market which will always show more creativity than a legislator can ever dream of. A special study (both on the legal and the economic side of matters) into the aspects of claim abuse is therefore deemed essential.

What could the Commission do in the meantime?

One of the points under scrutiny is whether public enforcement sanctions should, and could be reduced when antitrust-infringing undertakings have committed themselves to or have shown to have made a credible start in compensating the parties damaged by their infringing market be-

haviour. In certain enforcement decisions, the Commission seems to have taken such redress into account already when setting the fine. This approach merits a closer look.

If the assumption holds that accessible private damage redress mechanisms could be seen as having a direct deterrent effect on prospective antitrust infringements – which this author assumes to be the case, for the sake of argument – then it might also be true that the Commission could lawfully, and should take this deterrent effect into account in its decision when ordering the infringements to be brought to an end, pursuant to Article 7(1) of Regulation 1/2003.

Imposing fines is not the aim of the enforcement exercise, but deterrence and remedying the infringement at hand is and, with it, the avoidance of future antitrust infringements. For that purpose, the Commission has the power to impose proportionate behavioural or structural remedies. It is herewith submitted that it should be lawful for such remedies to include an order to submit to the Commission (within a certain reasonable period of time) proposals as to how the infringing undertakings intend to compensate the damaged parties for their losses suffered as a result of the infringement which is the subject of the Commission's decision.⁷ Depending on the effectiveness of such proposals, the Commission could in exchange reduce (subject to the satisfactory actual compliance with them) the amount of its fine in accordance with predefined criteria, which could be laid down in either the Notice on the setting of fines or the Leniency Notice. If this could be a viable way forward, 'voluntary' compensation might find its way more readily in the public enforcement practice. However, the aspect of deterrence in public enforcement should remain the over-riding principle. This necessarily entails that compensation of civil damage should never completely come instead of the public (detering) sanctioning. Sanction and compensation, taken together, will therefore always have to amount to (considerably?) more than the amount of the public sanction on its own.

COMMENT**RENÉ SMITS*****The complementary nature of private and public enforcement of competition law**

Complementary nature of private enforcement

In his contribution, Philip Lowe rightly emphasizes the complementary nature of private and public enforcement of competition law. However desirable a strengthening, Europe-wide, of legal instruments available to claimants in order to enforce their directly applicable economic rights under the Treaty may be, public enforcement should take the lead. This is because an independent, specialized authority is best equipped to determine the harm done to society by infringements of competition law. Furthermore, the administrative-law tradition of enforcing Community competition law by the Commission and NCAs will not easily be paralleled by equally effective civil-law enforcement.

Recommendations by OFT (2007)

One of these NCAs, the Office of Fair Trading, has positioned itself in the midst of the ongoing debate on private enforcement of competition law by, first, issuing a discussion paper¹ and, then, coming forth with specific proposals to the UK government on how to encourage private enforcement². Back in 2007, the OFT argued in favour of introducing representative actions for consumers and businesses in defence of competition. It discussed the possible coexistence of opt-out and opt-in procedures. In the former, consumers or businesses are subsumed in the class of plaintiffs if they do not undertake action. In the latter, they are excluded from the class of plaintiffs if they do not specifically intend to participate. The OFT Report also discussed funding arrangements and the interplay between public and private enforcement.

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Pending case on weighing leniency versus private enforcement

This interplay is very much the focal point of a pending case that the author mentions³. The Opinion by Advocate General Mazák⁴ makes clear that there are threats for public enforcement from civil litigation. This case is about the weighing of possibly diverging interests of cartel detection, relying on leniency programs, and the right to claim damages for harm suffered as a result of cartels. The claim by the German company allegedly suffering damages resulting from the décor paper cartel uncovered by the German NCA,⁵ relied on a specific provision of German procedural law giving an aggrieved party access to the file of the investigation. Normally, a claim would be made under the regulation on public access to EU documents.⁶ It is clear from this Opinion that business information or internal documents of competition authorities would be excluded from public access. In view of the possibility that different standards of disclosure to third parties by NCAs of information which leniency applicants communicate to them might affect the cooperation between the European Competition Network set up in Regulation No 1/2003, a question of Union law arises on the interaction of leniency programs and follow-on actions for damages. The Advocate General states that allegedly injured party access to files should be granted 'in the absence of overriding legitimate reasons of public or private necessity'. After all, injured parties have a fundamental right to an effective remedy, guaranteed in Article 101 TFEU, as interpreted by the European Court of Justice,⁷ and by the Charter of Fundamental Rights of the European Union and the European Convention for the Protection of Human Rights and Fundamental Freedoms. Arguing that leniency programs also benefit private parties injured by cartels, the Advocate General holds that it is also in their interests that leniency programs remain attractive and effective in undermining cartels. However, he restricts safeguards for leniency applicants to self-incriminating statements. All the other pre-existing documents submitted to a competition authority by leniency applicants should be open to access for claimants in civil follow-on litigation. Obviously, it remains to be seen what the ECJ will think of this. An effective public enforcement policy may require a stricter reading of the rights of individuals who claim damages. Without going so far as to limit the civil liability of leniency applicants, as has been the case in the United States,⁸ a broader protection of their status in the public-enforcement proceedings may be necessary in order to prevent undermining the leniency tool.⁹ Moreover, it may be necessary to introduce legislation giving full effect in follow-on proceedings

to findings of an infringement in public-enforcement decisions, as German legislator has done.¹⁰ Such provisions may make requests for access to the files of competition authorities redundant, as the Advocate General in the *Pfleiderer* Case duly notes.¹¹

Further interplay between public and private enforcement: compensation as a mitigating factor

In its Resolution of 26 March 2009 on the White Paper on Damages actions for breach of EC antitrust rules, which the author also mentions, the European Parliament touches upon the interplay between leniency and private enforcement. Parliament endorses out-of-court settlement of disputes about damages for cartel infringements. It calls upon ‘the competition authorities (...) to take account of the compensation paid or to be paid when determining the fine that is to be imposed upon the defendant undertaking’, something *NMa* can do pursuant to the Fining Guidelines.¹²

Prospects

With the consultation on the collective redress ongoing,¹³ as Philip Lowe mentions, one may expect legislative initiatives to be finally submitted with a view to enhancing the effectiveness of economic rights of EU citizens and corporations. The vagueness and the lack of commitment to a certain outcome of the consultation document are striking. After all, experience with the Green Paper and the White Paper had already induced the Commission to propose a draft directive on the enforcement of competition law. The current initiative seems to begin from scratch. Even the material scope of application of any initiative is left open: consumer and competition law are certainly intended to be covered, but whether environmental law, financial services law or any other area are to be included remains an open question. It would be best if the Commission endeavours to be bold after digesting the replies to the consultation document. A repetition of the seven years of consultations and deliberations in the area of competition law is not a welcome perspective. A horizontal initiative to enhance standing of individuals and companies through collective redress is.

Notes

ARTICLE

- 1 See http://ec.europa.eu/competition/consultations/2011_collective_redress/index_en.html.
- 2 For instance, the approach was recently confirmed by the Antitrust Modernization Commission (AMC), that was set up by US Congress to review the US antitrust system and to consider possible improvements.
- 3 These views, in particular, refer to the low cost risks for claimants, the low threshold of discovery and the efficiencies of class actions.
- 4 C-360/09 *Pfleiderer*.

COMMENT 1

- 1 Commission Staff Working Document leading to Public Consultation: Towards a Coherent European Approach to Collective Redress, SEC(2011)173 final of 4 February 2011
- 2 On the basis of Articles 1, 2 and 6 of Regulation 1/2003 and of Article 101(2) TFEU
- 3 Case C-453/99 *Courage vs. Crehan* [2001] ECR I-6297
- 4 Joined cases C-295/04 and 298/04 *Manfredi* [2006] ECR I-6619
- 5 Couldn't such an effort be based on Article 103 TFEU?
- 6 Cf. also F.O.W. Vogelaar, '*Interface: EC and Dutch Competition Law – In Which Fields or Areas Would the Netherlands Still Have Autonomous Regulating Powers? And would it be wise to use those Powers?*' in *Interface between EU Law and National Law*, D. Obradovic and N. Lavranos (eds), Europa Law Publishing, Groningen, 2007
- 7 In this manner, Article 7 would be used in conjunction with Article 9 of Regulation 1/2003 or, in the alternative, with the settlement procedure laid down

in Regulation 773/2004, as amended by Regulation 622/2008.

COMMENT 2

- 1 Private actions in competition law: effective redress for consumers and business, Discussion paper, April 2007, OFT916, at: http://www.of.gov.uk/shared_of/reports/comp_policy/of916.pdf.
- 2 Private actions in competition law: effective redress for consumers and business, Recommendations from the Office of Fair Trading, November 2007, OFT916resp, at: http://www.of.gov.uk/shared_of/reports/comp_policy/of916resp.pdf.
- 3 C-360/09 (*Pfleiderer*).
- 4 Opinion of Advocate General Mazák of 16 December 2010 in Case C-360/09 (*Pfleiderer*), nyr.
- 5 See: http://www.bundeskartellamt.de/wEnglisch/News/Archiv/ArchivNews2008/2008_02_05.php.
- 6 Regulation (EC) No. 1049/2001, OJ 2001, No. L 145/3. Please note that, in a document accompanying the White Paper, the Commission argued that this regulation does not form the proper basis for obtaining access to evidence for the purposes of pursuing private damages actions: Commission Staff Working Paper accompanying the White Paper on Damages actions for breach of the EC antitrust rules (SEC(2008) 404), paragraph 104.
- 7 Notably, in a judgment of 20 September 2001 in Case C-453/99 (*Courage vs. Crehan*), [2001] ECR 2001. I-6297 and in a judgment of 13 July 2006 in Joined Cases C-295/04 to C-298/04 (*Manfredi*), [2006] ECR I-6619.
- 8 The US *Antitrust Criminal Penalty Enhancement and Reform Act of 2004*,

- extended for another ten years in 2010, protects individuals and companies that self-incriminate with respect to violations of the Sherman Act to the Department of Justice from treble damages and joint-and-several liability in private lawsuits. On ACPERA's first five years, see: Michael D. Hausfeld, Michael P. Lehmann and Megan E. Jones, Observations from the Field: Acpera's First Five Years, *The Sedona Conference Journal*, 10, Fall 2009, pp. 95-114.
- 9 In its response to the Commission's Green Paper, NMa stated it considered 'the greatest possible protection of documents held by an authority in the context of a leniency application, to be indispensable'; see: http://ec.europa.eu/competition/antitrust/actionsdamages/files_green_paper_comments/nma_en.pdf.
- 10 Section 33 (4) of the German Competition Act states that, in civil antitrust litigation, '(...) the court shall be bound by a finding that an infringement has occurred, to the extent such a finding was made in a final decision by the cartel authority, the Commission of the European Community, or the competition authority – or court acting as such – in another Member State of the European Community' See: http://www.bundeskartellamt.de/wEnglisch/download/pdf/GWB/110120_GWB_7_Novelle_E.pdf
- 11 In footnote 75 of his Opinion referred to in footnote 19 above (italics added, RS): 'In those jurisdictions, such as the Federal Republic of Germany, where private litigants may in actions for damages rely on the final decision of the national competition authority or by a review court in order to establish an infringement of Article 101 TFEU, I consider that *access to evidence or documents disclosed in the course of the leniency procedure by the leniency applicant should not be granted* in that context as they are not necessary in order to give effect to the right to an effective remedy and a fair trial.'
- 12 Section 14 of the Policy Rules of the Minister of Economic Affairs on the imposition of administrative fines by NMa 2009 includes as a mitigating factor in imposing fines 'the circumstance that the offender – on the offender's own initiative – provided full compensation to the parties injured by the infringement'. See: http://www.nmanet.nl/Images/091218%20Policy%20rules%20of%20the%20Minister%20on%20Economic%20Affairs%20_fines__tcm16-13339.pdf.
- 13 See: http://ec.europa.eu/competition/consultations/2011_collective_redress/index_en.html.

Meeting China's competition

PETER VAN BERGEIJK AND PIERRETTE GAASBEEK*

Introduction

Only three years ago the development of the world economic structure appeared to be sound, sustainable and on track with a clear and consistent movement towards an efficient market-driven, multilaterally governed global system. The so-called Washington Consensus (which basically reflected the key neoclassical insights, including the vital importance of properly functioning markets and their underpinning institutions) governed policy debates (and the curricula of universities).

The emergence of this mainstream analysis had its roots in the 1980s when policymakers all around the globe felt the need for market-oriented reforms of the economic structures. In the developing world, the process reflected the failure of the system of central planning of the economy that was a common feature of the development ideology prevalent in the 1960s and 1970s. This failure of central planning was evident in all countries that we now know as the BRIIC group of emerging economies. In Latin America, import substitution strategies failed and fossilized industries that were protected from (international) competition lost market shares both at home and abroad (Taylor, 1998; Mesquita Moreiraa, 2007). The leap-forward strategy that had prioritized heavy industry had completely failed to deliver the desired catching up with the industrialized economies, not only in the major communist economies (China and the former USSR), but also in India and other non-communist countries (Lin, 2009). As a consequence of the recognized failures of state dirigisme and protectionism, economic policies became increasingly competition oriented and stimulated both openness and international integration.

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The reorientation of economic policy was, incidentally, not limited to the developing world. Also, in the OECD area, the detrimental experiences of stagflation, excessive taxation and inertia and inflexibility of both product markets and labor markets led to an ambitious and influential program of structural reform in the advanced economies (Van Sinderen, 1993). This process stood at the basis of the ‘Europe 1992’ program for the internal market (Emerson et al., 1988). A program that was effective and influential as it changed the competition policy landscape in Europe and *inter alia* led to the new Dutch competition law and the establishment of the NMa in 1998 (Van Bergeijk and Haffner, 1996).

All in all, in the 1990s, a global reorientation was taking place in all major economies and given the performance of the world economic system in terms of prices, employment and production during the ensuing period of the Great Moderation, the new market-oriented policy environment appeared to be ready for the twenty-first century.¹

The financial crisis that hit the world economy in 2008, however, drastically changed this perspective (Van Bergeijk et al., 2011). The initial economic answer to the crisis has been Keynesian with an unprecedented relaxation of monetary policy (especially quantitative easing), fiscal stimulus packages and support for the financial sector. Additionally, the apparent failure of markets fuelled demand for a larger role for government in terms of regulation, oversight, and involvement.

It is also relevant that economic growth recovered quickly (and often growth simply continued) in those quarters of the world where state intervention still plays an important, if not dominant role, in particular the BRIIC countries. This decoupling of economic fortunes that took place between the OECD and the BRIIC countries does not only question the validity of policy frameworks that essentially rely on markets. It also boosts self-confidence in the BRIIC countries in their own approach that mixes markets and public-sector involvement, and puts more weight on government as an actor and catalyst for development.

Against this background, we plan to take a closer look at competition policy in the People’s Republic of China. One reason for this endeavor is that the Chinese approach of gradual and experimental change differs fundamentally from the Big Bang approach that was followed by the former communist states in Eastern Europe and the Soviet Union. A second reason is that China is increasingly being recognized as one of the key players in the global community: its share in the world economy and its role in global governance (like that of the BRIIC countries in general) have substantially increased and are expected to continue to grow

(Kaplinsky and Messner, 2008). Therefore, the non-OECD view on markets and governments will gain weight already in the near future. Table 1 illustrates the relevant trends in the world economy that recently probably have only been strengthened due to the severe slump in the OECD.

TABLE 1 Shifting shares in the world economy (1995 versus 2015)

1995	Per cent	2015	Per cent
Europe	40	Europe	23
US	16	China	17
Japan	7	US	11
China	2	Japan	4
Rest of Asia	14	Rest of Asia	15
Rest of the world	14	Rest of the world	30

Source: Based on Hervé et al., 2007.

Based on a long run OECD study that was published actually just before the outbreak of the financial and economic crisis, Table 1 provides details regarding the unprecedented fragmentation of economic power over the period 1995–2015 as the C3 ratio (the share of the three largest economic players) decreases from 63 to 51 per cent and the Herfindahl index more than halves (from a score of 1909 to 995). The decrease of the ‘monopoly power’ of the market-oriented countries that stood at the very basis of the international institutions (IMF, World Bank, OECD) is also reflected by the observation that the share of Europe, the US and Japan over this period decreases from 63 per cent to 38 per cent.

It is naïve to believe that such a shift in economic power will not translate into a shift in the politics of international governance, and one should therefore expect a change in the norms and values in the global economic system. The non-OECD perspective is not anti-capitalistic *per se*, but gives more weight to coordination and the long-run effects of policies than is usually the case in the industrialized countries that essentially favor the atomistic individual freedom to choose. Bomhoff and Man Li Gu (2011) empirically investigate if and how modernization influences values and while they uncover substantial change into the direction of rational and individualistic value systems in the industrial coastal regions of China, it is also relevant that higher income is associated with a more traditional value orientation (and if so, economic growth will not be associated with a more Western orientation but rather with an Asian type of social market

economy). The probability of a change in the basic norms and values in world economic governance is not to be ignored, especially since it will be more difficult for the market economies to continue to exercise global leadership and global public goods (rules, institutions, etc.) in a highly fragmented world (Olson 1965) so that competition between the different competition policy regimes and philosophies is a realistic scenario. This provides yet another reason why a better understanding of the determinants of China's competition policy is important.

The remainder of this essay is organized as follows. In the first section we discuss the reasons behind the Chinese model and argue that these drivers will remain valid in the foreseeable future. In particular, we believe that China's national interest rather than a specific ideology will be the key determinant of its future actions. The following section then discusses the evolution and features of the Chinese competition policy and its instruments. We contrast these aspects with the characteristics of the competition policy framework(s) in Europe. In the final section, we speculate about the potential impact of the new role and influence of China on (global) competition rules and enforcement and offer a recipe to meet the Chinese competition.

Crossing the river

The roots of China's new competition policy are to be found in Deng Xiaoping's gradually implemented economic reforms: just as one crosses a river by climbing from one stepping stone to another the economic system is to be reformed step by step. This idea (that already in the early 1980s guided policy changes aimed at more autonomy for farmers and firms and a better functioning of the incentive systems in China) contrasts with the Big Bang approach that was characteristic of Michael Gorbachev's Glasnost in Eastern Europe and the Soviet Union. Clearly, political and geopolitical differences may explain why one communist empire opted for pragmatic gradualism, while another communist empire chooses the short cut of deep recession and high-speed adjustment.² The ad-hoc character and broad range of institutional changes and industry specific reforms, however, can also be recognized in the way structural reforms were implemented in New Zealand in the early 1990s (Hall 1999). New Zealand for quite some years was the showcase for structural reform in the OECD. The Chinese model differs from these approaches and did so notably well before the negative consequences of the Big Bang approach in terms of temporary output loss and unemployment became

clear. Basically, the Chinese did it their way and probably most likely for cultural and historic reasons rather than based on an economic analysis of the costs and benefits of different adjustment trajectories.

Theoretical underpinning of gradual reform

Importantly, however, the Chinese policy model of gradual and experimental adjustment processes also has important economic underpinnings. This economic theory is discussed in several publications co-authored by Justin Yifu Lin, who is presently senior vice president and chief economist of the World Bank (for example Lin et al., 1998 and Lin, 2009).

A first key insight is that the communist command and control economies that mobilized domestic capital via forced savings and prioritized heavy industries (steel, machinery, vehicles, etc.) severely distorted the macroeconomic environment since the prices of the production factors (wages and interest) and (intermediate) inputs³ were set at artificially low levels (and accompanied by strict quantity targets). Two important aspects of macroeconomic distortion are especially relevant. The first issue is that a pattern of specialization develops that actually works against comparative advantage (Oldersma and Van Bergeijk, 1992; van Sinderen and Van Bergeijk 1994; Lin, 2003). The alternative would be to upgrade the endowment structure – that is fast accumulation of (human) capital – rather than the industry/technology sector, which would react and on a trial-and-error basis, would follow and develop comparative advantage.

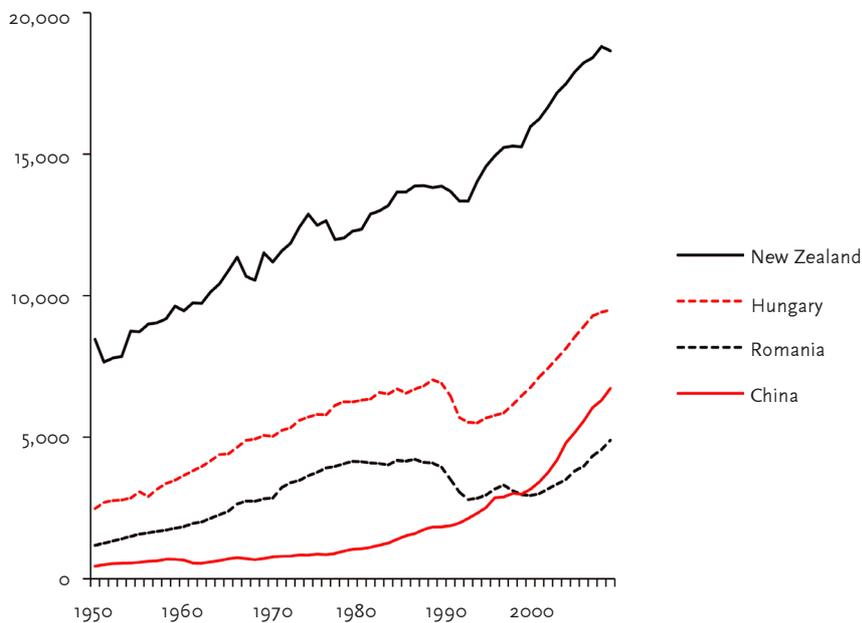
The second issue is that state-owned enterprises *appear* to be healthy at the outset of structural reforms because they often reap monopoly rents at suboptimal input prices and output quantities. Hughes and Hare (1991) even established that for many Eastern European products negative added value would occur if outputs (i.e. the products) and inputs (capital, labor, raw materials and intermediate inputs) were valued at market prices. A Big Bang approach and instant liberalization imposes an idiosyncratic shock in input costs, output prices and production processes that exposes these weaknesses instantly (as it did in Eastern Europe and the former Soviet Union and incidentally also in New Zealand) with strong reductions in production and significant increases in unemployment as direct consequences (see Van Bergeijk and Lensink, 1993). In addition, from this perspective, it is important to note that although non-state production exceeds production in the state sector, regions and sectors of the economy may still be dominated by state-owned enterprises (SOEs). In 1996, the share of SOEs in total industrial output stood at 29%. Importantly, how-

ever, 57% of urban population and 52% of fixed industrial investment was still accounted for by state-owned enterprises (Lin et al., 1998, p. 422). This insight stood at the basis of the Chinese choice to give priority to reducing the policy burdens first (that is the macroeconomic distortions that follow from central planning).

At the practical level of implementation, gradual reforms were introduced giving opportunities and autonomy to new enterprises,⁴ including the so-called township and village enterprises, in order to allow markets to develop and to provide the necessary adjustment time to state-owned enterprises. Moreover, so-called Special Economic Zones had been created (starting in the early 1980s with Hainan, Shantou, Shenzhen, Zhuhai and Xiamen) where new export-oriented industries (largely funded by foreign capital in the form of joint ventures and/or fully foreign-owned subsidiaries) could emerge in an environment where developments and decision-making were mainly market driven.

Figure 1 illustrates the effectiveness of these policies in terms of increases in per capita GDP, and also provides a comparison with three specimen countries that followed the Big Bang approach to structural reform (New Zealand, an OECD economy from the start and Hungary and

FIGURE 1 GDP per capita 1950-2008 (constant 1990 international dollars)



Source: Maddison data base available at <http://www.ggd.net>.

Romania, initially centrally planned economies). For the right interpretation of the graph, it is important to note that the first Chinese steps in the 1970s already doubled income per head, and the same achievement can be observed in the 1980s (when the newly established market mechanisms and improved allocation stimulated the economic dynamism). The productivity increase since the start of the new millennium, although obviously much larger in absolute terms, is of comparable relative strength. Figure 1 clearly illustrates the continuing positive trend in China's average GDP per capita, which contrasts with the large fluctuations and drops in the other countries.⁵

The future course of Chinese policy change

The appropriate metaphor for policymaking in China is the oil tanker, not the sailing yacht. It is unlikely that Chinese policymakers will be tempted to change the course of their economic policies and opt for quick and ad hoc changes, given the (also comparatively) good performance of the Chinese economy and the managed transition that its development policy so far achieved. Importantly, many macroeconomic distortions ('policy burdens') are still in place and here a gradual approach will have to be followed if a decrease in per capita income is to be avoided (such a drop would increase the risks of instability and thus the political costs of structural change). Moreover, China weathered the crisis quite well. Gong and De Haan (2011) argue that China was actually well-prepared for the crisis, probably having learnt the lessons from the Asian crisis in 1997–98: 'This appears directly in line with China's pragmatic reform policies which had become its hallmark since 1978' (Gong and De Haan, 2011, p. 231). On balance, a gradual approach regarding reform towards a social market economy is thus the most likely scenario. One-size-fits-all recipes will not be followed and also more ideologically inspired visions of market economics will not have an impact on policymakers in Beijing. This is not to say that policies will remain the same. Important changes have taken place and will take place. One such important step forward consists of the changes in competition policies and regimes that took effect as of February 2011.

TABLE 2 Introduction of competition laws in China

Year	Law	Key features
1993	Law against unfair competition	Condemnation of abusive conduct of public enterprises and oversight assigned to SAIC
1997	Price law	NDRC established as regulator regarding restrictive agreements, in particular price cartels and including price fixing, predatory pricing and price discrimination
1999	Law on Bid Invitation and Bidding	Regulates cartel activities in fields such as procurement that require bidding
2003	Interim provisions on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors	MOCFOM (together with SAIC) entrusted with oversight; only for mergers and acquisitions involving foreign firms
2003	Tentative Provision on Prohibition of Acts of Price Monopolization	Administrative rules which prohibit the abuse of 'market dominance.' The rules also contain prohibitions against price coordination, supply restriction, bid rigging, vertical price restraint, below-cost pricing, and price discrimination, which are described as abuses of dominance. The rules also prohibit government agencies from 'illegally intervening' in market price determinations
2004	The Foreign Trade Law	Updated in 2004, prohibits monopolistic behavior and unfair competition in foreign trade activities
2006	Provision on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors	Administrative rules on notification requirements and the terms of an antitrust review for pending mergers
2007	Anti Monopoly Law	Mainly deals with concentration of operators, monopoly agreements and abuse of dominant market position and resembles the provisions of antitrust laws in typical market-oriented economies
2011	Rules on the Prevention and Restriction of Price-related Monopoly Conduct (NDRC Rules) SAIC Monopoly Agreements Rules SAIC Dominant Position Rules Rules on the Prohibition of Abuse of Administrative Power resulting in the elimination or restriction of competition.	The rules will guide the enforcement of the Anti-Monopoly Law against price-related and non-price related anti-competitive conduct. The NDRC Rules clarify the kind of anti-competitive conduct between competitors and conduct between companies and business partners that the NDRC will investigate. The SAIC Rules clarify the types of agreements and concerted practices that are prohibited under the AML. The provisions mainly address commercial practices between competitors but provide a catch-all prohibition against anti-competitive agreements that may apply to companies operating at different levels of the supply chain.

Sources: Compiled by the authors and based on studies by Xiaofei, 2008; Mehra and Yanbei, 2008; and Wang et al., 2011.

Introduction and modernization of competition laws in China

China's socialist tradition and culture differ considerably from that of the advanced economies. In China, the commercial laws and regulations are still under construction. Private ownership was gradually introduced since the 1980s, but it was only explicitly allowed across the whole spectrum of the economy in 2004 when the Chinese National People's Congress amended the Constitution so as to explicitly protect private ownership of property, businesses and wealth. It actually took quite a long time for China to reach consensus on a competition law due to the fundamental issues arising from China's historic transformation from a centrally planned economy to a market economy, including the role of the state-owned enterprises, perceived excessive competition, mergers and acquisitions by foreign companies, the treatment of administrative monopolies, and antitrust enforcement (Owen, Sun and Zheng, 2007; Van Sinderen and Severijnen, 2008, provide a useful overview in Dutch). As in other aspects of economic policy, competition policy reform was gradual, pragmatic and deliberate, but it also often turned out to be inconsistent. According to Xiaofei (2008, p. 497), the result is 'a fragmented legal framework against restrictive behavior in the Chinese market'. Table 2 highlights the key legislative steps of the Chinese government since the introduction of the first competition law in 1993.

Catalytic impact of WTO accession

The movement towards a modern competition framework was thus for long essentially gradual and slow. In 2001, however, China entered the WTO and agreed to abide by global trade rules. Of particular relevance were China's new commitments regarding

- the non-discriminatory treatment to all foreign individuals and enterprises, including those that have not yet invested or registered in China with respect to the right to trade;
- the elimination of dual-pricing practices as well as differences in treatment accorded to the location of final consumption; and
- the use price controls (which would no longer afford protection to domestic industries or services providers).

Importantly, the WTO Agreement required implementation in an effective and uniform manner by revising the then existing domestic laws and the enacting of new legislation fully in compliance with the WTO Agreement.

The economic implication of China's WTO membership was that barriers to foreign goods would shrink as the door to foreign investment opened. Foreign retail firms could set up wholly owned outlets and sell goods that were not produced in China. As a consequence, the number of foreign firms entering China increased, but the entering foreign firms were confronted with the fact that the conduct of Chinese firms was, generally speaking, not governed by codified law. The use of administrative power to reward local industry creates dangerous opportunities for rent-seeking. Favored firms and industries can develop quite cozy relationships with local and regional officials. This is especially relevant since for China as a socialist market economy, the state still remains the dominant economic actor. Competition between companies increased but also the risk of anti-competitive conduct of companies and abuse of dominant position by state actors spread. Laws actually varied greatly from region to region and depended on local traditions, but also on the preferences of local government and regulators. It became therefore increasingly clear that WTO membership would also have legal implications for China in order to provide a level playing field *inside* the country.

European perspective

It became thus increasingly clear that better, more coherent and comprehensive rules regarding competitive and non-competitive behavior were necessary. To China, competition is an unfamiliar concept. Since making its transitions to a market-oriented economy, attention is being paid to the importance of competition as an institution. As a result, China has been looking to the antitrust laws developed in Western countries for guidance in designing its competition policies and institutions. On May 6, 2004, the Ministry of Commerce of China and the Directorate General for Competition of European Commission reached agreement on a structured dialogue on competition.⁶ China has formulated various competition-related policies, laws and regulations. On its side, the EU has a relatively complete set of competition legislation. This provides a basis for a dialogue between both parties on competition legislation and enforcement. The primary objective is to establish a permanent forum of consultation and transparency, and to enhance the EU's technical and capacity-building assistance to China in the area of competition policy.

Interestingly, the European experience – from a historical perspective – shares some similarities with the present Chinese situation and this may provide some useful lessons. At the start of the 1990s, the European com-

petition landscape was a spaghetti bowl of national and inconsistent competition laws based on different principles. The Netherlands, for example, deployed the Abuse Principle that legally allowed cartel activities – and actually approved notified cartels – unless these cartels did ‘proven harm’ to the economy. Also, the size, independence and competence of the institutions that markets under regulation differed greatly across Europe (in the Netherlands, the task was devoted to a relatively small section in the ministry of Economic Affairs, and no economic merger review existed).⁷ It was only after the Europe 1992 initiative aimed at the completion of the European internal market and the EMU project that competition policy was harmonized (so that a level playing field emerged) and the EU Commission became a powerful regulator. The implication is that – while scope continues to exist for local regulators and specialization – integration, coordination and harmonization are pre-requisites for achieving effective oversight.

Big leap forward?

After a thirteen-year legislative process, the Anti Monopoly Law (AML) was published in 2007, and became effective on August 1, 2008. The majority of the AML's fifty-seven articles resemble the provisions of antitrust laws in typical market-oriented economies. The provisions aim at the prohibition of price fixing, monopolization, and mergers that significantly concentrate industries within China. While drafting the AML, China built on the experiences of United States and the European Union. The law contains explicit provisions targeting anticompetitive government action – especially widespread local protectionism – in a large transitional economy. Since the AML's introduction in August 2008, much of the precedent and practice issued has focused on the merger control regime. China's National Development and Reform Commission (NDRC) and the State Administration for Industry and Commerce (SAIC) recently issued new rules that focus on the two remaining traditional pillars of an anti-trust regime. On February 1, 2011, these new rules came into effect.

The NDRC published rules on price related infringements. The SAIC published rules on non-price related infringements. While these rules offer clarity on these competition issues, they do overlap and thus inherently raise questions. In economic terms, there is little difference between an agreement to limit output and, on the other hand, a price-fixing agreement. Unlawful conduct can attract considerable fines (up to 10 percent of global turnover) and even criminal sanctions in certain cases. It is still un-

clear how China's regulators will enforce these laws. The powers of enforcement have been delegated to local enforcement agencies. This will encourage enforcement at local level but potentially will lead to divergences in enforcement, fining policy and leniency application.

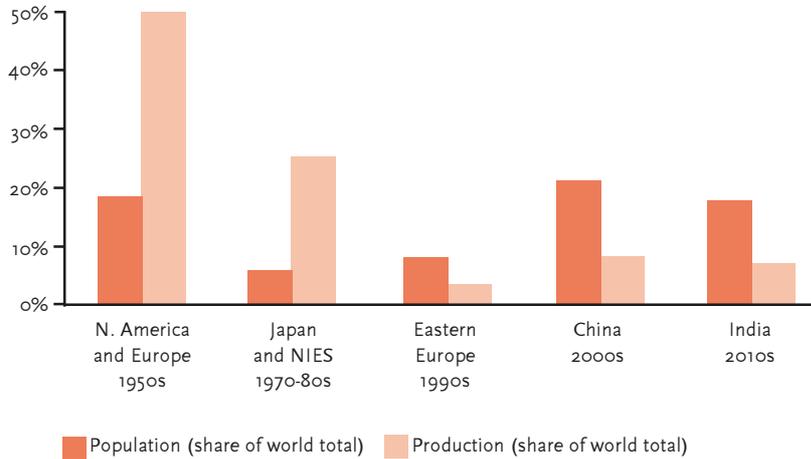
The way ahead

Since the World War II, the world economic system absorbed several waves of new entrants that each did not challenge the basic underpinnings of its governance even though observers sometimes saw these 'miracles' as threats for the group of leading economies.

The integration of the war-prone economies in Western Europe led to a strong economic power base of the advanced economies. The re-emergence of Japan as an important economic power and the subsequent advent of the Newly Industrializing Economies (the so-called Asian Tigers⁸) in the 1970s and 1980s did, in the end, not constitute a threat to the governing paradigm of multilateralism and markets, because the new entrants embraced those principles. Likewise, the fall of the Iron Curtain and the collapse of the Soviet Union in the 1990s actually further strengthened the domination or market orientation. So why would it this time be different?

Figure 2 illustrates that the difference of the new wave of global integration does not follow from the production share of the new entrants at the start of the wave (although the increase in China's global production share over the last decade in line with the developments that were illustrated in Figure 1 has been spectacular indeed). The challenge that China and India pose to the world economic system follows from the size of their populations (and thus from their potential production shares that will be realized if their labor productivity catches up economy-wide). Indeed, within a decade, the BRIICs may have a global majority share in terms of both population and production. This will constitute a powerful and hard to ignore base for change, both regarding the governance of the international system and direction of the world economic institutions, also because key long-term problems (such as global warming) simply cannot be solved without the BRIICs.

Obviously, one of the key questions from the perspective of this essay is whether the Chinese strive for a social market economy by necessity requires a change of global competition rules. So far China has – gradually, but decisively – moved into the direction of a modern competition regime. This trend is, however, by no means certain if China's national interests

FIGURE 2 Shares of Key Players at the Start of the Waves of Global Integration

are not (perceived to be) served by further steps, new institutions and legislation that would be necessary to bring the competition regime effectively up to Western standards. In particular, the Chinese culturally and historically determined preferences for coordination and cooperation and a more long-term orientation than the market typically can provide, may motivate the authorities to choose for a Chinese blend of competition policy and industrial policy. This would not result in a system that meets all demands from the advanced economies, but there could be much wisdom in allowing the Chinese this room for maneuver.

If the market system is considered to be the best – or the optimal – system available and if this system should continue to be the basis of global integration in a multilateral setting, then the industrialized world should not to alienate China (and the other BRIIC countries for that matter) from that system. First of all, this implies that rather than simply imposing Western norms and values one should respect the difficulties and choices underlying the Chinese development model. Being patient may have a high payoff if the ultimate result is that China continues to move into the right direction. Second, international measures should not be focused disproportionately against China (as presently appears to be the case both in the arena of currency imbalances and in terms of trade distorting measures). Overreaction against emerging economic powers is not a sensible recipe if one wants to get their commitment to an open multilateral system.

COMMENT**CARL BAUDENBACHER*****Chinese competition: do we need a new competition policy regime?**

Main propositions

The observations of the authors can be summarized as follows: Until the onset of the financial crisis in 2008, there was, at least in OECD countries, wide agreement that the policy of an open-market economy as embraced by the Washington Consensus is the most effective mechanism to achieve and maintain economic development. However, with the unravelling of the financial crisis, it became evident that countries, in particular the so called BRIICs, which relied to a greater extent on state intervention than the Western countries, were able to recover faster from the resulting slump in economic growth than OECD states, if experiencing any crisis at all. This has cast into doubt traditional market-oriented pre-crisis policy frameworks.

China, like other BRIICs countries, has been particularly successful in weathering the financial crisis and emerging relatively unscathed. Considering China's increasing share in world trade, its views on markets and government action will gain considerable weight on the global level. Against this background, understanding the determining factors of China's competition policy becomes particularly important.

In the past, China has pursued a policy of gradual transition rather than sweeping reforms with often disastrous economic consequences as witnessed by many Eastern European countries. Importantly, changes in competition policy will likely be geared towards national interests rather than specific ideological dogma. Although commercial laws and regulations are still under construction, Chinese competition policy took a big leap forward with the entry into force of the Anti-Monopoly Law (AML) in 2008, which has been modelled on existing American and European anti-trust legislation. The act covers price-fixing agreements, monopolization as well as concentrations. Irrespective of its general scope, the practical application of the AML has so far concentrated on merger control.

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In the past, emerging new economies were largely absorbed without fundamental changes to the governance of the international system. The case of China could be different because of the size of its population and, assuming an approximation of labour productivity, its future production shares. Thus, the crucial question is whether China's shift towards a market economy necessitates a change of global competition rules. Notwithstanding China's present attempts to emulate modern competition regimes, its preference for long-term co-ordination and co-operation may prove an obstacle to a full transition. Despite this, Western countries should not risk alienating China by imposing too burdensome requirements. Being patient may in the long run ensure that China moves into the right direction, which would ultimately outweigh any short-term disadvantages.

Comments

The article considers possible implications of China's unprecedented rise to economic great power status for global competition rules. To this end, a broad overview of Chinese competition law is provided. The contribution thus serves as a very good introduction into the topic. The focus of these comments is on the second part of the article ('Introduction and Modernization of competition Laws in China') as it deals with specific questions of Chinese competition law.

The Antimonopoly Bureau of the Ministry of Commerce (MOFCOM, in Table 2 referred to as 'MOFCOM'), which conducts merger reviews, is not further mentioned in the article. In fact, there is a two-tiered Chinese enforcement structure consisting of the Anti-Monopoly Commission (AMC) and the Anti-Monopoly Enforcement Authorities (AMEAs). AMEAs comprise the three main government agencies MOFCOM, NDRC, and SAIC. AMC is responsible for formulating broad anti-trust policies, whereas the AMEAs are charged with carrying out the main enforcement activities.

The authors rightly observe that much of the precedent and practice issued has focused on merger control. In fact, it is understood that during 2009 MOFCOM issued decisions in 67 cases with only one merger, the purchase of *Huiyuan* by *Coca-Cola*, being blocked. However, in March 2010, the NDRC reported in the Rice Noodle Cartel the first infringement decision for restrictive practices between undertakings according to Article 13 of the AML.

The article places further emphasis on the fact that the rules on price-related and non-price-related infringements considerably overlap as, for example, agreements on market or customer allocation have the manipulation of prices as their ultimate goal, too. The possible overlap concerns both the enforcement responsibility of either SAIC or NDRC but may also become visible in conflicting approaches in the interpretation and application of the substantive rules. In addition, possible legal overlaps may occur between the scope of application of the AML on the one hand, and the Anti-Unfair Competition Law (AUCL) and the Price Law on the other.

Attention is drawn to the fact that anti-competitive behaviour can even entail criminal sanctions in certain cases. As a general rule, violation of the AML may only result in administrative fines being imposed. However, it is, albeit controversially, discussed whether Article 225 of the Chinese Criminal Law may be applied. This provision prohibits 'illegal business activities that seriously disrupt the market order'. If Article 225 were to be applied, this would allow criminal prosecution even for non-hard-core violations such as vertical restrictions or the abuse of a dominant position. As a result, China would have a stricter enforcement system in place than the United States under the Sherman Act. Therefore, it remains doubtful whether, in the future, Chinese competition rules will be criminally enforced on a consistent basis.

The availability of leniency is stated without any further background information. The AML (Article 46) explicitly permits the granting of leniency for cartelists that 'on their own initiative, report information concerning the conclusion of monopoly agreements and provide important evidence' to the authorities. Interestingly, on its face this provision is much broader than comparable provisions in the U.S and in Europe, since a ringleader, too, may benefit from the leniency program.

No mention is made of private litigation as an enforcement tool for the Chinese competition rules. The AML (Article 50) provides that 'undertakings that cause loss to others as a result of their monopolistic conduct shall be liable for civil liabilities in accordance with the laws.' In the recent past, several private lawsuits have been brought under the Anti-Monopoly Law (AML).

Finally, it must be noted that the AML merger provisions grant considerable leeway to MOFCOM with respect to wider policy considerations. Art. 27 of the AML mentions the 'development of the national economy' as one of the factors relevant in the substantive review. Moreover, Article 31 of the AML provides for a separate national security review of transactions involving foreign investors. Criteria that must be taken into account

are, amongst other ones, the impact of the concentration on China's economic stability or its social order (see Notice of the General Office of the State Council on Establishing the Security Review Mechanism for Merger with and Acquisition of Domestic Enterprise by Foreign Investors). To be sure, comparable reservations exist in U.S. and in European merger control. Thus, according to Article 21(4) of Regulation 139/2004, Member States may take special measures to protect legitimate interests such as public security, plurality of the media and prudential rules. But still, the Chinese provision in question appears to have been couched in a broader way. It may thus be taken as an example for a more cautious Chinese approach to an open-market competition policy in general.

Generally speaking, Chinese competition law is to a much larger extent based, based on state intervention than the competition laws of the Western jurisdictions. In this context, a case may be mentioned that is pending before the United States District Court for the Eastern District of New York in which four Chinese companies have not contested the allegations that they colluded to limit production and fix prices of Vitamin C in the United States. But they invoked the foreign sovereign compulsion doctrine, arguing that the Chinese government forced them to conspire. China's Ministry of Commerce confirmed that the four companies were compelled to coordinate their conduct by Chinese law (*Jane Lee*, 2010 *Virginia Journal of International Law*, 758 ff.). With regard to the authors' final conclusion that a change of global competition rules may be required, the question arises which set of 'global competition rules' they refer to. From a legal point of view, it could be argued that, until now, no global competition rules have been developed, but only national or regional competition regimes that are extraterritorially applied. It appears that the contribution of *Pierrette Gaasbeek* and *Peter van Bergeijk* equates at least to a certain extent the principles of an open-market economy (Washington Consensus) with a set of purportedly globally recognized competition rules. To make the authors' argument more compelling, some further clarification of this notion could be helpful. Reference could be made, for example, to the Recommended Practices adopted by the ICN such as dominance/substantial market power analysis pursuant to unilateral conduct laws, the UNCTAD Model Competition Law or the OECD recommendations. For the sake of order, it must be added that such sets of rules constitute only soft law. If these global competition rules were indeed to change, an interesting question would be what this would look like. It could be argued that Western countries would be tempted to change their own competition rules and, in particular, become more leni-

ent towards state intervention. A recent example suggesting that such a conclusion may not be too far-fetched is the UK, which, in the middle of the financial crisis, introduced a new public interest ground of preserving financial stability in order to clear the Lloyds/HBOS merger. One must not overlook in this regard that, before the achievement of the Washington Consensus, Western countries frequently allowed the state a considerable role in competition policy. It might be that China whose competition policy is in its infancy will later move to a more market-oriented solution. For the foreseeable future, one will, however, have to assume that China will stick to its actual policy. Therefore the question comes up indeed whether this policy will have repercussions on the set of global rules which, in one form or the other, is emerging.

COMMENT

PETER FREEMAN*

Competition policy in an international setting

I take much pleasure in contributing to this *Liber Amicorum* on behalf of Pieter Kalbfleisch, a trusted friend and colleague. I am asked to comment on ‘International Co-operation of the NMA with authorities in developing and emerging economies’ and specifically on an essay by Peter van Bergeijk and Pierrette Gaasbeek entitled ‘Chinese Competition: Do We Need a New Competition Policy Regime?’

There can be little dispute that in the coming years and decades, it will be very important both for China and its (potential) trading partners around the globe that a clear and coherent competition policy is developed and applied within China and in its external relations. That policy may not need to be an exact clone of predominant global competition policy, but it probably does need to be broadly consistent with it.

China clearly recognises that a competition regime is a key element in supporting industrial development. As described in the essay, China has in recent times taken the admirable step of adopting a series of competition laws. At this time of consolidation of these major initial steps, it is particularly important that the application of the new laws should command the confidence of all concerned, both inside and outside China.

* Peter Freeman has just stepped down as Chairman of the UK Competition Commission.

It is likely that particular attention will be paid, for example, to any sectoral exceptions from the scope of competition law, to the practical application of merger controls to international transactions and to any overlaying public-interest criteria. It is common in most countries for the interests of national security to be taken into account in the application of competition law, and on occasions to override it. Given the significance of China for the world's economy, how the competition regime in China develops in relation to such matters will be watched with interest by all observers concerned for the successful implementation of the new laws.

In seeking to grow domestic wealth to the benefit of its citizens, China will no doubt continue to encourage investment from, and to trade with, other countries many of which already operate with developed systems of competition law. But of course, a full market economy may not be the goal of all countries, and other values and ideologies can be of great importance. How to accommodate China's particular aims and culture in the context of global trade and competition policy will be a key question in which the global competition community should provide as much informed and constructive encouragement as possible.

The essay notes 'the Chinese approach of gradual and experimental change'. Other countries may take their lead from China. The more that the introduction and application of effective competition policy in China works alongside and consistently with international policy, the greater the encouragement of other parties to implement the same.

Such encouragement can be achieved on many levels, including through co-operation amongst national competition authorities. The sharing of experience from countries with established regimes may assist with the learning and experimentation process within China. For example, following publication of an article by the NMa's Chief Economist, Jarig van Sinderen, together with Astrid Severijnen, regarding the new Chinese Competition Act, the NMa was privileged to meet with the Chinese Ambassador in 2009. Another example is the Memorandum of Understanding signed in January 2010 by the UK's Office of Fair Trading (OFT) and China's National Development and Reform Commission (NDRC) to promote co-operation between the two authorities. The OFT signed a further Memorandum with the Chinese State Administration for Industry and Commerce (SAIC) in March 2011 and expects to sign an agreement with the Ministry of Commerce (MOFCOM) in June 2011.

Global organisations also provide a forum for China to derive further ideas and learning on best practice in competition law and policy. China acceded to the WTO in December 2001, and its influence will increasingly

be felt within international competition bodies such as the ICN (the NMa is kindly hosting the ICN annual conference this year) and the competition committee at OECD. This development will be of mutual benefit.

In conclusion, I endorse the overall tenor of the essay that the international competition community should support China in taking, in a timely fashion, the necessary steps along the path to full application of competition law and policy consistent, so far as possible, with global best practice and with China's existing and emerging goals and values. The NMa, under the tutelage of Pieter Kalbfleisch, has already shown its willingness to assist in this process, playing a valuable role in promoting competition policy in an international setting.

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Notes

- 1 The point is of course not that everybody was happy with the system. Many critical voices were raised. A clear example is Stiglitz's Nobel Price Lecture (Stiglitz).
- 2 Actually, the Big Bang approach may have been politically motivated by the desire to permanently destroy the power structures of the Communist Party and set irrevocable steps towards private production (and a way from the big conglomerates of state owned enterprises).
- 3 This did not only have implications for the pricing policy for, e.g., raw materials, but also for the exchange rate.
- 4 According to Lin et al. (1998, p. 425) the share of the township and village enterprises in total industrial output increased from 7% in 1973 to 31% in 1996.
- 5 The only exception is a short phase of stagnation due to the Asian Crisis in 1997-8.
- 6 'Declaration on the Start of a Dialogue on Competition by the EU and China' and 'Terms Of Reference Of The EU-China Competition Policy Dialogue' document available at <http://ec.europa.eu/competition/international/legislation/china.pdf>.
- 7 See Van Bergeijk and Haffner 1996, pp. 22-30 and especially Table 2.2 for an impression of this spaghetti bowl.
- 8 Hong Kong, Taiwan, South Korea and Singapore.

PART

4

Competition and the courts

The courts and the art of concentration

MONIQUE T.P.J. VAN OERS AND
ANKE S.M.L. PROMPERS*

Introduction

When the Competition Act entered into force in 1998, a new model of legal protection was introduced in the Netherlands. The Competition Act provides for judicial appeal in two instances with a concentration of jurisdiction in a single court, not only at the highest level but also in first instance, i.e. at the level of the District Court. The District Court of Rotterdam is awarded exclusive jurisdiction in appeals directed towards decisions of the Netherlands Competition Authority (NMa).¹ If exclusive jurisdiction had not been awarded to the District Court of Rotterdam, decisions of the NMa would have been open to appeal in one of the 19 District Courts of the Netherlands, depending on the place of residence of the companies involved. All rulings by the District Court of Rotterdam may be appealed before a higher court, the Trade and Industry Appeals Tribunal (Appeals Tribunal) in The Hague.

The main reasons for the concentration of jurisdiction were the limited number of cases expected to be presented per year and the specialised character of competition law (involving economic concepts such as relevant market, market power, and dominant position). The concentration of jurisdiction was thought to allow for a swift development of expertise, and to guarantee continuity and uniformity.²

After more than 10 years, the question may be asked whether the reasons that led to the concentration of jurisdiction have indeed proven to be valid after all. Another question is whether the specialized courts have contributed to the development of competition law in the Netherlands. We will focus on these questions from different perspectives. First, however,

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we will further elaborate on the issue of jurisdiction in two instances and the selection of the exclusive courts.

Exclusive jurisdiction in two instances

Under the Dutch Competition Act, the NMa may issue fining decisions. Like fines imposed by the European Commission, fines imposed by the NMa are considered to be punitive sanctions. The mere fact that fines are imposed by an administrative decision does not deprive them of their punitive character. In 1978, the Netherlands ratified the International Covenant on Civil and Political Rights (ICCPR) of the United Nations. According to Article 14(5) ICCPR, everyone convicted of a crime shall have the right to his conviction and sentence be reviewed by a higher tribunal according to law. In this view, the Dutch legislator took the position that fining decisions of the NMa must be open to appeal and higher appeal.³

In the Netherlands, the Appeals Tribunal is an administrative court which rules, in first and last instance, in matters involving administrative decisions relating to specific rules and regulations for trade and industry.⁴ Quite often, the Appeals Tribunal deals with issues involving EU law. From the start, the Appeals Tribunal was therefore regarded to be well suited to deal with competition matters. Nevertheless, because of the requirements resulting from Article 14(5) ICCPR, jurisdiction could not be assigned exclusively to the Appeals Tribunal. Instead, it was decided to award jurisdiction in first instance to (the administrative Chamber of) the District Court of Rotterdam.⁵ As a result, the Appeals Tribunal kept its special position in economic matters, though as a court of appeal. The District Court of Rotterdam acquired a new, special task. Up to that moment, the court of Rotterdam was not awarded any special jurisdiction whereas the courts in The Hague and Amsterdam already had been assigned special jurisdiction in other areas of law.

Limited number of cases?

Based on the existing practice of the European Commission, the Dutch legislator expected legal appeals in about 10 to 15 competition cases per year. This was considered a small number which, taking together with the expected complexity, would justify concentration of jurisdiction.

Table 1 shows the number of cases dealt with by the courts over the last six years.

TABLE 1 Number of cases dealt with by the courts

	Total Competition Act cases	District Court	Appeals Tribunal
2010	35	11	24
2009	35	29	6
2008	39	33	6
2007	23	17	6
2006	18	13	5
2005	25	22	3

Until 2007, the number of cases was around 20 cases a year which brings the input and output in line with the expectations at the time the law was created. In 2008, the number increases substantially due to appeals against the large number of construction cases the NMa dealt with between 2004 and 2007.

In this period, the NMa issued more than 1,200 fining decisions involving construction companies. After initial investigations and information from a whistleblower, it became clear that cartel practices were widely spread within the Dutch construction industry. Upon a call from the Dutch government to come forward and become clean, more than 400 leniency applications were filed with the NMa. The NMa then took the position that it would not suffice to single out a couple of companies involved in cartel activities. In order to provoke a fundamental change in the sector, it had to initiate proceedings against all companies involved.⁶ All fining decisions could subsequently be challenged by the company involved. Although the appeals-ratio was lower than normally in competition cases, the construction cases led to a large number of appeal cases in the period 2008-2010: of the 1,200 fining decisions, approximately 5% was challenged before the Court in Rotterdam, in most of which cases subsequent higher appeal was lodged before the Appeals Tribunal.

It may be concluded that, over the last years, the construction cartels have resulted in a higher number of appeals cases than expected when the Competition Act entered into force. One could argue that this was an exceptional situation. On the other hand, one can not rule out similar situations in the future. In addition, the powers of the NMa under the Competition Act have been increased over the years as a result of amend-

ments to the law. Since October 2007, the NMa is authorized, for example, to impose fines on individuals who take a key position in the cartel behaviour of their company. Hence, the number of fining decisions of the NMa could increase and exceed the number predicted by lawmakers.

The question is whether the fact that the number of competition cases may not remain as limited as originally anticipated by the legislator will invalidate arguments in favour of exclusive jurisdiction to single courts.

Development of expertise?

Although competition law is a fairly new field of Dutch law, competition law is not new to lawyers in the Netherlands. When the Competition Act entered into force, a lot of Dutch lawyers already had an existing practice in European competition law and were well aware of the case law of the Courts in Luxemburg. Judges equally encountered European law issues in various fields of their practice. There was, therefore, not an absence of direct applicable knowledge when the selected courts started to practice their exclusive jurisdiction in competition cases. In addition, from the start, judgements of the District Court of Rotterdam and the Appeals Tribunal have been analysed in detail and commented upon in professional journals. It is, therefore, fair to say that competition law in the Netherlands was in a good starting position for further development.

In addition, once exclusive jurisdiction was awarded, the Court in Rotterdam has given due dedication to the training of its judges and the development of its expertise. The Court established an Expert Centre for Financial and Economic Law, which organises courses and training for judges (from Rotterdam or other courts) involved and/or interested in legal and economic issues related to competition law.⁷ Within the Court, competition cases are dealt with by a (fairly small) special team of judges and their assistants. This team may also call upon (part-time) external judges with special expertise in competition law.⁸

An interesting question that is put forward every now and then is whether the courts in competition cases should include members with an economic background (economists). As competition law is characterised by economic theory and principles, a call for more economic expertise is understandable. In our view, however, the judges in the special courts (Rotterdam and Appeals Tribunal) have demonstrated to be able to develop sufficient (economic) expertise to deal with the competition cases at hand. Often, what is needed is not more economic theory but more insight in the relevant facts, in particular the markets at stake and their

characteristics in relation to the facts constituting the alleged infringement. Over the years, the courts seem to have become more critical towards the NMa's assessment of the facts that are presented to support the suggested theory of harm related to the alleged infringement. Insofar the courts need further information on economic concepts or theories, they can call upon the parties or independent experts to present economic reports. The assessment of the facts in view of such theories remains crucial. We consider this typical qualities of a lawyer-judge.

Due to the system of permanent circulation of positions, which is common within the Dutch judiciary, judges regularly change position. Switches within a period of four years are common. Positions within the specialized team of the Court of Rotterdam, however, seem to be more long term. We welcome this situation. In addition to the involvement of specialist outside judges, the institutional framework (Expert Centre) and working methods of the team, it fosters the continuous development and sharing of expertise.

A recent study carried out by Radboud University Nijmegen shows, more generally, that the establishment of special courts is considered to contribute to the substantive quality of their judgments.⁹ Concerning the special courts for competition cases, the researchers held expert meetings and interviews with various stakeholders: companies involved in competition procedures and their lawyers, the NMa and also the judges of the Rotterdam Court and Appeals Tribunal. All parties agreed that the concentration of jurisdiction was necessary to develop the required expertise. Although not each individual case may be considered complex, the fact that all competition cases are judged in a consistent way contributes to the overall (increasing) quality of the jurisprudence in competition law.¹⁰

Development of a common practice

Practical issues related to legal proceedings in competition cases were not given any consideration in the debate on whether to establish specialized courts or not. After more than ten years of experience, however, we can say that the actual practice in competition cases is characterized by unique features. The concentration of jurisdiction has been helpful to develop – where possible in consultation between the court and the NMa – a satisfactory approach to deal with these features in a relatively short period of time.

Competition cases typically involve more companies in one case (cartel cases) and often consist of very large files. In addition, these files consist

of data that may include large sets of business secrets (particularly in abuse and merger cases). Companies involved often do not wish that such information is revealed to other parties. Under the applicable rules of administrative law, the NMa must submit its files to the court, unless there are compelling reasons not to do so (Article 8:29 General Administrative Law Act). As companies fear the intervention of competitors or complainants, they often claim the existence of such compelling reasons. On the basis of experiences in early cases, the NMa and the Rotterdam Court have been able to develop an efficient way of handling files and a customized Article 8:29-test, which is satisfactory to all parties involved.

Another example is the construction cases. Potential administrative difficulties here lay in the waiting periods as the files were enormous and, to a certain extent, interrelated. Moreover, many companies were directly or indirectly involved in various cases. The practical handling of these cases was a challenge to the NMa, the parties, and the court. For a smooth operation, it appeared essential that the Court of Rotterdam had a clear view of the way the NMa had organised its files and administrative procedures and how to handle the Article 8:29-tests in competition cases. Both the NMa and the parties could confine themselves to the arrangements and time scheduling of the Court of Rotterdam. It is almost certain that proceedings in the construction cases would have been more time-consuming and would have resulted in misunderstandings and frustrations on the side of the companies, the NMa and the courts if the appeals had been scattered around in District Courts throughout the country. Furthermore, from a cost perspective, the concentration in Rotterdam may be considered beneficial: a multiplication of the files was avoided, and various hearings could take place in one day before the same judges.

Worth mentioning is also the pilot project of the District Court of Rotterdam concerning digital files and procedures. Considering the size of most competition files, the NMa was happy to participate in this project. Due to some teething troubles, the District Court has not yet been able to formally adopt digital operations in all its proceedings. The NMa believes, however, that, in the near future, competition cases will consist of electronic files (also during the administrative proceedings within the NMa). The NMa, therefore, favours further testing of the possibilities of electronic files by the District Court and the Appeals Tribunal.

Continuity and uniformity?

As follows from the foregoing, the legislator clearly opted for a concentra-

tion of competition cases before the District Court in Rotterdam and Appeals Tribunal. Indeed, most cases involving the application and enforcement of the Competition Act by the NMa are subject to appeal before these courts. In some cases, however, the NMa is summoned before the District Court in The Hague. In addition, Districts Courts throughout the country may be called upon to apply competition law in legal disputes between civil parties. Does this harm the exclusivity of both the Rotterdam Court and the Appeals Tribunal?

The special jurisdiction awarded to the Court in Rotterdam is centred around administrative decisions of the NMa. From its rulings, it follows that the District Court considers its jurisdiction strictly limited to formal administrative decisions of the NMa. In practice, however, the NMa also engages in factual conduct and preparatory acts. In fact, crucial steps in its investigations do not involve a formal administrative decision. For example, inspections at the premises of companies by the NMa (so called 'dawn raids') are not based on a formal administrative decision.¹¹ Hence, the NMa notice by which a dawn raid is announced and the subsequent steps cannot be challenged before the special Court in Rotterdam. Consequently, disputes that may arise during inspections like, for example, disputes concerning the possibility of the NMa to collect certain information and the use of certain digital technologies during the investigation have been brought to trial before the civil court in The Hague.¹² More recently, a company opposing the exchange of information between the public prosecutor and the NMa initiated proceedings for interim relief before the civil court in The Hague.¹³ In the latter case, the court ruled in favour of the NMa, which could then continue its cartel investigations using said information. The fining decision that the NMa subsequently issued is subject to appeal before the District Court in Rotterdam. In such proceedings, the Court of Rotterdam will look into all arguments put forward by the parties, including possible claims disputing the legitimacy of the acquisition of evidence by the NMa, although it may be assumed that the Court will take into account the preliminary ruling of the civil court in The Hague. Nevertheless, we regret the fact that crucial issues related to the (investigative) powers of the NMa cannot be brought to trial directly before the special Court in Rotterdam as this court is in a better position to value the merits of the case and the direct consequence of its ruling. The current separation of jurisdiction follows from the application of the legal framework of the General Administrative Law Act for the resolution of issues relating to the Competition Act. We doubt whether the abovementioned consequences were envisioned by the legislator when he

created the Competition Act. We would, therefore, welcome amendments to the law that would extend the jurisdiction of the Court in Rotterdam and the Appeals tribunal to preparatory acts and conduct of the NMa.

Legal disputes between civil parties may include all kind of arguments, including violation of competition rules. Indeed, in commercial litigations, one of the arguments often heard is that the contract at stake is not valid due to its incompatibility with competition rules. Fining decisions of the NMa may also trigger civil disputes. For example, victims of cartel behaviour may wish to claim (follow on) damages from the companies that violated the Competition Act according to the assessment of the NMa. For civil disputes, involving competition law, the regular civil rules on jurisdiction apply. This means that, in the absence of a special arrangement between the parties, the District Court of the district in which the defendant resides has jurisdiction. This implies that potentially all Districts Court in the Netherlands may be addressed to decide upon the application of competition rules. On average, over the last years, the number of civil cases involving competition law issues was around 45 cases per year.

The question is whether these civil cases should be brought to trial in Rotterdam because of the existing expertise of its judges and whether this would encourage civil enforcement of competition law.¹⁴ In civil cases, competition law issues are often just one of the (smaller) aspects of the case at hand. The suggested concentration of cases would, therefore, rather result in a large mix of cases being transferred to Rotterdam than to a sophisticated concentration of competition issues. The general view is, therefore, that the suggested concentration is not desirable. By consequence, in civil cases, all District Courts must be prepared to deal with competition law issues. Although, in our view, there are some cases in which it is apparent that the judge failed to comprehend the full dimension of competition law, the District Courts have been able to deal with competition law issues quite well. Undoubtedly, this may in part be contributed to the Expert Centre in Rotterdam, which is open not only to the judges of the District Court of Rotterdam but also to judges and assistants of other courts.¹⁵

The NMa may also play a role in civil proceedings. Following the adoption of EU Regulation 1/2003, the NMa (and the European Commission) may, of its own accord, act as *Amicus Curiae* and submit written and oral observations to the national courts on issues relating to the application of EU rules on competition (Articles 101 and 102 TFEU). In the subsequent national implementation, the Dutch legislator did not extend the *Amicus Curiae* role to the application of the national rules on competition.¹⁶ So far,

the NMa has hardly made use of its *Amicus* powers. In fact, the NMa only filed an *Amicus* brief in one case.¹⁷ The civil judge involved explicitly requested the NMa to intervene as *Amicus Curiae* and largely followed the NMa's reasoning in his ruling. Indeed, the *Amicus Curiae* position gives the NMa the possibility to contribute to the further development and a uniform application of competition law. Practice, however, does not show any special need for such intervention because most civil judges, as mentioned, have been able to handle the core concepts of competition law quite well. Difficulties are more related to the discovery and assessment of the facts. This, however, is not the task of NMa acting as *Amicus Curiae*. Moreover, as for the core concepts of competition law, we see evolving contributions of the Appeals Tribunal by rendering instructive judgments (see further below). By doing so, the Appeals Tribunal, i.e. the highest specialized national court, contributes to the uniform application of the Competition Act not only in administrative law cases but also in civil cases.

Development of case law

The last question we wish to address is whether the specialized courts have contributed to the development of competition law in the Netherlands. It is our view that, over the years, the Court of Rotterdam and Appeals Tribunal have consistently elaborated their jurisprudence.

For the development of its enforcement practice, it is crucial for the NMa to get clarity on the interpretation and application by the Court of Rotterdam and the Appeals Tribunal of core concepts of competition law, such as 'restriction of competition (by object or effect)', 'appreciable effect', 'dominance' and 'abuse'. This is closely related to more general issues concerning procedural law and standards of prove and review: how do the Courts apply existing (national) standards in the field of competition? Furthermore, typical for competition law is the issue of economics: to what extent are the rulings of the court influenced by economic theories and evidence?

As the core provisions of Dutch competition law (Articles 6 and 24 Dutch Competition Act) are a copy of the EU rules on competition (Articles 101 and 102 TFEU), the Court of Rotterdam and the Appeals Tribunal can lean on the case law of the General Court and the European Court of Justice in Luxemburg. Although the assessment of competition issues depends heavily on the specific facts of the cases at hand, it is clear that the Court of Rotterdam and the Appeals Tribunal follow developments in de

European case law very closely. Their rulings often include references to recent case law of the Courts in Luxembourg. This approach must be welcomed, in particular in the perspective of Regulation 1/2003, which envisioned a decentralised but harmonised application of (European) competition law.

Landmark cases on the basis of which it may be concluded that EU law is closely followed, are the ruling of the Appeals Tribunal in the *Modint*-cases⁸ on ‘appreciable effect’ and the *Mobile Operators*-case⁹ on the difference between ‘restriction of competition by object’ and ‘restriction of competition by effect’. Already in the early 1960s, the Court of Justice ruled on these issues. The question arose, however, whether this case law was still valid and how it should be applied in modern times, in which there is a call for a more economic approach to competition law. These questions are closely linked to the question to what extent the Competition Authority has to investigate and prove the potential or actual negative effects of the alleged violation of the cartel prohibition. In the *Mobile Operators*-case, the Appeals Tribunal made a reference for a preliminary ruling to the Court of Justice in Luxembourg.²⁰ The Court of Justice ruled that, in case of a ‘restriction of competition by object’, the Competition Authority does not need to prove the actual effects of the contested conduct.²¹ At the same time, the Court of Justice and, subsequently, the Appeals Tribunal ruled that the facts and (legal and economic) circumstances of a specific restriction, i.e. the so-called ‘context of the restriction’, have to be investigated in order to demonstrate that the alleged conduct is likely to restrict competition. This (theoretically) clear distinction between the strict notion of ‘restriction of competition’ and the wider ‘context of the restriction’ was not apparent from earlier case law. Hence, by making reference to a preliminary ruling, the Appeals Tribunal contributed to the further development of case law at EU-level. For the NMa, in its turn, it is clear that in all its decisions it has to pay due attention to the (legal and economic) context in which the alleged restriction of competition takes place.

As for the role of economics, the recent judgment of the Appeals Tribunal in the *CR Delta*-case demonstrates that the Court follows the developments of the European Commission in this field.²² In its original *CR Delta* decision of 2003, the NMa followed the rulings of the Court of Justice in *Michelin II* and *British Airways* on fidelity rebates, which can be characterized as examples of a formal (i.e. legal) based approach of the concept of ‘abuse’. During the national appeal proceedings, the European Commission started a public consultation on the scope of Article 102

TFEU (*cf.* Article 24 Dutch Competition Act). In view of its attempt to modernize the concept of (exclusionary) abuse, the Commission opted for a more effect-based approach.²³ Although the NMa generally favours such an approach, it could not apply this new approach (with retroactive effect) in an ('old') case which was already pending before the Appeals Tribunal. In line with the new approach of the European Commission, the Appeals Tribunal decided that, in abuse cases, the potential economic effects had to be analyzed in order to establish an infringement of Article 24 Dutch Competition Act. Consequently, the fining decision of the NMa for alleged abuse of dominance was annulled as the result of more recent developments at European level. The *CR Delta* case may be seen as an example of the ultimate consequence of the interaction between national and European competition courts/law.

Most crucial in view of development of case law is the standard of proof and review applied by the Courts.²⁴ Although these are procedural matters, which, in general, are considered issues of national law, the *Mobile Operators*-case illustrates that, here too, European law is relevant. In its reference to the European Court of Justice, the Appeals Tribunal put forward a question related to the autonomy of the national courts with respect to the application of national rules on the standards of proof. The Appeals Tribunal seemed to assume that there was room to apply national rules of proof and, consequently, that it did not need to apply the ANIC-presumption developed in EU law in the national *Mobile Operators*-case. The European Court of Justice, however, concluded that the rule of proof embedded in the ANIC presumption forms part of substantive competition rules embedded in Article 101 TFEU, which must be applied in a uniform way throughout the European Union. For the future, we expect the borderline between national procedural rules (including issues of proof) and the European substantive competition law rules to remain under discussion. As a consequence of the interrelation between national law and European law, this will also affect the development of national competition law.

A negative consequence of this interrelation is surely the duration of judicial proceedings. The abovementioned leading judgments, which brought about important clarity on major issues of the competition law, took close to ten years. The *Mobile Operators* case, which started in 2001 has not even come to an end yet. Nowadays, an appeal before the Court of Rotterdam takes one to two years on average. A higher appeal before the Appeals Tribunal takes longer, two to three years on average. Over the years, the average duration of proceedings before the Court of Rotterdam

has diminished. The caseload of the Appeals Tribunal and the relatively small group of its very specialized judges seems to give it less room to solve the issue of the duration of its proceedings.

A suggestion we would like to make to further facilitate the sound development of competition law, is the introduction of an Advocate General to the Appeals Tribunal.²⁵ In the Netherlands, opinions of Advocates General are common in (civil, criminal and fiscal) proceedings before the Supreme Court. So far, Advocates General do not play a role in proceedings before the administrative courts, such as the Appeals Tribunal. Although this would result in an extra procedural step, opinions of Advocates General generally include valuable preparatory instructions, which aim to facilitate the decision-making process by the court. More importantly, in their opinions, Advocates General may put the pending case in a broader perspective and advise on the application and consequences of new developments and new case law.²⁶ Certainly, this can accelerate the development of national competition law, including the related procedural rules. Mr. Keus²⁷ and Mr. Wattel²⁸, both Advocates General to the Supreme Court, have rendered opinions that can be regarded as good examples of constructive contributions to the development of national-law issues related to competition.

Concluding remarks

Within the Dutch legal system, competition law is still a relatively new field of law. Over the last 12 years, however, the practice of the NMa and the subsequent legal proceedings before the courts have resulted in a fair amount of case law. The consistent development of competition law, which is clearly notable, may be accredited to the special Court in Rotterdam and the Appeals Tribunal. A main argument for the concentration of jurisdiction was the expected limited number of cases per year. In practice, over the years, the number of cases may turn out to be larger than expected. Nevertheless, there are sufficient other arguments in favour of concentration, including practical reasons (smooth administrative handling of cases) and the development of consistent case law. These developments not only include competition law concepts but also the application of rules of procedures and standard of proof and review in competition cases. However, for the development of competition law, not only its core concepts and the procedural framework within which its rules apply are relevant, also clarity about the extent of the (investigative) powers of the competition authority is crucial. In view of this, we would

favour an extension of the jurisdiction of the Court of Rotterdam and the Appeals Tribunal so as to include disputes on preparatory and actual conduct of the NMa. The same does not apply to civil disputes. To further develop civil enforcement of competition law, we do not consider a centralisation of jurisdiction necessary. Instead, we would suggest to look for ways to increase the instructive value of judgments of the special courts, in particular the Appeals Tribunal by, for example, the introduction of an Advocate General who, in his opinions, may put the existing law and pending issues in a broader perspective. Assuming that the Advocate General will closely watch the opinions of his (existing) counterparts at the Supreme Court (and vice versa), the introduction of a Advocate General to the Appeals Tribunal may moreover contribute to safeguard the uniformity of the application of competition law both in administrative and civil law cases.

In this paper, we focused on contributions of the Courts to the development of competition law in the Netherlands. We did not give any special attention to the development of an enforcement practice at the level of the NMa. Needless to say, however, that case law of the courts can only develop on the basis of an actively operating Competition Authority. To a large extent, the NMa practice, which allowed for the development of the currently existing case law, came to be under the guidance of Pieter Kalbfleisch as chairman of the Board of the NMa. During the years that we have worked with him, we have come to know and appreciate Pieter as a person who is very conscious of the tasks of a Competition Authority as the protector of sound competition. At the same time, respect for the courts and principles of due process were key elements in the internal discussions we had together before decisions were taken or cases were brought to trial. The balance, which is clear from the NMa practice and its sound track record of cases, may be considered a result of much fruitful debate within the NMa, stimulated by Pieter. As chairman of the Board, Pieter has definitely also made large contributions to the public debate on competition law issues. These contributions together with recent NMa decisions will form the basis for future case law that lies ahead of us.

COMMENT**ERIK VAN DEN EMSTER*****‘Investing in the judicial system pays off’**

In their contribution Van Oers and Prompers essentially conclude that the Netherlands Competition Authority’s experiences of the way the judiciary is organized have definitely been favourable, at least as far as administrative competition law is concerned (to which their contribution is limited). This organization is characterized by the fact that the cases concerned are under the jurisdiction of a single court, both in the first instance (the District Court of Rotterdam) and in appeal (the Dutch Trade and Industry Appeals Tribunal). This jurisdiction is not extended to civil competition cases, and I agree with Van Oers and Prompers that it would not be advisable to do so for the reasons they outline.

The article makes reference to a study – conducted at the request of the Council for the Judiciary – into (briefly stated) ‘customer’ satisfaction regarding what is termed ‘the exceptional, specialized facilities’ for more complex lawsuits. Besides those already mentioned, those include, for example, the Amsterdam Court of Appeal’s Enterprise Division and the Hague District Court’s Patent Division. As Van Oers and Prompers have already described, ‘customers’ appear to be very satisfied. The study clearly shows that investment in such facilities pays off. I am using the word ‘investment’ deliberately here, since it is not one that is normally applied in relation to the judicial system. In fact, there has been little recognition to date that the legal infrastructure, of which the judicial system is a vital component, is of major economic significance. Essentially, it is impossible to act economically without entering into contracts, for instance, or creating by law (e.g. a company is subject to regulation by the Netherlands Competition Authority) various types of legal relationships. The manner in which the rights and obligations arising from those legal relationships can actually be mutually enforced is determined in large part by the performance of the judicial organization. Such performance thus has economic implications. For example, for investors, it is crucial that the judicial apparatus in a country is reliable (independent, impartial and incorruptible). With respect to any disputes with the government or powerful private parties, it must be beyond any doubt that a lawsuit will

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proceed fairly. The duration of proceedings is economically significant, too. The maxim ‘time is money’ applies here as well: waiting for the result of a lawsuit about the validity of a contract or government permit costs companies money. Finally, the quality of judicial decisions is important. Cases involving substantial commercial interests are often complex in nature, and it is therefore imperative that judges have adequate knowledge of the legal area in question from a national and international perspective, as well as of the (real) world beyond. As to the latter point, competition judges must specifically be cognizant of how the business world and, more generally, the economy are structured and operate. Van Oers and Prompers point this out too.

The economic significance of a country’s legal infrastructure is clear for all to see, by no means least of all when it comes to competition law. This law is primarily aimed at maintaining a level playing field for all businesses operating in a market. The degree to which a country is successful at this has direct consequences for how attractive it is for companies to invest and engage in activities in that country. Effectiveness in this sense is partly determined by the performance of the judicial system. The specially designed facilities at the District Court of Rotterdam and the Dutch Trade and Industry Appeals Tribunal have made an important contribution to the effectiveness of the judicial system in the aforementioned sense (speed and quality).

There has long been a desire within the judicial system to also design such special facilities for other complex cases with major economic significance. The existing facilities should be expanded further, and new ones should be added. As a follow-up to the study mentioned above, research is currently being conducted into which new areas should be encompassed.

Moreover, as mentioned, how the existing facilities might be improved further is also being looked at. We would like to have further discussions with those using these facilities, including, of course, the Netherlands Competition Authority. The idea which Van Oers and Prompers put forward in their article of appointing a special advocate general for competition cases is less appealing to me at first glance. Their article makes it clear that ‘customers’ are satisfied about the two special judicial tribunals’ knowledge of the subject matter. Appointing and then providing support for an advocate general would involve the allocation of sufficient resources – resources that could better be used within these tribunals. This is more likely to result in shorter proceedings than the efforts of an advocate general, which, in fact, can be expected to make proceedings

longer. The proposal does not seem to foster legal uniformity, either. How much more legal uniformity can you gain if there is already just one judicial tribunal for each instance? But I'm getting ahead of the discussion. I suspect that Pieter Kalbfleisch would have liked to have his say in that discussion...

COMMENT

MARK B.W. BIESHEUVEL*

Serious doubt

his contribution to Pieter's *Liber Amicorum* raises a number of interesting viewpoints, which certainly merits reading. It also provides a panorama on the role of Dutch and EU courts in the development of competition law in the Netherlands. The starting point is indeed the legislature's choice to award exclusive jurisdiction to a specialised court to supervise the NMA's decisions. The need of special expertise in the analysis of market structures and the effects of restrictions to competition was an important, if not decisive, reason to centralise judicial control in administrative competition matters.

Ironically, the original choice ignored the evident track record of the Appeals Tribunal. In fact, the bill introduced to Dutch Parliament devoted a single provision on judicial protection: presenting the District Court of Rotterdam as the new centre of expertise in first instance; the Administrative Jurisdiction Division of the Council of State would function as the court of appeal. The latter choice was not motivated in the Explanatory Memorandum to the bill. With respect to the Appeals Tribunal, it was casually noted that the possible use of 'its highly and generally appreciated expertise in this area of law' would be a matter of further reflection. Flattering words which, in fact, were nothing but a gratuitous farewell speech to the Appeals Tribunal. Whilst vigorously highlighting the necessity of special judicial expertise in the area of competition law, the authors of the bill actually set aside the Appeals Tribunal, including its solid expertise build-up over decades in the application of competition law and EU law. However, at a later stage in the legislative procedure and at the request of various parties in Parliament, the Council of State was swept away, and so the Appeals Tribunal became the court of appeal in administrative compe-

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tition matters. We will never know how the envisaged concentration and specialisation would have worked out if the original bill had been enacted.

The authors obviously have a point where they conclude that the District Court of Rotterdam and the Appeals Tribunal, sometimes inspired by Community law, have consistently and adequately contributed to the development of competition law in the Netherlands. They also have a point where they mention the duration of judicial proceedings, with the Appeals Tribunal being increasingly unable to set hearings and to render judgments within a reasonable time frame. For that reason, the proposal to introduce an Advocate General to the Appeals Tribunal, albeit tempting, should not be seriously considered until the duration of proceedings is cut back significantly. Otherwise, this extra procedural step will inevitably be part of the problem and not of the solution.

The authors regret that crucial issues relating to the investigative powers of the NMa cannot be brought to trial directly before the District Court of Rotterdam as it is in a better position to assess the merits of the case and the direct effect of the consequences of its rulings. However, such crucial issues can be raised at the level of the Rotterdam Court when it is invited to scrutinise the validity of any decision of the NMa. In this context, parties can bring forward, for instance, that the NMa's fact-finding or evidence is defective as it is based on a fishing expedition or a disproportionate digital search. This is not, however, what the authors have in mind. Thus far, the NMa had to alter its (digital) search methods more than once due to the outcome of civil injunction proceedings. Apparently, the authors recommend abolishing the latter route. There may be plausible reasons to do so, but the authors do not clarify why in this respect the Rotterdam Court is in 'a better position to value the merits of the case and the direct consequences of its rulings'. Nor do they explain why the competent civil courts fail to meet this standard. The civil injunction judgments rendered thus far do limit to some extent the digital search powers of the NMa. But it would be impossible to argue that these judgments were mistaken or lack understanding of their direct effects. Nor did these judgments create a lack of clarity. In reality, the need of clarity is created by the fact that, in daily practice, disputes arise as the NMa interprets the available civil case law as narrowly as possible, whilst companies and their advisors for obvious reasons do the opposite. Thus additional questions relating to the scope of the NMa's powers arise and more clarity is needed. But that is not, in itself, an argument to seek that clarity from the Rotterdam Court alone. The current civil injunction route has the advantage that interim measures can be obtained in first instance and in appeal

without limitation, that is: without the need to await the outcome of main proceedings, which is impossible in the administrative judicial process. Therefore and on balance, the recommendation to abolish an important form of legal protection is open to serious doubt.

Notes

- 1 Section 93 Dutch Competition Act.
- 2 Explanatory Memorandum to the Competition Act (bill 24 707, nr. 3, pp. 100-101).
- 3 This is different for the European Commission. The European Union is not a member to the UN Covenant on Civil and Political Rights. The European Convention on Human Rights and Fundamental Freedoms, which the European Union does respect, does not contain an equivalent to Article 14(5) of the UN Covenant.
- 4 This is contrary to the regular proceedings in administrative cases. In the absence of special courts, administrative decisions may be challenged before the administrative sector of (one of) the District Courts with the possibility of higher appeal before the judiciary sector of the Council of State. In the Netherlands, special courts exist for economic matters (Appeals Tribunal for Trade & Industry) and, in higher appeal, for social security matters (Social Security Appeals Tribunal).
- 5 Article 14(5) of the UN Covenant on Civil and Political Rights limits the right to review in two instances to cases involving punitive sanctions. However, as it is favoured to have a uniform system within a single law, the Competition Act determines that all decisions of the NMA may be appealed before the District Court of Rotterdam with a possibility of higher appeal before the Appeals Tribunal.
- 6 Such an approach would have resulted in a very heavy workload which would have taken many years to deal with. This was not an attractive perspective for both the NMa and the sector. The NMa, therefore, looked for ways to accelerate its proceedings and developed the so-called fast lane procedure as an alternative to its regular sanction proceedings. In the fast lane procedure, the company involved would, in exchange of a 15% fine-reduction, not be allowed to dispute the facts and the assessment thereof by the NMa as set out in its Statement of Objections. This approach allowed the NMa to deal with a very large number of cases in a fairly limited period of time.
- 7 Judges of other courts may be interested in participating as they may be called upon to decide on competition law issues in civil disputes before them.
- 8 Including, for example, *preferendaires* from the General Court in Luxemburg and academics specialised in competition law. In general, individual cases are dealt with by three judges, mostly including one outside judge.
- 9 Research Report of Brocker A., Hawinga T., Jettinghoff A., Klaassen C. and Bakker L., *Specialisatie loont?!*, Research Memoranda of the Raad voor de Rechtspraak, nr. 1/2010.
- 10 The researchers distinguish four dimensions of quality: (a) approach of the parties, (b) impartiality, (c) legal quality of the court proceedings and its

- decision, (d) length of the procedure, Research Report pp. 224-225. In general, impartiality of the court (dimension a) is considered a predominant condition. Subsequently, the legal quality (dimension c) –more in particular the legal quality of the court’s decisions– was considered most important.
- 11 Under EU law, the notice issued by the Commission is considered a decision which can be challenged before the Courts in Luxemburg.
 - 12 In civil cases, the places of residence of the defendant determine which District Court has jurisdiction. As the NMa and the state entity of which it forms part, are located in The Hague, the civil courts in The Hague have jurisdiction in civil cases where the NMa appears as the defendant.
 - 13 *Janssen de Jong Groep BV vs the Public Prosecutor, the NMa and the State of The Netherlands*, Judgement of 26 June 2009 in interim proceeding before the civil court in The Hague. (www.rechtspraak.nl, LJN: BJ0047, 337607 / KG ZA 09-616.)
 - 15 Further contribution to the continuity and uniformity in the interpretation and application of competition law is made by the Courts of Appeal and the Dutch Supreme Court which ultimately rules in civil cases (with, in addition, the possibility of prejudicial questions to the Court of Justice in Luxemburg when interpretation of EU-law is involved).
 - 16 See Article 89 under h. to j. Competition Act and Article 44 Dutch Code on Civil Proceedings.
 - 17 *Distributors vs Kia*, Court of Amsterdam, 3 December 2009 (www.rechtspraak.nl: LJN: BK6496, 437668/KG ZA 09-1941).
 - 18 *Modint*, Trade & Industry Appeals Tribunal, 28 October 2005, AWB 04/794 and 04/829 (www.rechtspraak.nl, LJN: AU5316).
 - 19 *Mobile Operators*, Trade & Industry Appeals Tribunal, 12 August 2010, AWB 06/657, 06/660 and 06/661 (www.rechtspraak.nl, LJN: BN3895).
 - 20 *Mobile Operators*, Trade & Industry Appeals Tribunal, 31 December 2007, AWB 06/657,660,661 en 662 9500. (www.rechtspraak.nl, LJN: BC1396).
 - 21 *Mobile Operators*, Case C-08/08, 4 June 2009, European Court of Justice (ECJ) (www.curia.europa.eu).
 - 22 *CR Delta*, Trade & Industry Appeals Tribunal, 7 October 2010, AWB 07/596, (www.rechtspraak.nl, LJN: BN 9947).
 - 23 Communication from the Commission — Guidance on the Commission’s enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings, OJ 2009, C 45/02.
 - 24 See also Parret L., *Side effects of the modernisation of EU competition law*, Wolf Legal publishers, Nijmegen, 2010, pp. 61-92.
 - 25 This suggestion was also put forward in discussions among experts which were organised by the University of Nijmegen (see footnote ix). Amendments to the General Administrative Law Act (bill 32 450), which are currently debated in Parliament, include the possibility for the Appeals Tribunal to install a full Chamber and/or to appoint a Advocate General in complex (competition) matters.
 - 26 If a court needs specific expertise, it may appoint an (court) experts pursuant to article 8:47 General Administrative Law Act. In 2010, the Court of Rotterdam appointed a chartered account as a (court) expert in NMa case regarding the Weighed Average Cost of Capital (WACC) in the field of regulation of (shipping) pilotage (Court of Rotterdam, 20 January 2011, AWB 08/4739 (www.rechtspraak.nl, LJN:BP 1526).

PART 4 COMPETITION AND THE COURTS

- 27 Opinion of Advocate General Keus to the Supreme Court, 16 January 16, Co7/17oHR, concerning the issue of whether Article 101 TFEU and Article 6 Competition are a matter of public policy (www.rechtspraak.nl, LJN: BG3582).
Opinion of Advocate-General Keus to the Supreme Court, 18 December 2009, o8/00899, on the definition of the relevant market (www.rechtspraak.nl, LJN: BJ9439).
- 28 Opinion of Advocate General Wattel to the Supreme Court, 16 November 2010, HR 10/01358 on the tax deductibility of fines imposed by the European Commission in cartel cases (www.rechtspraak.nl, LJN: BO6770).

The role of economics and economists in the Court

BEREND JAN DRIJBER*

Introduction

At a conference (it must have been around the year 2000), David Edward QC, judge at the European Court of Justice (ECJ), was asked how the Court was able to decide complex cases involving infringements of the competition rules. His short and simple answer was: ‘In the end, it’s a sniff test’. The smell of the case determines the outcome

Competition law is economic law. Yet, for a long time, competition law has virtually been monopolised by lawyers. The reason may be that lawyers ultimately decide whether there is an infringement of antitrust provisions. Lawyers tend to be normative by nature, and often have a preference to classify behaviour in fixed categories: prohibited, admitted, or prohibited unless justified, etc. The first signs that economic reality started penetrating competition analysis stem from ECJ rulings that have been associated with a rule-of-reason approach.¹ In essence, a contractual provision cannot be held to restrict competition if, without that provision, there would be less competition on the market. This was economic thinking in its most embryonic form. I should mention, however, that, from the early 1970s, two intellectual giants, René Joliet² and Valentine Korah,³ argued in their academic writings in favour of a more economic application of what was, at the time, referred to as the ‘common market competition rules’. They were ahead of their time.

The rise of economics and economists

Until the mid-1990s, the effects of firms’ conduct on competition were clearly not at the forefront of DG Competition’s priorities. This attitude

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has gradually changed, under the growing influence of economic theory prevailing in the US and, in my view, also because the Merger Task Force was generally perceived as outperforming the other antitrust directorates in economic analysis in spite of the strict time limits. The older generation of predominantly German officials started losing influence. The analyses of vertical restraints, horizontal restraints and, finally, exclusionary abuses all underwent a transformation towards a more effect-based approach.

An effect-based approach produces better decisions and, ultimately, better rulings. Putting the impact of conduct on consumer welfare at the heart of the analysis also increases the fairness and the legitimacy of the decisions of competition authorities. There is, however, not a single test for determining the likelihood of harm. Much depends on the relevant market and the market power of the companies present on that market. The undeniable downside of an effect-based approach is a lower degree of legal certainty. What matters however is a fair outcome. A 'certain outcome' based on simple rules is clearly not to be preferred over an outcome based on a careful assessment of the impact on competition.

The rise of economics in antitrust cases has not been self-evident. The main reason why policymakers have been reluctant to embrace the effect-based approach too enthusiastically is that, on average, it raises the standard of proof for the competition authority.⁴ The struggle between achieving the best possible analysis of firms' behaviour and maintaining the widest possible control over firms' behaviour may be one of the reasons why the December 2005 Discussion paper on exclusionary abuses⁵ has not been transformed into proper formal guidelines, like the guidelines on horizontal mergers and the guidelines on vertical mergers.

Statistics apparently show that economic consultancy firms nowadays earn more than 15% of their turnover from competition cases.⁶ Each time competition authorities 'invent' new theories of harm, more business opportunities for consultants are created. A feature of most economic studies is that they are based on assumptions that have been chosen deliberately. As one author puts it, economists 'often show great intellectual elasticity'.⁷ That sounds like a polite way of saying that economists, just like lawyers, adopt the assumptions that serve their clients' case. Input determines output. This is perfectly legitimate as long as economists do not suggest that their findings are scientifically proven and therefore 'objectively true'.

The European Courts and economic evidence

In the view of this author, there are no compelling reasons for the ECJ not to support the economic approach followed by the Commission. Key concepts such as restriction of competition, abuse of a dominant position and significant effect on competition are sufficiently wide and flexible to allow for the use of more economics. What has changed compared to the early days is the assessment what conduct *does* harm competition in what circumstances.

In certain abuse of dominance cases, the General Court maintained what one may call a more formal approach. For example, in *Michelin II*, it held that rebate schemes ought to be identical for all customers.⁸ However, in *Tomra*, the General Court examined carefully the Commission's analysis of the structure and the characteristics of the market and the 'suction effect' of the rebate schemes.⁹ Recent rulings in dominance cases show that the ECJ too is willing to follow the lines set out in the Commission's Guidance Paper on Enforcement Priorities.¹⁰ In *Deutsche Telekom*, it accepted the 'as efficient-competitor test' applied by the Commission.¹¹ The ECJ held that the practice of margin squeezing constituted an abuse to the extent that it had an exclusionary effect on competitors who are at least as efficient, to the detriment of consumers' interests. In its bare essence, this test is not really different from the old *Hoffman-La Roche* case ('through recourse to methods different from those which condition normal competition in products or services').¹²

In merger cases, the Commission's decision to appoint a Chief Economist was triggered by the triple defeat in *Airtours*, *Tetra Laval* and *Schneider Legrand* in the year 2002.¹³ The General Court held, in essence, that the economic reasoning underlying those decisions was not sufficiently solid.

Generally speaking, the impact of economic thinking is the least noticeable in the case law on Article 101 TFEU. In *T-Mobile*, the first preliminary ruling in a case to which the NMa was a party, the ECJ gave a very wide interpretation of restriction by object, which is hard to reconcile with an effect-based approach; the mere possibility of reducing competition suffices.¹⁴ The distinction between restriction by object and restriction by effect now seems somewhat blurred. The ruling shows that the ECJ is aware that 'more economics' may result into 'less effectiveness'.

Importantly, the Courts have made it clear that they will not interfere with the complex economic analysis that is necessary to take correct decisions. This means that the Courts cannot substitute their own assessment of matters of fact for the assessment made by the Commission. This holds

true for cartel, merger and abuse cases. Nevertheless, practice shows that the Courts may indirectly interfere with complex economic assessments, for example, by lowering the standard for holding that the Commission had made ‘a manifest error of assessment’ or by finding a lack of reasoning where the facts of the case are simply not convincing.¹⁵ In addition, high fines are likely to cause stricter judicial scrutiny.

The European Courts and economists

Roughly speaking, there are two methods for the European Courts (‘the Court’) to use expert evidence. Either they appoint a neutral expert, or the parties submit expert reports attached to their pleadings. This is basically the system known in continental countries that have a civil-law tradition. There are no specific rules on the qualifications of a prospect expert. Nor are there specific criteria regarding the scientific nature of the evidence.

Appointing an independent expert may be appropriate when the Court is confronted with contradictory information of an extremely technical nature. There are very few examples of the commissioning of an expert’s report in competition cases. A thorough article on this matter mentions the old *Dyestuff* and *Woodpulp* cases as the only known examples.¹⁶ Both cases concerned the proof of a concerted practice in the presence of parallel behaviour. A cartel infringement cannot be inferred from economic data alone. However, economic evidence may be used to corroborate evidence of other material indications of collusion, an obvious example being simultaneous price movements following proven contacts between competitors. Economic evidence may also show that a cartel agreement had little impact (or no impact at all), which may be relevant for the level of fines.

To the knowledge of this author, in none of the high-profile merger cases decided in the last decade did the Court ask for an independent expert opinion. One reason may be that in view of the submissions of the parties there is no need to ask for it. Another reason could be that the Court is reluctant to give the impression that it delegates adjudication to court-appointed experts. A further consideration could be that the Commission, as was just mentioned, enjoys a large margin of appreciation as regards complex economic assessment. The Court may fear that relying on expert evidence will lead to it substituting their appreciation to that of the Commission.¹⁷

For expert witnesses of the parties, the situation is as follows. The formal status of the expert and his report is unclear. There is no system of

examination and cross-examination. There are no rules on admissibility of expert testimony based on the reliability of the methodology used, as were established by the US Supreme Court in *Daubert*.¹⁸ The Court is free to take party expert evidence into account since the procedure is governed by the principle of unfettered evaluation of evidence in front of the Court. Nonetheless, party expert evidence is frequently produced and it definitely plays an important role.

Parties to a cartel procedure may produce economic studies to claim that the cartel had no impact. Such a study will not carry much weight if the Commission's findings are based on documentary evidence. For example, in *Carbonless Paper*, the General Court held that in the presence of evidence of collusion on prices, the Commission was not required 'to examine the details of the parties' arguments seeking to establish that the agreements in question did not have the effect of increasing prices beyond those which would have been observed under normal conditions of competition'.¹⁹ In *Austrian Banks*, the General Court used explicit language to reject the argument that, according to an economic study, the cartel had not led to a higher level of transaction prices than without the cartel: 'it would be disproportionate to require such proof, which would absorb considerable resources, given that it would necessitate making hypothetical calculations based on economic models whose accuracy would be difficult for the Court to verify and whose infallibility is in no way proved.'²⁰

Economic evidence in decisions of the NMa

One might call Pieter Kalbfleisch 'every inch a lawyer'. As a former judge, he is well aware that judges must be convinced on the basis of credible evidence. Economic analysis has, over the years, become increasingly important to the NMa's decision-making. Like its big sister DG COMP, the NMa has fully incorporated economic analysis in the handling of all cases, including cases on restrictive agreements or concerted practices. This is also reflected in the staffing and internal organization of the NMa.

In a number of merger cases, the NMa has been innovative. Three cases are worth mentioning.

In December 2003, the NMa authorized the acquisition by *Nuon* of electricity producer *Reliant* under the condition that Nuon would make part of the acquired production capacity available to the market. On the basis of its market share, the post-merger group would not have a dominant position. The NMa argued, however, that, in times of peak demand, the company was likely to be in a dominant position in significantly more

situations than pre-merger. What was new, but corroborated by evidence, was the concept of ‘time-wise dominance’. The presumed dominant position at those relevant moments of time would enable Nuon to increase prices, inter alia by capacity hoarding. However, the expected effects on prices were entirely calculated on the basis of econometric simulation models. The Dutch courts held that the economic evidence the NMa had produced was not capable of satisfying the required standard of proof.²¹ Since ‘traditional’ factual evidence of present or past behaviour was lacking, the courts concluded that the NMa had not demonstrated that, as a result of the merger, Nuon would have such power over prices in those periods of time it would be dominant that it would be capable of raising prices significantly. Thus, economic models may be useful, but they cannot remedy the lack of ‘real’ evidence.

In August 2008, the NMa unconditionally cleared a merger between *Dutch Yellow pages* and the *Dutch Telephone Directory*.²² This 2-to-1 merger led to the integration of the directory activities of the two companies. An effect-based assessment by the NMa paved the way to this merger clearance, one of the key findings being that a large percentage of advertisers would benefit from the integration of the two directories. Contrary to what one might think at the outset, most advertisers will reach a larger number of ‘eyeballs’ than if they use two separate guides. In addition, it was found that pre-merger the two directory providers exercised limited competitive constraint on each other. The final assessment of the case was, to an important extent, based on economic evidence produced by the parties at an advanced stage of the second-phase investigation.

In May 2010, the NMa unconditionally cleared the takeover of *Alpuro* (number 2) by *Van Drie* (market leader) on the Dutch market for the production and sale of veal. As a result of the merger, the share of the merged group on the demand side of the buyer market for new born calves went up to over 90%. The NMa held that this was not likely to cause a price increase on the downstream market for veal, which is a European market.²³ In the opinion of the NMa, competition on the downstream market is such as to discipline the merged company on the upstream market of ‘inputs’. This is clearly an interesting approach that is largely based on economic assumptions regarding consumer welfare.

Dutch courts and economic evidence

In the Netherlands, there are two specialist administrative competition courts: in first instance the District Court of Rotterdam, and in appeal the

Trade and Industry Appeals Tribunal (*College van Beroep voor het bedrijfsleven*; 'CBB'). Those courts clearly do not see procedural law as something subsidiary to substantive law.²⁴ They apply the General Administrative Law Act (*Algemene wet bestuursrecht*), which is applicable throughout Dutch administrative law.

As in European administrative law, there are *a priori* no limits on the admissibility of evidentiary elements (*vrije bewijsleer*). The administrative courts enjoy quite an amount of 'freedom' to decide whether the administrative body has met the standard of proof. The court will normally require that the administrative body must make his case 'plausible' (*aannemelijk*). The standard of proof is similar to the one in the European proceedings, but certainly not less strict. As stated before, judges must be convinced by credible and 'tangible' evidence they can verify. Economic reports should be drafted and presented in such a way that 'the average lawyer' understands the gist of it.

The administrative courts have the power to appoint a neutral expert to whom they submit questions.²⁵ Like in the European courts, this option is used only very rarely. In spite of that, the CBB in particular attaches considerable importance to a proper economic analysis of the facts of the case. In two rulings of 2005 in vertical cases, the CBB required a more extensive economic analysis than the European Courts did at the time.²⁶ In cases on economic regulation, too, the CBB is receptive to economic arguments. For example, a party that has been identified by Dutch telecom authority OPTA as having 'significant market power' for the purposes of telecom *ex ante* regulation may challenge this finding by producing reports that the relevant market has been ill defined. Several decisions of OPTA were annulled for lack of economic evidence.²⁷

Conflicting reports may have the effect of neutralizing each other, causing the courts to rely on its own analysis. Faced with a battle of reports, courts will, generally speaking, perceive reports published by a public authority such as OPTA, the NMa or the CPB (the economic think-tank of the Dutch government) as objective and, therefore, superior to opinions drawn up at the request of the parties.²⁸

In a case on tariffs advised by trade organizations of psychologists, the NMa had to show how competition on the market would have developed in the absence of the advised tariffs. In other words, the CBB required proving an infringement by using the counterfactual. The NMa submitted an expert report drawn up at the request of the Dutch Ministry of Health, which revealed that, in this segment of the health care industry, providers

compete on prices. The CBb examined the rapport very carefully and concluded that it did not support the NMa's findings.²⁹

In a recent ruling on abuse of dominance resulting from a rebate scheme, the CBb again decided in favour of the applicant, basing its decision on an economic report that had been drawn up at the request of the applicant at an advanced stage of the court proceedings.³⁰

COMMENT

ANNETJE OTTOW AND LOES BREKHOF*

Economic evidence has many faces

In his article, Drijber discusses the economization of competition law and illustrates the intrinsic link between competition law and economics. This link originates in the notion that competition is an economic concept, which brings a rich field of economic debate into the arena of competition lawyers. Consequently, the rise of economics in competition cases has had a significant impact on the enforcement of competition law.

As there is not one universally accepted theory of competition, the theoretical and practical input of economics in competition law is seemingly without borders.¹ This has also been pointed out by Pieter Kalbfleisch, commenting on the frequent confrontation at hearings between conflicting opinions of economic experts: 'We have been forced to go as far as the United States, in order to find 'independent' economists, to test the support for the theories of our internal experts.'² Although the European Courts have made it clear that they will not interfere with the complex economic assessments performed by the European Commission, their influence in this matter is still substantial. Drijber rightly points out that the courts may indirectly interfere by reviewing the overall assessment and the process of reasoning followed by the Commission.

The economic debate in competition cases does not only depend on the choices of economic instruments used for the analysis by the parties involved. The economic arguments that are expressed are also of great importance with regard to the underlying normative approach of economic

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viewpoints on competition. These viewpoints may vary according to the different goals assigned to competition policy.³ It must be acknowledged that different views on the notion of competition and competition policy exert a significant influence on the outcome of the case. Economization does not reflect a standard recipe, but has many different faces with different underlying schools of thought.

The European Court of Justice (ECJ) has influenced this debate by determining the starting points of economic analysis through its interpretation of the goals of European competition law and the specific provisions. This is well illustrated by cases such as *T-Mobile*⁴ and *GlaxoSmithKline*⁵, showing that the analysis of anticompetitive behavior is not only restricted to demonstrating consumer harm, but that it also ought to look at ‘the structure of the market and thus competition as such’⁶. In the *GlaxoSmithKline* ruling, the ECJ ruled that the competition law provisions aim ‘to protect not only the interests of competitors or of consumers, but also the structure of the market and, in so doing, competition as such’⁷. Therefore, it is not just consumer welfare that should be placed as the central goal of competition law, but other elements, too, regarding the impact on competition in the marketplace as a whole may be at stake. Although the focus of the Commission has been on the protection of consumer welfare, the ECJ has opened the door for a broader approach. The European Court made it clear that multiple interests should be served by competition policy, which in turn widens the scope for economic debate.

Drijber believes that the influence of this economization is least noticeable in cases concerning Article 101 TFEU, due to the application of the object-based approach. Here, the question rises whether this is really the case. The object-based approach does not entirely exclude the input of economic analysis in case-by-case assessments. As pointed out by Advocate-General Kokott in the *T-Mobile* case, reiterating the Court’s viewpoints in earlier competition cases, the anticompetitive object of the behavior ‘must be established not in the abstract, but in the circumstances of the individual case, that is, having regard to its specific legal and economic context and the particular conditions of the relevant market’.⁸ Economic analysis thus remains relevant to establish the economic context of the case. Even though a tension⁹ exists between the object-based approach and the full economization of competition law promoting an analysis of the effects, the intrinsic link between competition law and economics shows itself in both approaches.

COMMENT**ESTHER LAMBOO AND MILOU DIJKMAN*****Is the smell of a case determined by an arm-wrestling contest?**

Competition and economics are inextricably linked. In the world of antitrust, we live in an era influenced by the effect-based approach. This approach¹ has its pros and cons. One of the advantages of this trend is that cases can be assessed more and more on their economic merits, thereby providing both legal and economic justifications for decisions. An additional benefit of the effect-based approach is that it leaves more room for competition authorities to take into account so-called ‘public interests’, as well as special circumstances in specific markets. However, this does not take away the fact that this development of economization also has its drawbacks, such as (a) complication of procedures for both the competition authorities as well as the parties involved resulting in longer procedures, (b) a multitude of opinions in one case, where one opinion contradicts the other (‘an arm-wrestling contest’ between conflicting teams of economists), leading to (c) increased legal uncertainty. Besides these drawbacks, the development of economization also implies more research to be carried out by the competition authority, resulting in higher costs and an increasing appeal to the investigation resources of the competition authority. In order to mitigate these drawbacks as much as possible, constant efforts are needed to find the right balance between effective legal protection and the importance of having a decisive competition authority. In that regard, the ECJ’s ruling in the *T-Mobile* case² gives some reassurance to competition authorities, since the ECJ explicitly deals with the risk of, as Drijber puts it, ‘more economy’ potentially resulting in ‘less effectiveness’.

As for the use of economic evidence in cases, we believe that economic arguments should be presented as practical and understandable as possible, and should have a sound connection to the concrete facts of a case. This will enable the courts, as Drijber puts it, to ‘smell’ (the so-called ‘SNIFF-test’) what the case is about, and to include this in their assessment. Naturally, the next question is at what point a judge believes the case begins to ‘reek’, leading him to conclude that competition rules have been violated. In other words, how high is the burden of proof?

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In the NMa's enforcement work, the economization trend has produced a shift in the way investigations into suspected violations of the Dutch Competition Act are conducted. Investigations in cartel and abuse cases have witnessed an increased emphasis on carrying out a so-called context analysis, which basically comes down to the NMa having to identify all the relevant facts in each case. This often means having sufficient knowledge of how the market in question functions, and of the role that the identified behaviour plays therein. In concentration cases, the economization trend has particularly affected the assessment of the so-called efficiency defense. A clear example of the latter category can be found in the merger cases Yellow Pages Netherlands (*Gouden Gids*) and *Telefoongids*³. In general, it is important to remember that every investigation under the Dutch Competition Act must have a certain degree of concreteness, and should be able to progress beyond merely theoretical or abstract exercises.

When validating a theory of harm, for example in a cartel or merger case, the NMa has the option of commissioning an economic market study. In addition, the parties involved also have the opportunity to, and often do, commission economic studies to support their arguments or challenge the findings of the NMa. A case may end up having so many economists involved, that, as mentioned earlier, an 'arm-wrestling contest' between conflicting teams of economists may arise, with each team taking a different position based on economic theories. It will be eventually up to the courts to assess these diverging economic opinions. In this respect, it is important that economic studies are transparent with regard to the chosen methodology and the assumptions on which the results of this study are based. What is clear though, is that the courts demand, in cases where a decision by the NMa relies heavily on economic/econometric evidence (such as economic theories, projections, etc), that this evidence is also sufficiently supported by factual evidence.⁴ This factual evidence should prove that the economic assumptions in the case in question are logical, and are not merely a theoretical or abstract description of the market situation. This has been the outcome of the ruling by the Dutch Trade and Industry Appeals Tribunal (CBB) in the Nuon/Reliant merger case.

As for carrying out a sound context analysis in cartel cases, this has become standard NMa practice by now. A series of court decisions, starting with the Modint⁵ and Secon⁶ cases, and ending, for now, in the T-Mobile case, have made it clear that the NMa is, and can be, expected to identify and look into the actual legal and economic circumstances in each investigation. Be this as it may, one has to be mindful that economization of

competition law does not result in a burden of proof reaching such proportions that it jeopardizes a regulator's effectiveness and decisiveness, if that burden leads to a disproportionate utilization of the regulator's investigation resources. In that context, the NMa (and other regulators alike) has welcomed the ECJ's ruling in the T-Mobile case, not in the least because it drew a line with regard to the scale of the required context analysis in cartel cases. In the end, competition law will always be, as Pieter Kalbfleisch puts it, '*economics in a legal context*', and not the other way around.

Contrary to what Drijber argues, we believe that the ECJ's and CBB's rulings in T-Mobile case make clear that there still is, and should be, a clear difference between restrictions by object and restrictions by effect, and that the level of investigation into the concrete effects differs in those two cases. Nevertheless, these rulings do, once again, stress the importance of identifying the relevant legal and economic contexts in *every* investigation, including cases where, eventually, a restriction by object is established. After all, only after a restriction by object has been established, using the context analysis that has been carried out, further investigation into the behaviour's impact will no longer be needed for establishing the violation. If it is concluded that there is no restriction by object, but possibly one by effect, the investigation into the effects must then be continued.

When looking at antitrust rulings, what has more and more become clear over the years is that, as Drijber rightly points out, the CBB highly values a proper economic analysis of the facts of a case. What exactly such an analysis should entail does not have to be subject of a highly academic debate. At the end of the day, it is about regulators knowing what is going on in a market and how it functions, and, on the basis of those facts, making a plausible enough case as to why certain behavior is not acceptable from an antitrust point of view. Whereas the NMa failed in that respect in the CR Delta case⁷, it succeeded convincingly in the Shrimps case⁸.

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Notes

ARTICLE

¹ Case 26/76, Metro, [1977] ECR 1875.
Case 258/78, Nungesser, [1982] ECR
2015, Case 42/84, Remia, [1985] ECR
2545.

² Professor of Economic Law, inter alia
Liège, Bruges and London (King's
College). From 1984 until his death in
1995 judge at the ECJ.

- 3 Professor Emeritus Competition Law, London (UCL), Bruges (Collège d'Europe), and New York (Fordham). She is the author of one of the most lucid textbooks on competition law.
- 4 See for an analysis of this phenomenon under Dutch national administrative law, Ottow & Doing 2008.
- 5 DG Competition discussion paper on the application of Article 82 of the Treaty to exclusionary abuses, Brussels, December 2005.
- 6 Neven (2008).
- 7 Castillo (2009), p. 558.
- 8 Case T-203/01, Michelin, [2003] ECR II-4071. See also Case C-95/04P, British Airways, [2007] ECR I-2331.
- 9 Case T-155/06, Tomra, judgment of 9 September 2010, n.y.r. in ECR. See also Italianer 2010.
- 10 Guidance on the Commission's enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings (OJ 2009, C 45/7).
- 11 Case C-280/08P, Deutsche Telekom, judgment of 14 October 2010, n.y.r. in ECR.
- 12 Case 85/76, Hoffmann-La Roche, [1979] ECR 461.
- 13 Case T-342/99, Airtours, [2002] ECR II-2585, Case T-5/02, Tetra Laval, [2002] ECR II-4381, Case T-310/01, Schneider Legrand, [2002] ECR II-4071.
- 14 Case C-8/08, T-Mobile, [2009] ECR I-4529. See the annotation by Gerbrandy 2010. Interestingly, Loozen (2009) argues that that T-Mobile precisely shows that the Court follows a more economic approach than in the past.
- 15 See, e.g., Joined Cases T-70/92 and T-71/92, Florimex, [1997] ECR II-693. The CFI needed 30 paragraphs to find that no adequate reasons had been given (paras. 139 – 169).
- 16 Barbier & Sibony (2008), p. 949.
- 17 Barbier & Sibony (2008), p. 951.
- 18 In sum: can the theory be tested, peer review, rate of error and wide acceptance. US Supreme Court *Daubert v Merrell Dow Pharmaceuticals* 509 U.S. 579 (1993). See Lianos (2009).
- 19 Case T-109/02 a.o., Bolloré and Others, (2007) ECR II-947, para. 451.
- 20 Case T-259/02 a.o., Raiffeisen Zentralbank Österreich, [2006] ECR II-5169, para. 286.
- 21 Rechtbank Rotterdam 1 June 2005, LJN: AT6440 and CBB 28 November 2006, LJN: AZ3274.
- 22 NMa decision 6246 of 28 August 2008, appeal withdrawn. See Camascasa (2009) and Visser & Bishop (2009).
- 23 NMa decision 6891 of 4 May 2010, appeal pending.
- 24 See for an extensive analysis, Gerbrandy (2009).
- 25 Article 8:47 Algemene wet bestuursrecht. For a recent (and rare) example see Rechtbank Rotterdam 20 January 2011, Loodsencorporatie, LJN: BP1526. The contested issue concerned the Wacc (permitted return on capital costs in a system of tariff regulation).
- 26 CBB 28 October 2005, Modint/NMa, LJN: AU5316 and CBB 7 December 2005, Secon/NMa, LJN: AU8308.
- 27 See, e.g., CBB 29 August 2006, MTA, LJN: AY7997 and CBB 18 August 2010, Broadcasting distribution, LJN: BN4243.
- 28 See, e.g., President District Court The Hague, 22 March 2006, NL. Tree/KPN, LJN: AV6314. Faced with conflicting reports produced by the parties this civil court relied on an opinion by OPTA.
- 29 CBB 6 October 2008, NMa/NIP a.o., LJN: BF8820. Ottow, A.T. and E. Doing-Bierens, Enige contouren van het economisch bewijsrecht, *Jurisprudentie estuursrecht plus*, 10, 2008, no. 4, pp. 170-187 (Ottow & Doing, 2008). Visser, M. and S. Bishop, When One is Enough? – Effects-Based and Efficiencies Analysis in practice, *European Competition Law*

Review, 30, 2009, no. 9, pp. 403-406 (Visser & Bishop, 2009).
 30 CBB 7 October 2010, CRV/NMa, LJN: BN9947.

COMMENT 1

- 1 On the different economic schools of thought of competition analysis see e.g. R.J. Van den Bergh and P.D. Camesasca, *European Competition Law and Economics: A Comparative Perspective*, Intersentia, 2001.
- 2 P. Kalbfleisch, 'Competition law and policy for multinationals in a global context: issues for agencies and business', speech given at the Wall Street Journal Competition 2009 Summit, 4 December 2009, Brussels.
- 3 Cf. A. Gerbrandy, 'Case note to Case C-8/08, T-Mobile' *Common Market Law Review*, 47, 2010, pp. 1206-1207.
- 4 Case C-8/08, *T-Mobile*, judgment of 4 June 2009, ECR I-4529.
- 5 Joined Cases C-501/06 P, C-513/06, C-515/06 P, and C-519/06 P, *GlaxoSmithKline*, judgment of 6 October 2009, ECR I- 9291.
- 6 Case C-8/08, *T-Mobile*, judgment of 4 June 2009, ECR I-4529, at paragraph 38.
- 7 Joined Cases C-501/06 P, C-513/06, C-515/06 P, and C-519/06 P, *GlaxoSmithKline*, judgment of 6 October 2009, ECR I- 9291, at paragraph 63.
- 8 Opinion of A.G. Kokott in Case-8/08 *T-Mobile*, judgment of 4 June 2009, ECR I-4529., at paragraph 48.

9 See A. Gerbrandy, 'Case note to Case C-8/08, T-Mobile' *Common Market Law Review*, 47, 2010, pp. 1206-1207.

COMMENT 2

- 1 The NMa actually welcomes this trend, also see the speech of Pieter Kalbfleisch, given on December 4, 2009 at the SAS Radisson in Brussels (can be found on www.nmanet.nl)
- 2 Case C-8/08, *T-Mobile Netherlands and others v. the Board of the Netherlands Competition Authority*, [2009] ECR I-4529.
- 3 Decision of August 28, 2008 by the Board of the Netherlands Competition Authority, case number 6426, European Directories (Telefoongids) – Truvo Nederland (Gouden Gids).
- 4 In this context, see the CBB ruling of November 28, 2006, AWB 05/440, the Board of the Netherlands Competition Authority and Nuon and Essent.
- 5 CBb of October 28, 2005, AWB 04/749 and 04/829, *Modint v. the Board of the Netherlands Competition Authority*.
- 6 CBb of December 7, 2005, *Secon Group B.V. and G-Star International B.v. v. the Board of the Netherlands Competition Authority*.
- 7 CBb of October 7, 2010, AWB 07/596, *CRV Holding and the Board of the Netherlands Competition Authority*.
- 8 CBb of March 17, 2011, AWB 06/672 and 06/681 and AWB 06/599, 06/604, 06/631, 06/671 and 06/673, *Shrimp case*

PART

5

Instruments of competition policy and regulation

What rate of return to allow? Do we truly understand it?

ARNOUD W.A. BOOT AND JEROEN LIGTERINK*

Introduction

Many utility companies and infrastructure companies that have a natural monopoly position are subject to regulation to prevent them from charging excessive tariffs. Examples include TenneT's electricity transmission system and KPN's fixed-line network, which other parties must be able to use through interconnection, and Schiphol Airport's aviation activities that airlines depend on.

Part of the regulation entails determining the maximum return on invested capital that can be passed on. This is referred to as rate-of-return regulation. The maximum rate of return on the invested capital is – in principle – determined such that it matches the rate of return required by the providers of capital (i.e. the investors in the capital market). The underlying idea is that the rate of return on an activity to which a dominant position appears to be attached, must be limited to a level which just matches the required return of investors in the capital market. It should be neither too high nor too low.

In this contribution we discuss how the normative rate of return should be determined and we assess the underlying methodology and theory. Both the determination of the normative rate of return and the application of the theory of corporate finance on which it is based are highly vulnerable to misconceptions. Our aim is to contribute to a better understanding and hence to improvements in the future practice of the rate-of-return regulation.

We also address the limitations associated with the rate-of-return regulation and its methodology. What exactly is the purpose of this approach

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and to what extent is it implemented correctly in practice? Although the subject of rate-of-return regulation may, at first glance, appear to be somewhat technical and perhaps even boring, the many fascinating aspects that it encompasses must not be overlooked. Of interest, for example, is the very basic question as to the precise purpose of regulating the rate of return on the capital that is employed. As already indicated, the rate-of-return regulation is designed to prevent the abuse of a dominant position. At the same time, however, it should provide the right incentives for inducing optimal investment behaviour. That is, if the normative rate of return is set too high, it may induce overinvestment; if it is set too low, it may induce underinvestment. More in general, the regulated party should have optimal incentives to operate efficiently and effectively. The normative rate of return that is imposed and other elements of the 'regulatory package' should not be at odds with this.¹

The investment behaviour is an interesting issue because it directly affects the capital that is employed and therefore the total compensation (in Euros) on the invested capital; this compensation being the normative rate of return times the total (regulated) capital employed (i.e. invested capital). An expanding asset base which does not benefit the end users can therefore be just as damaging for them as an excessively high rate of return.

First we discuss the role of rate-of-return regulation within the cost-plus and price-cap approaches that are common in the regulation of natural monopolies. It is important for the reader to understand that defining a norm for the rate of return plays a similar role in both approaches. Then we deal with the basic principles of rate-of-return regulation building on the core insights from the field of corporate finance. A familiar concept that will be introduced here is Beta as a measure of risk and therefore as a key determinant for the normative rate of return. The higher the Beta, the higher the rate of return required by investors and therefore the rate of return that will be allowed. The section thereafter shows that the normative rate of return can be considered as a weighted average cost of capital (WACC) of debt and equity financing.

Then we discuss the limitations of corporate finance theory. In particular, we consider the extent to which the exclusive focus on Beta as a measure of risk is justified. We continue by discussing implementation issues relating to the WACC and Beta and by focusing on the distinction between single-till and dual-till regulation. This distinction is of importance in situations in which there are related activities that may or may not fall within the scope of regulation. The final section concludes with a few sobering remarks about the stunning importance that the rate of return or WACC methodology has acquired in practice.

Two approaches to the regulation of tariffs

The two standard approaches to the regulation of tariffs are the cost-plus approach and the price-cap approach. In the price-cap approach utility companies may increase prices each year in accordance with, for example, the change in the consumer price index corrected for expected annual changes in efficiency and/or quality. In the cost-plus approach, the price is set such that it covers the company's allowed costs plus a maximized rate of return on its asset base.

Comprehensive and in-depth treatises can be written about the possible differences between the price-cap approach on the one hand, and the cost-oriented approach on the other. These differences are less relevant to this contribution, however, since we focus on the determination of the rate of return on invested capital, which is relevant to both approaches anyway. That is, in the cost-plus approach the return is explicitly added, while in the price-cap approach a remuneration is included for the invested capital that is tied up ('employed') in the activity. Nevertheless, we will indicate differences where they are important. If the price-cap approach is strictly applied, for example, usually more risk remains with the regulated company because it is more difficult to pass on (unexpected) changes in costs. The cost-plus approach is often more accommodating. This affects the normative rate of return on the invested capital, since more risk must be reflected in a higher allowable rate of return. In practice though, one must be extremely cautious when comparing the approaches because, when it comes to implementation, a great variety of hybrid elements are often included that blur the strict theoretical distinction.

Basic principles of rate-of-return regulation

How can one establish the appropriate allowable rate of return on invested capital? To answer this question, a general method is available which results from theories developed in the field of corporate finance. The method is derived from the Capital Asset Pricing Model (CAPM) which has been developed in the 1960s and is the 'workhorse' of corporate finance. Although the model itself requires specialised knowledge to understand, it is easy to explain in terms of use. The model indicates that the rate of return that investors require on an investment in a particular activity equals the (appropriate) risk-free rate plus a compensation for risk, a risk premium. This premium only includes non-diversifiable risk (meas-

ured by Beta). Diversifiable risk plays no role. Why this is the case, at least according to the underlying theory, is explained below.

Risk can be mitigated through diversification, for instance by simultaneously investing in different companies (or activities). Assuming, as is done in the field of finance, that investors are risk averse on average, diversification is a good thing because it reduces risk. In finance jargon, diversifiable risk is referred to as company-specific risk. This concerns company-specific events that do not play a role within a diversified portfolio of investments. That is, spreading investments across a multitude of companies makes this risk 'disappear'; setbacks for one company are compensated by windfalls for another. The important insight is that since investors can avoid being harmed by company-specific risk through diversification, they do not require compensation for it in terms of a higher rate of return. It does therefore not show up in the risk premium.

The non-diversifiable risk, also referred to as market risk, does require compensation. The degree of market risk associated with an investment can be measured by means of the familiar Beta. Market risk refers to the degree of sensitivity to the (world) economy, or the market as a whole. This risk cannot be avoided through diversification.² It must be borne by somebody. While everyone can individually opt to be free of market risk (e.g. by not investing, or by investing in activities that are immune to the aggregate state of the economy), we cannot altogether avoid it. Hence there will always be investors who must bear this risk. This should not come as a surprise, since together we must bear the fluctuations of the economy as a whole.

What does this mean for an individual investor? An individual investor can only avoid market risk by passing it on to someone else. This is the reason that compensation is required for bearing such risk, since other individuals will only be prepared to take it over (and therefore bear it), if there is a compensation for doing so. The more an asset moves with the market, the greater the market risk associated with it, which is reflected in the investment's Beta. A higher Beta means that an investment entails greater market risk, and thus that investors will require a higher risk premium. Beta is based on the idea that, because market risk is non diversifiable, it has a price. In other words, because this risk does not simply disappear, someone must bear it, and that party will require compensation for doing so. In accordance with finance theory, this compensation takes the form of a risk premium in the rate of return required by investors. The risk premium is proportional to the investment's Beta, which is a measure of the quantity of market risk that the investment is subjected to.

Company-specific risk, on the other hand, ‘melts like snow in the sun’ in a diversified portfolio. Indeed, an investor can eliminate this risk through diversification. In keeping with the earlier wording, it is possible to avoid company-specific risk without passing it on to someone else. Hence, no compensation is needed; it can costlessly be avoided by everybody. Thus, the required rate of return is not affected by diversifiable risk.

We have now almost completed the full circle. The normative rate of return with respect to a regulated activity is determined by the degree of market risk associated with the activity concerned. The market risk is the reason for the risk premium that is added to the risk-free rate in the calculation of the required rate of return according to the CAPM. An activity free of market risk is therefore allowed to pass on a rate of return equal to the (well chosen) risk-free interest rate. For an activity with market risk, an additional risk premium applies which is proportional to the activity’s Beta.

A complication is that sometimes a company simultaneously carries out regulated activities as well as other, non-regulated ones. A first step in understanding this complication is how to look at individual activities when they are jointly undertaken by one firm. An important result from the field of corporate finance is that the required rate of return for an activity must be defined solely on the basis of that particular activity’s risk profile. By extension, it follows that if a regulated activity is carried out by a large conglomerate, the risk of the conglomerate as a whole should not affect the determination of the required rate of return on the regulated activity. The reason is that the risk of the conglomerate is affected by all the other activities that the conglomerate undertakes. A separate estimate must therefore be made for the normative rate of return on the regulated activity. That is, the question is how the investors view the activity concerned on its own merits. For finance wizzkids, the core result in corporate finance pertaining to capital budgeting decisions applies: in determining the net present value of an investment project, the expected future cash flows of the project must be discounted against the required rate of return that is determined *solely* by the project’s risk profile and not by the risk profile of the company as a whole.³

Things get more complicated if there are synergies between the company’s regulated activities and other activities taken up by the same company. This makes it more difficult to identify the cash flows that can be attributed to the regulated activities. One such example is Schiphol Airport, where non-aviation activities, such as retail revenues, fall outside the scope of the regulation. For now, it is sufficient to note that it is precisely

this kind of example that can lead to conflicts. Certain non-aviation activities at Schiphol Airport depend to a significant extent on the regulated aviation activities. For example, if there were no flights, there would be fewer retail customers. A question then is whether these retail revenues should not count – at least in part – as returns on the regulated activities (and thus indirectly lower the permitted return on the regulated activities). The other activities could also affect the actual all-in risk profile of the regulated activities. In addition, it might be difficult to attribute investments to one or another activity. These interrelationships are further discussed in the final section of the paper.⁴

Weighted average cost of capital (WACC)

The rate of return allowed under regulation is, in principle, determined by the rate of return that investors or providers of capital would require for the financing of such an activity. In the implementation of rate-of-return regulation, the normative rate of return is linked to a notional weighted average cost of capital (WACC). In layman's terms, it is assumed that the regulated activity is financed as a separate company by means of debt and equity. Assuming a certain (normative) debt to equity ratio, the holders of debt and equity require specific rates of return on their claims. So if we know the debt to equity ratio and their respective required rates of return, we could compute the weighted average cost of capital or WACC. This is explained in the box on the next page.

We have already stated that the required rate of return for the investors (i.e. providers of capital) depends on the risk profile of the activity to be regulated. The division of invested capital into its source, equity and/or debt, seems to be a somewhat unnecessary complication. Why not assume that the entire activity is (notionally) financed by equity only? In principle, doing so should be acceptable because, as Nobel Laureates Modigliani and Miller have taught us, the way in which something is financed is of secondary (if any) importance. That is the risk of an activity must be borne by the providers of capital, irrespective of the way in which the capital is divided. Opting for two kinds of capital – equity and debt, for example – does not alter the total risk of the activity. The only thing that happens is that the risk is distributed in a particular way, allocating proportionally more risk to equity and proportionally less to debt, as debt has priority over equity.

BOX 1 The essence of the WACC method

The weighted average cost of capital (WACC) is the weighted average of the required rate of return on debt (after tax) and the required rate of return on equity, with the market value of debt and the market value of equity as fractions of the total value as weights. The formula is as follows:

$$\text{WACC} = K_d \times (1-T) \times (D/(D+E)) + K_e \times E/(D+E)$$

in which:

- K_d : cost of debt (required rate of return for debt holders);
- T: marginal tax rate;
- D: market value of debt;
- E: market value of equity;
- K_e : cost of equity (required rate of return for equity holders).

The WACC is usually determined on the basis of the Capital Asset Pricing Model (CAPM).

The CAPM states that the required rate of return on an asset or security (debt or equity in this case) depends on the risk-free interest rate and a premium for the non-diversifiable risk, based on Beta as the measure of applicable market risk for that asset. The formula is as follows:

$$R_i = r_f + \beta_i (R_m - r_f)$$

in which:

- R_i : required rate of return on asset i, where R_i is either K_d or K_e ;
- r_f : risk-free interest rate;
- β_i : Beta of asset i, with i being debt or equity;
- $(R_m - r_f)$: market risk premium.

The following variables are important for the determination of the WACC on the basis of the CAPM:

- Risk-free interest rate (r_f)
- Cost of equity (K_e = required rate of return on equity)
- Cost of debt (K_d)
- Leverage (gearing g; equals Debt / Regulatory Asset Base)
- Beta's

The determination of these parameters is far from trivial. A comprehensive appendix detailing the way in which the different parameters can be determined is available from the authors (in Dutch, see www.acf.nl/boot/index.php?id=1; the appendix also contains a bibliography of relevant works).

The choice of capital structure is therefore primarily an issue of distribution, and is not of substantive importance. After all, the weighted average risk of equity and debt is equal to the risk of the activities on the left hand side of the balance sheet. And note that these activities are the source of risk. Risk originates on the left hand side of the balance sheet and gets distributed on the right hand side of the balance sheet. If we recall that providers of debt and equity both require a compensation proportional to the risk they bear, the distribution of risk should not matter for the total compensation that the firm has to pay, and therefore capital structure would not matter. The weighted average cost of capital (the WACC) should therefore – in principle – not be affected by changes in the ratio between equity and debt.

This is the key insight of Modigliani and Miller. There is considerable misunderstanding about this concept in practice, since it is thought that debt is ‘cheaper’ than equity. This is an incorrect way of thinking. Debt only appears to be cheaper because it carries less risk due to the priority it is given. This priority is at the expense of equity holders and makes debt look cheap and equity look expensive. Nevertheless, in regulatory practice, it has become conventional wisdom that a notional capital structure must indeed be chosen in which a certain (maximum) level of debt is chosen such that at least a minimum credit rating is guaranteed.⁵ This limits the amount of debt. It is assumed in the calculations that this partial debt financing leads to a lower allowable rate of return.

In principle, this runs counter to the view of Modigliani and Miller. Modigliani and Miller stress that all the fuss about the ratio between equity and debt is merely an issue of distribution and not substance. In other words, it distributes the risk that is created on the left hand side of the balance sheet over these two forms of capital, but the total risk remains the same, and hence the total risk premium that needs to be paid to debt and equity holders together. The only real justification for the assumption that changing the ratio of equity to debt has an effect, is the unequal tax treatment of debt versus equity. Due to the tax deductibility of interest payments, debt is considered to be cheaper than equity. It is indeed the case that if a third party (the government) ‘contributes’ towards one kind of capital (debt) and not towards the other kind (equity), then financing by means of (more) debt results in a saving for the company. Consequently, there is a justification for the WACC approach.⁶

Is Beta taken too seriously?

While great for finance theorists, including ourselves, to see theoretical concepts like WACC and Beta gain such prominence in reality, some qualifications should be made. It can be questioned whether people are truly aware of the kind of theoretical world that must be created to develop Beta as *the* measure of risk. Among other things, it requires everyone to have the same (homogeneous) expectations about the future and specifically the asset or activity considered. Investors should also experience no ‘frictions’ in their investment decisions, i.e. transaction costs cannot exist. These criteria are obviously not met in the real world.

The use of Beta as the measure of risk requires that investors face no transaction costs because they must be able to spread their investments as optimally as possible without incurring costs and thereby remove the company specific risk through diversification. While in the real world transaction costs are a fact of life, one might say that investors could – in principle – via index funds and ETFs obtain diversification at relatively low cost.⁷

Would this mean that a company is indifferent to diversifiable risk – that is, to company-specific risk? Of course not. Every entrepreneur knows that one is just as likely, or perhaps even more likely, to run aground as a result of company-specific risk than as a result of market risk. This means that companies most certainly take into account company specific risk, and it therefore cannot be simply ignored. This could mean that a regulated activity which through the WACC receives compensation only for Beta, i.e. market, risk, faces insufficient investment incentives because the company concerned experiences other risks that make it reluctant to invest. Such risks could also include fear of a change in regulations imposed by the government for which insufficient compensation is anticipated.

Empirical research shows that also investors take company-specific risk into account. There is no exclusive focus on market risk. The conclusion is that risk is important, and goes beyond market risk. Some modesty is therefore required to ensure that the theoretically watertight distinction between non-diversifiable market risk and diversifiable company-specific risk in the CAPM world is not interpreted in such absolute terms. The practical experience of risk is a more complex phenomenon.

Implementation of WACC and Beta

Apart from the considerations in the previous section, the implementation of WACC and Beta-like concepts is by no means a straightforward affair. The measurability of the parameters of the WACC and the determination of the Beta itself can lead to almost unsolvable problems. For example, what is the Beta of a particular activity? It must accord with how its rate of return will move together with the rate of return on the market as a whole in the future. But how do we know this? After all, it refers to future movements. Often beta is estimated on the basis of historical data. The assumption then is that the type of activity concerned will move with the market in much the same way as it did in the past. If the structure of the economy does not fundamentally change over time, for Beta estimation purposes historical data could give a meaningful direction for the future.

Another important parameter for the WACC is the market risk premium. The market risk premium stands for the compensation *per unit* of market risk that investors – in expected value sense – wish to receive on top of the risk-free rate as compensation for bearing such risk. The market risk premium is the remuneration for the risk that applies to a diversified investment in the market portfolio. The market portfolio is a ‘basket’ of all investments available in the market, weighted according to size. Typically, a particular broad equity market index is chosen for this purpose. The market portfolio has – by definition – a Beta of one.

What is the remuneration for the risk associated with the market portfolio? Once we know that, we can establish the required compensation (on top of the risk free rate) for a specific activity; that compensation equals the Beta of that activity times the market risk premium. Again, we require a forward-looking estimate. The past could serve as a guideline for the future. For example, based on the past, we could conclude that, on average, the equity market performed 4 or 5 percentage point better each year than risk-free bonds.⁸ From this, we could conclude that the market risk premium is approximately 4% or 5%. However, this line of reasoning confuses the past with the future. Why would this average continue to apply in the future?

The issue is, in fact, a more complex one than the relevance of the past for establishing the Beta. The reason is that two diametrically opposed views could be posed as to how the past could be interpreted for the future. Note that both approaches realize that a forward-looking estimate is needed. According to one view, if we have data for the past 60 years and

the equity market performed, on average, x percentage point better each year than risk-free bonds, then this provides a meaningful estimate for the future. Apparently the dynamics in the market enforce such premium, and why would this suddenly be different in the future? After all, we do not have any other 'hard' information, so how could we justify any other estimate?

The problem is that the alternative view leads to diametrically opposite insights. It draws the conclusion that a high estimate of the risk premium based on the past must entail a low estimate for the future. So the future does not follow the past, but goes counter to it. The underlying line of reasoning is as follows.

A high estimate of the market risk premium based on the past means that high rates of return were achieved in the past. A reason for this could be that prices in the stock market have risen due to a decreasing risk aversion on the part of investors. For example, increasing (average) wealth over time might have enhanced the willingness of people to assume risks in their investments. Note that stock prices should have increased in value at the point in time when that decrease in risk aversion manifested itself. This relationship is not difficult to see: people are willing to pay more for the same shares when they are less risk averse.

The past therefore exhibits a high rate of return on the stock market (stock prices increased) but expected future rates of return are lower because of lower risk aversion (and higher starting share prices). This completes the circle. Due to a decrease in risk aversion, share prices have shot up in the past, and this is what can explain the high rates of returns on equity observed in the historical data. From this higher level, however, expectations with respect to future rates of return are correspondingly lower. After all, stock prices have reached a high level from which it is more difficult to achieve a high rate of return. Since investors have become less risk averse, they are willing to accept such lower expected future rate of return, and therefore a lower market risk premium. In this view, the high returns in the past imply lower expected returns in the future!

Thus, there are two possible views on the relation between past and future rates of return, and they are diametrically opposed. This has enormous consequences for the estimation of the WACC. The market risk premium is far from a trivial parameter. It must be noted, perhaps superfluously, that the discussion is not about the validity of the theory but, rather, about the way in which to get to estimates of key parameters in the WACC.

Mixture of regulated and non-regulated activities: dual-till versus single-till regulation

The interrelationship between regulated and non-regulated activities can give rise to considerable complications. In section 3, we stated that only the risk profile of the activity to be regulated must be considered when determining the normative rate of return. How does this apply when the cash flows are interrelated? For example, in regulating aviation activities of airports where investments in aviation can also benefit non-aviation activities, one is confronted with the question how to deal with these synergetic (interrelated) cash flows. This is the issue in dual-till versus single-till regulation. Under a single-till regime, all activities are regulated as part of one integrated bucket, whereas in a dual-till regime regulation applies exclusively to the 'monopoly' activities. In practice, hybrid variants frequently apply.

If a pure dual-till approach is adhered to, then a related activity remains outside the scope of regulation. It could be argued that this promotes entrepreneurship in the organisation because profits achieved outside the regulated part do not come under the rate of return regulation and therefore provide real benefits for the investors and, indirectly, for the managers (potentially higher pay) in the company. This can also be favourable to the regulated activity if it gains as a result, for instance, because such benefits provide an additional incentive to ensure that the regulated activity is performed according to high standards. Schiphol Airport, for example, could have a greater interest in exceptionally clean terminals (part of the regulated aviation activity) to ensure that passengers are more inclined to spend time at the airport in order to visit its shops (the non-regulated activity). The risk here is potential 'gold plating', i.e. that, at the expense of the regulated activity, more is invested in the regulated activity than is socially desirable (excessive cleaning or something else).⁹

A different concern is precisely the mirror image of the entrepreneurship referred to above. Although entrepreneurship sounds good, it can likewise mean that management allows itself to be too distracted by the non-regulated activity and starts ignoring the regulated activity. Countering such distractions could benefit the utility nature of the regulated activity. Another aspect is that entrepreneurship in the non-regulated activity can also mean opportunism of a kind that leads to high risks that impact (threaten?) the regulated activity. If this is indeed the case, the continued existence of a regulated activity can be put in jeopardy by the non-regulated activity. These concerns can be addressed by the single-till

form of regulation, which serves to contain the degrees of freedom in both types of the activities simultaneously, possibly at the cost of less entrepreneurship.¹⁰

Conclusion

One way to interpret this contribution is that it is somewhat surprising how generally accepted the WACC approach is in the rate of return regulation. Many questions can be raised with respect to both the theoretical underpinnings and the practical implementation. The problem, however, is that there is no readily available alternative.

From a theoretical perspective, the WACC is important for inducing optimal investment incentives. But investment incentives are also heavily influenced by other events. A disaster such as the credit crisis that took place in 2007-2009 is a case in point. It does not seem possible to sufficiently fine-tune a regulation method to deal with such extreme circumstances.¹¹

Another legitimate concern about the WACC method is that regulated activities often require long-term investments, whereas remunerations based on the WACC method are usually fixed for shorter periods of time, often for one year or for a certain contract period with a user. The long-term nature of the investments together with the perceived risk from say changes in regulations (a form of sovereign risk) or other circumstances are perhaps not sufficiently taken into account.

One should also be aware that investment decisions are affected by opportunity costs in general. These concern all scarce resources, not only the financial capital on which the WACC method focuses but also other resources like available land, the reach of management and so forth, and particularly the alternative uses of such resources. This latter aspect is of particular importance in situations in which, as discussed in the previous section, there is a mixture of regulated and non-regulated activities in an organisation.

The overall conclusion must be that the popularity of rate-of-return regulation and the precision suggested by the WACC methodology are somewhat surprising. Considering the many pitfalls of the methodology, particularly in its implementation, great care should be taken and outcomes will be far from perfect, whatever the objectives.¹²

COMMENT**WINFRED KNIBBELER*****The doctrine of justum pretium: controversial choices in adopting price regulation**

Should competition authorities aspire to identify a fair price?

The trade-off between short-term consumer welfare interests – that could lead to price regulation – and long-term consumer welfare interests that tend towards not intervening to allow entry and innovation has been a consistent theme in the contributions that Pieter Kalbfleisch has made in the debate on competition policy.¹ A landmark lecture of Pieter in an early phase of his leadership of the Netherlands competition authority was his speech on 4 February 2004, defending the thesis: ‘A justum pretium does not exist’.² In this speech he warned for the temptation for competition authorities to intervene in excessive pricing cases. Pieter reminded many of the approach of US Courts and agencies who do not consider excessive prices anti-competitive and the position of the European Commission³ that competition authorities are not well-equipped to make pricing decisions and that price regulation can have counterproductive effects for entry and innovation, in spite of the text of Article 102 TFEU which prohibits dominant companies to impose ‘unfair prices’.

For sector-specific regulators, price intervention may be unavoidable, in particular in the network industries. If it is clear that infrastructures cannot be replicated, then access to them should be priced. In the Dutch context, this has led to the use of Capital Asset Pricing Models for the regulation of electricity and gas networks, telecommunication infrastructure, airport tariffs, the tariffs for harbour pilots and even the allocation of radio frequencies. Outside the context of sector-specific regulation, the NMa applied Capital Asset Pricing Models previously in relation to specific routes for air carriers, the cable sector and the banking sector. In these non-regulated markets, the NMa seems to have become much more reluctant to constrain pricing behaviour. After 2004, it became increasingly clear that the NMa does not seek the role of a price regulator, and is reluctant to intervene in pricing mechanisms in markets that are not subject to specific regulation.⁴

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Arnoud Boot and Jeroen Ligterink in their article provide an instructive explanation on the theory of Capital Asset Pricing and the WACC methodology and rightfully point out that this instrument has become – also in the regulated sector – too easily accepted without a thorough analysis of the inherent questions, which should form part of applying these models.

The subjectivity of cost of capital studies – and the choices that are implicitly made – deserve a proper debate as can be seen by the recent discussions on the cost of capital applicable to Dutch energy networks and the recent judgment of the District Court of Rotterdam on the WACC methodology for pilotage charges in Rotterdam.

Before discussing these two cases, I raise two questions on the contribution of Boot and Ligterink from the perspective of a competition practitioner.

First, Boot en Ligterink point out that Nobel prize winners Modigliani and Miller have demonstrated that the question whether activities are financed with debt or equity is irrelevant for the cost of capital. Total risk will always be borne by the providers of capital. They conclude that the division between debt and equity is an allocation question that should not be decisive for the calculation of average cost of capital. This theory may be appealing, but, from a practical perspective, raises concerns. Companies can have an inefficient capital structure because equity is generally more expensive than debt, as private equity companies have well understood. Moreover, if equity and debt were equally expensive (after tax effects), it is difficult to understand why, for example, financial institutions still seem to have a strong incentive not to increase their equity very much beyond regulatory minimum requirements. Although the theory of Modigliani and Miller seems plausible, in practice, a benchmark must be identified for an efficient mix of equity and of debt.

Second, in many cases, the real challenge for a valuation based on WACC is to identify a proper ‘peer group’ with a similar risk profile. Debates on a peer group are complex and protracted for this reason exactly.

Illustrative of the inherent subjectivity of cost of capital studies is the debate between the firms Oxera and Nera that was held in 2010 on the appropriate methodology and choices to establish the cost of capital for Dutch energy networks.⁵ This debate was conducted in the context of the regional electricity and gas networks and the national electricity grid. The two reports that are publicly available, and are also easy to read for the non-economists provide valuable insights on the choices that often must be confronted. To select a few topics in the debate: what is the relation be-

tween 'gearing' (relative position of debt to equity in the company) and cost of debt. A gearing level of, for example, 60% may not enable a regulated gas network to fall within a rating class that secures attractive financing. A lower debt rating requires a higher debt premium and, accordingly, these two topics are related and cannot be considered in isolation. Secondly, can past inflation be used as a proxy for future inflation forecasts? Third, incentive regulation as such has a tendency to increase a company's systematic risk compared to a company that is exposed to a cost of service regulatory system. Accordingly, the companies that are used in a 'peer group' to assess beta should be subject to a similar regulatory system. Is the peer group rightly selected? Fourth, in selecting a peer group, the liquidity of the stock concerned seems to be quite important. Fifth – and very surprisingly – even on the equity risk premium for the Netherlands (a general parameter across all sectors) no consensus has emerged between experts. Although the NMa adopted estimates of between 4-6% in the past for the Netherlands, the recent volatility of most capital markets, and also the AEX, point to a higher equity risk premium since 2007. These difficulties are exacerbated because the number of economic experts that are capable of providing a credible and meaningful capital asset pricing and WACC analysis is limited, and these experts operate in a concentrated market themselves. Many of these experts have been acting both for regulators and for market participants and their analyses – even of universal parameters – may result in different outcomes, depending on which side of the fence they have been sitting. Significant discrepancies exist, for example, between the work that has been done in December 2008 to calculate the cost of capital for KPN and work for the NMa which has been done by the same expert in 2010.

What does this mean for the judicial review of the highly technical debates that can occur between the regulators and the regulated in the context of a WACC? The requirement that courts impose is that methods are consistent, based on up-to-date numbers and commonly accepted according to generally accepted economic principles. Recent case law of the District Court of Rotterdam⁶ where a decision of the NMa to adopt a WACC was annulled on the basis of an expert who had been appointed by the District Court of Rotterdam, is illustrative of the fact that, in legal review too, this debate can be constructively held, in particular on matters of consistency. Courts generally should not shy away from a common-sense legal review of the subjective choices that are made.

In view of the inherent uncertainties and subjectivity, which is inherent in applying Capital Asset Pricing Models, competition authorities and

regulators should be prudent when imposing price caps, and should also think very carefully about the valuation of the Regulatory Asset Base to which they apply a WACC. The outcome of any WACC methodology should be that regulated entities have access to capital markets, not only in theory but also in practice. They should be able to finance their activities and they should be able to attract significant sums of capital on a forward-looking basis. Actual market developments and volatility that, for example, are the result of the financial crisis cannot be ignored, because it is ‘a fact of life’ for any company that must attract capital in the financial markets. Regulators should be aware of the different choices underlying WACC methodologies, and if considerable uncertainty exists, should err on the side of caution to allow for sufficient revenues to invest. Judges should be prepared to critically review the choices that have been made and, if necessary, should appoint independent experts to ensure that decisions are based on a robust and consistent methodology. WACC theories are used to regulate the revenue stream of many vital infrastructure assets in modern society. Their application in practice matters.

COMMENT

**PETER PLUG, MACHIEL MULDER
AND LUUK SPEE***

Regulation of return: using finance theory in actual regulation

During the period of Pieter Kalbfleisch** chairmanship of the board, the NMa has continuously developed its method of setting an appropriate return on capital for regulated companies in the energy and transport industry. This method of determining the WACC (weighted average cost of capital) is based on both theory and practical experience.

In their essay, Boot and Ligterink point out that setting a regulatory weight on debt and equity (or: gearing) contradicts the theory of Modigliani and Miller, stating that in a world without tax, the debt and equity ratio is indifferent for the total risk of the firm. It is true that

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** The authors are very grateful to Pieter Kalbfleisch for his guidance, collegiality and friendship which made it highly pleasant to jointly work on regulating the energy and transport industry.

attracting more debt leads to a higher debt premium, which in turn is offset by a lower proportion of the (in general) more expensive cost of equity. In principle, this interaction has a stabilizing effect on the final WACC. However, the theory of Modigliani and Miller does not hold, as the total effect is not a one-on-one relation. This can be shown by extending the model of Modigliani and Miller with taxation. When tax exists and debt gets 'subsidized' by the government, it would be under the Modigliani Miller theory that the rational firm would finance itself with 99% debt. In practice, however, almost all (regulated) firms use lower levels of debt to achieve an optimal level of gearing. Hence, the level of gearing does matter in practice and also in regulation.

Another interesting point of view presented by Boot and Ligterink is on the market risk premium (MRP), stating that using the historical MRP results in too high values. When setting the WACC for a future regulatory period, the NMa has to formulate an expectation about what the MRP will be. Long-term historical data are valuable as an estimator, as the average includes a mix of bull and bear markets, wars, crises and so on. A problem with historical data could arise when there are structural changes in the MRP, such as the change in risk preference mentioned by Boot and Ligterink. Another structural change affecting the usefulness of long-term historical averages is the increased integration of financial markets, leading to better possibilities for diversification (see Dimson, Marsh and Staunton, 2009, p. 8). As a result of this change, the systematic risk decreased resulting in real return on equity of nearly 13% in the 1980-2000 period. According to Dimson, Marsh and Staunton, this phenomenon is incidental and non-repeating, and should be taken into account when using historical data to determine the MRP. The above changes can be a subject of further research for the NMa. Still, in predicting the MRP, the NMa is not just focused on historical data, but complements these with market expectations. This ex-ante approach consists of expectations made by, for example, finance and economics professors and the MRP used by European companies. The ex-ante results are often within range of historical results, and thus actually confirm the use of historical data as an adequate estimator for the MRP.

Another issue raised by Boot and Ligterink is the distinction between systematic and non-systematic risk. The WACC is based on the theoretical idea that investors only need reimbursement for systematic risks. This does not imply that firms do not face non-systematic risks, but that capital markets only give a reward for those risks that cannot be diversified. Why is this theoretical notion used in the actual determination of the WACC?

The reason is that the regulatory frameworks are meant to set regulated revenues such that only efficient costs are reimbursed. By efficient costs, it is generally meant the costs of the most efficient supplier. In the case of costs of capital, this means that the most efficient investor only needs reimbursement of its systematic risks, as this investor has reduced its risks by solving the non-systematic risks in its diversified investment portfolio. Here, the theoretical concepts appear to be very fruitful in actual regulation.

The main question by Boot and Ligterink was whether the NMa ‘truly understand it’ when setting the return in regulation. Overall, we think that the NMa combines theoretical and practical aspects into a proper and reasonable methodology. More important is the judgement of stakeholders about our regulatory approach. From an ex post assessment of the regulatory framework by PwC (2009) follows that this framework enables transmission and distribution companies to finance all the investments they need to do for maintenance and extension of the networks. In addition, credit rating agency Moody’s (Merli, 2010) mentions ‘*the well-defined, transparent, but strongly cost-efficient oriented Dutch regulatory framework*’. Based on the above, it appears that we do understand it.

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Notes

ARTICLE

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| <p>1 In most cases, many other instruments designed to contribute to a desired level of efficiency and effective operations exist simultaneously. Examples include instruments like yardstick competition and a broad range of requirements pertaining to (participation in determining) the investment policy.</p> <p>2 Unless we start trading with Mars and</p> | <p>investors can allocate their investments to both the Earth and Mars. In this case, a degree of diversification of market movements on Earth would be possible by also taking up positions on Mars. After all, the market on Mars would certainly move somewhat differently than the one on Earth. We have not yet reached this stage, however.</p> <p>3 The underlying idea is that the finance</p> |
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- doctrine stresses the importance of value additivity. Apart from synergies in cash flows, diversification within the company is not important. Investors in the market can accomplish this diversification themselves. Therefore, companies can simply specialise in what they are good at and must not themselves diversify. This is also connected to the exclusive focus on Beta risk. In the section 'Is beta taken too seriously', we set out a number of qualifications regarding the exclusive role of the market risk within the finance doctrine.
- 4 In the case of airports, this problem is dealt with in different ways by regulators. In certain countries, single-till regulation is applied, which essentially means that the activities that coincide with the aviation activity are regulated in a single bucket. In other countries, such as the Netherlands, dual-till regulation is applied, which means that aviation activities are in principle considered separately. In practice, a hybrid structure is almost always in place (see final section).
 - 5 The underlying idea is that too much debt causes an excessively high probability of bankruptcy, and that this entails additional costs. In addition to the existence of taxes (see later), such bankruptcy costs are a second deviation from the world conceptualised by Modigliani and Miller.
 - 6 Also in the case of Schiphol Airport (100% government owned), the government tries to secure a degree of debt financing, since the prevailing tax legislation means that such financing creates a saving for the company. In the case of a government owned company, however, this is a bizarre game, since the amount that the company gains as a result accrues to the government as a shareholder, while, at the same time, the same government loses exactly the same amount in tax revenue.
 - 7 Note that investors often incur sizable transaction costs also with mutual funds. This is still one of the puzzles, how such expensive asset management industry can continue to exist.
 - 8 We do not expand on how to define the market portfolio. The market portfolio includes all risky assets. Often the (local?) equity market is chosen as representation for this broader market.
 - 9 The existence of non-regulated activities in a dual-till situation can also mean that a far lower tariff, and therefore a far lower actual return, is deliberately chosen for the regulated activity because, in one way or another, doing so benefits the non-regulated activity. This appears to be akin to offering very affordable hotel accommodation in Las Vegas in order to attract 'captured' customers to the hotel owned casino. In an average Las Vegas hotel, finding the exit has been made as difficult as possible and, insofar as the exit can even be found, it can only be reached after a host of obstructive gaming machines have been negotiated. Another point is that due care must be taken to avoid potential competition-related problems. These may arise if the non-regulated activity becomes inappropriately powerful relative to other providers of this activity that do not simultaneously benefit from having a monopoly on the regulated activity.
 - 10 Single-till regulation appears to be logical only for activities that are related to each other. However, risk can likewise originate from non-related activities and can lead to major financial or other problems that can damage the regulated activity. In this case, it is not illogical to set restrictions with respect to who is permitted to be the owner of a certain regulated activity.
 - 11 In the most extreme case, such a disaster

could mean the bankruptcy of some companies with regulated activities. It is highly unlikely that the government will refrain from intervening in such a case. Consider, for example, Schiphol Airport. If that airport had faced permanently lower air traffic due to the financial crisis or permanent 'ash cloud' problems, what would have happened? The problems concerning the operation of the high-speed railway line between Amsterdam and Belgium are a different but nevertheless pertinent example in this regard. The operator of the initial lease (i.e. the winner in the bidding war for the right to exploit the new high speed rail connection) appears bankrupt. The government, however, might feel compelled to come to the rescue.

- 12 The recent credit crisis is an interesting illustration of the practical and theoretical problems related to the WACC approach. The credit crisis gave rise to a (short term) increase in the market risk premium and the credit spread (i.e. the difference between the cost of debt and the risk free rate). What is the implication for the WACC to be used in regulation? Should it go up? We are of the opinion that one should be very careful to draw implications from

these increases. Financial markets were frozen and companies adapted by reducing their investments, irrespective of the WACC.

COMMENT 1

- 1 Cf. *Consumer welfare, innovation and competition*, Innsbruck, 26 February 2009.
- 2 'Op prijs gesteld, lezing rondetafelconferentie', 4 February 2004.
- 3 Cf. J. Faull and A. Nikpay, *The EC law of competition*, Oxford University Press 2007, para. 4.363-4.365.
- 4 The European Commission was instrumental in blocking proposed retail price regulation by telecommunication regulator OPTA for the cable sector in 2005 (press release OPTA 12 December 2005).
- 5 Cf. OXERA (2010a), *Updating the WACC for energy networks – Quantitative Analysis*, 5 February 2010 and OXERA (2010b), *Updating the WACC for energy networks – Methodology Paper*, 2 February 2010; *Critique of OXERA's Report for the NMA on the Cost of Capital*, 22 December 2010.
- 6 Judgment 20 January 2011, pilotage charges, AWB 08/4730, LJN: BP1526.

Are cost-benefit analyses a tool for decision-making between free competition and regulation?

JAAP DE KEIJZER*

Introduction

In one of the board meetings during the first few months of my tenure at the Netherlands Competition Authority (NMa), Pieter Kalbfleisch mentioned that he had not slept very well the night before. He kept brooding about a remark made during a conference about a decision taken by the NMa. A person had mentioned that the NMa was not enforcing competition policy, but had rather acted as a regulator. Apparently this had a negative connotation. I probably added insult to injury by telling Pieter to get used to this idea: ‘Competition is so 2009! Regulation may be perceived as a (temporary) new kid on the block, but it is here to stay.’

In the year to follow, I noticed on many occasions that the notion expressed above is a pervasive one among competition practitioners: the word regulation is preferably only used in the context of ‘de-regulation’.

In my view, this is too simplistic. There are certain situations where competition law enforcement fails to deliver. In addition, I often, and deliberately, express the view that regulation is inherently as difficult as competition law enforcement, and in some respects, I think, more difficult. A regulator must have knowledge of the specific market involved, take tailor-made decisions, commonly involving various conflicting interests, and has to uphold its independent position in frequent and intensive interactions with actors in the sector and towards policymakers. This is a difficult and challenging balancing act, and quite different from submitting an ex-post intervention (e.g. cartel fine) simply to a court to decide.

In this contribution, I will touch upon various aspects of the interaction between competition and regulation, based upon experience within

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the NMa. In order to stimulate the discussion, I will advocate the role of (appropriate) sector regulation, and to pro-actively use a cost-benefit analysis to determine which coordination mechanism (competition, various forms of regulation) delivers the best results in terms of consumer welfare.¹

A unique institution

The NMa is unique within Europe, in the sense that it combines in one organization both the general competition authority and the regulator for energy and transport. Apart from Estonia, no other national competition authority or national regulatory authority combines both functions to this extent in one organization.^{2, 3} Only the European Commission is in a similar position, as it both enforces EU competition law and develops sector regulation at EU level. In this respect, the NMa is a true (non-financial) market authority, whether markets are free, regulated or in transition from a regulated market to a free market. Why not change its name into the ‘Netherlands Market Authority’, appropriately abbreviated as ‘NMa’?

In my opinion, the combination of general competition authority and (non-financial) sector regulator(s) in one organization, makes the NMa more effective and efficient in its mission ‘to make markets work’, whether these markets are free, regulated or in between. In this day and age, where society appears to have conflicting demands with, on the one hand, a preference for high trust with less rules and bureaucracy, and, on the other hand, a demand for stronger and more effective oversight, an integral approach towards competition and regulation enables an optimal use of know-how, best practices and instruments to deliver tailored results.

Competition and regulation

By definition, competition policy enforcement and sector regulation do not form a happy marriage. They originate from different schools of thought, and also tend to be advocated by different sides of the political spectrum.

Competition policy is based on free enterprise and the notion that competition is the best mechanism to discipline markets, driving companies to be efficient and to innovate, and benefiting consumers in terms of lower prices, better quality and more choice. Competition policy puts an end to cartels, stops companies from abusing their dominant position,

and prevents mergers that may significantly reduce effective competition on the market. Archetypical protagonists of free markets are allergic to intervention through regulation. It represents the fear for 'Big Government', deciding paternalistically what is in the best interest of consumers.

Regulation, typically, has certain underlying policy goals as its objective. These goals may be wide-ranging, such as a transition to a sustainable energy future, protecting vulnerable customers, enhancing the quality of health care, good public transportation, etc. These are all public interests: the question is 'can regulation deliver results in these areas efficiently and against the lowest costs? Or is competition policy better suited for these purposes?' The archetypical advocate of these public-policy objectives will voice skepticism about the ability of 'Greed is Good' capitalistic free markets to achieve such policy goals.

Obviously, reality is often not black and white, but shows different shades of grey over time. For various industry sectors, the pendulum swings back and forth between 'more market' and 'more government regulation'. For many sectors, both are there to stay in some form and degree. And, fortunately, in many cases, competition instruments and regulatory instruments go very well together, or complement each other. Consider for instance the market most naturally associated with a free market: a stock exchange. It happens to be one of the most regulated markets as well.

Major advantages of competition law enforcement are that it relies primarily on the self-regulatory effects of markets, and generally applies to all industry sectors. If a market works well, it disciplines the market participants, and intervention is only needed, mainly ex-post, in a limited number of situations (cartels, abuse of dominant position, mergers which may significantly reduce effective competition). The costs of intervention are relatively low. And in general, there is little or no intervention by policymakers if the market is considered to be a free market. Disadvantages of competition law enforcement are that intervention is usually late, after the fact, the tools (fine, order) are limited and relatively blunt, and procedures take a long time. There is a considerable information advantage of the companies involved over the competition authority, and the burden of proof is high (and tends to become higher when more economic analysis is required).

The attraction of regulation is that it is more predictable. It is forward-looking in setting the rules, and there is a wide range of instruments that could be used, tailored to the specific sector involved. The information asymmetry between the regulator and the sector is still there, but less so,

as regulatory authorities tend to interact more frequently with the actors in the sector and follow developments closely. Regulation, however, usually comes with higher costs of intervention, the question whether the intervention is really efficient, a more political environment in which a regulator has to operate, and the risk of regulatory capture.

Complementary approach towards competition and regulation

In practice, the differences are not as extreme as they seem to be, as both competition authorities and regulatory authorities have taken steps to mitigate the perceived disadvantages of their institutional settings, actions and instruments. Competition authorities, for instance, have become much more active in advocacy, guidance and opinions (including informal ones), have set up departments which closely follow certain industry sectors (e.g. perform sector enquiries) and are using alternative, more tailored instruments (e.g. settlements) more widely. Equally, regulatory authorities are well aware of the fact that extensive regulation can be a barrier to competition, are moving to more light-handed forms of regulation, and have underlined their independence, not only from the participants in the regulated sector, but also from national policymakers.

It is already widely recognized that there are benefits when taking a complementary approach towards competition and regulation.

For the U.S.A., Carlton and Picker⁴ provide a historic overview of anti-trust and regulation as competing mechanisms to control competition. They use the expression: ‘competition has difficulty in saying yes, regulation has difficulty in saying no’ to nicely underscore the relative strengths and weaknesses of competition and regulation.

As to Europe, European Commissioner Joaquín Almunia expressed this complementary approach in a speech in 2010 at the Center on Regulation in Europe:⁵

‘For competition and regulation to play their essential, and complementary, roles in making markets work for consumers, there needs to be close cooperation between regulators and competition law enforcers.’

Also at the national level in the Netherlands in a recent letter from our Ministry of Economic Affairs, Agriculture and Innovation to Parliament, in reaction to an advice by our Social-Economic Council of March 2010, it is expressed, particularly for deregulated industry and service sectors:

*'The solution to problems of society lies in a practical and result-oriented mix of market and government. An ideological debate is not meaningful. It is all about finding the right combination of what the market can do, and the government must do. The result for consumers and companies is what counts.'*⁶

If one indeed looks at competition law enforcement and sector regulation as two concurring sets of powers that can work complementary to 'make markets work', and, in the case of the NMa, operate within a single organization, then it is of interest to see how this works in practice.

In the subsequent sections, I will discuss three areas where competition and regulation interact in the practice of the NMa, and where the question can be asked whether the right instrument is chosen in terms of maximizing consumer welfare.

Gap between competition and regulation – dominant positions

One area in which competition policy enforcement arguably is not always the most effective instrument is in case a company has a dominant position on the market. Only in case of abuse (exploitation of consumers, exclusion of competitors) of a dominant position, the competition authority may intervene.

The number of cases finalized, based on Section 24 of the Dutch Competition Act (Article 102 TFEU),⁷ is limited. The fact that there is a gradual change in behavior from ordinary competition on the merits to abusive behavior, the information asymmetry between competition authority and the company involved and the high burden of proof, make that procedures are few, long and difficult, and the damage is already done. As there is quite a gap between 'excessively high prices', which could form the basis for intervention based on competition law, and 'reasonable prices' (here assumed to reflect costs and a reasonable return), an intervention based on competition law is often 'too little, too late'. Carlton and Picker (2005) point out that in terms of stimulating certain actions (e.g. efficiency) and price setting, regulation can be a more effective mechanism than competition.

There are various types of regulation (cost-plus, rate of return, price-cap, benchmarking) with different strengths of incentives for efficiency, for investments and for distribution of cost reductions to consumers, which can be applied in a more soft or tighter manner. The benefits in terms of reasonable prices for consumers can be high, and if an appropriate light-handed form of regulation is chosen, the costs of intervention could be relatively low.

Particularly in sectors where there are significant structural barriers to entry and the market structure is such that it is not inclined to move towards effective competition in the medium term, regulation may be a more effective tool than competition enforcement to discipline a company with a dominant position, particularly in relation to efficiency and price setting.

Markets that meet those criteria are commonly industries in which a company has a natural monopoly (e.g. through universal service obligations), or owns essential infrastructure. In these industries, it may be worthwhile to investigate whether the most effective coordination mechanism (competition versus regulation, and the various forms of regulation) in terms of consumer welfare is in place. Industries concerned in the Netherlands are, for instance, airports (Schiphol), ports (port authority Rotterdam), water companies, and railways (NS, Prorail).

For Schiphol, the NMa has recently published a study⁸ at the request of the Minister of Infrastructure and the Environment. The NMa concluded that competition law enforcement may not be sufficient to discipline Schiphol, and that the current form of regulation does not provide sufficient incentives to be efficient.

With respect to the port authority of Rotterdam, a recent court decision could indicate that private action based on competition law may not be sufficient to protect customers of the Rotterdam harbor against potential excessive pricing.⁹ One could at least raise the question whether some form of regulation is required.

As far as water companies are concerned, new regulation is being introduced. My understanding is that a full fledged cost-benefit analysis of the alternative forms of regulation has not been performed yet, leading potentially to a suboptimal outcome in terms of consumer welfare.

And with respect to railways, the sector is highly regulated, but also subject to a highly politicized debate. In this climate, it is almost impossible for NS and Prorail to adequately run their businesses on a long-term basis, with conflicting interests like reasonable prices for their costumers, efficient operations, high quality of material and services and sufficient investments and innovation.

In my view, the main obstacles to more consumer welfare in this market are the day-to-day impact of political debate, and a form of regulatory capture. As to the first, politicians preach high trust, but practice day-to-day interference in the business based on incidents. No company can effectively be managed on that basis. In addition, in this industry, we see that, in practice, the government (in the form of the ministry of Infra-

structure and the Environment) is effectively the regulator. I question whether a ministry as a regulator can act sufficiently independent from both the companies it ought to regulate and from the political debate. A form of 'regulatory capture' or 'government capture' seems to be the case. In the not-too-distant past, the same thing happened between the Ministry of Economic Affairs, Agriculture and Innovation and the natural-gas industry in the Netherlands. The lessons we have learned from regulation in the energy sector, where European Directives require full independence of the regulator from the private *and* public sector, are not applied yet in industries where a ministry effectively operates as the regulator, and may lead to a suboptimal outcome for both the companies involved and consumers alike.

Overlap of competition and regulation – end user price regulation

In the energy industry in the Netherlands, the NMa has the power to intervene in prices set by suppliers to retail consumers if these prices are not considered reasonable.¹⁰ This provision was incorporated into the Electricity Act and Gas Act to protect vulnerable consumers. In European legislation similar provisions, enabling the protection of vulnerable customers, exist.

In practice, the NMa intervenes a couple of times each year in prices set by suppliers for retail consumers. The NMa uses a confidential model to determine the reasonable price.

The retail energy market was liberalized in 2005, and, although the incumbents still hold a large part of the market ($C_3 > 75\%$), the market is quite dynamic, with new entrants gaining market share, and a reasonable amount of customers switching suppliers.¹¹

At the NMa, there is an internal discussion about the future of this retail price regulation.

On the one hand, the aim was to liberalize the market, and let free competition be the coordinating mechanism for prices. The retail price regulation was only meant to be a temporary measure. Suppliers will argue that the market has developed sufficiently, so that this end user price regulation can be terminated.

On the other hand, the NMa still has to intervene a couple of times each year, because the market is apparently not working well enough yet to correct potential abuse.

In my opinion, retail price regulation in itself distorts free competition,

and I question whether this form of consumer protection is really necessary next to extensive regulation already in place to protect consumers, such as minimum service obligations and transparency requirements. On the other hand, it is an effective, and very simple and low-cost mechanism to keep prices reasonable for consumers. In that respect, it is not surprising that in some countries (Spain, France), voices are heard to formally re-regulate retail prices in general, and only keep the wholesale market as a fully liberalized market. In Spain, for instance, price regulation, intended to protect vulnerable consumers, has again evolved in fully regulated prices for the retail sector as all retail consumers are considered to be ‘vulnerable’. And in the Netherlands, the largest consumer organization has publicly indicated that the form of retail price regulation in the energy sectors is an example that should be used in the mortgage and insurance sector as well.¹²

From regulation to competition – markets in transition

When, in connection with the liberalization of the energy market, the Third Package is mentioned, I cannot help but smile. Obviously, there is merit to take a gradual, step-like approach in the case of liberalization of a market, but I cannot avoid thinking that it apparently took three attempts (and maybe even more) to get it right. Although we are well ahead in terms of liberalization in the Netherlands compared to other European countries, there are lessons to be learned here as well.

Essential in the case of liberalization is the complementary application of pro-competitive regulation.¹³ According to Armstrong and Sappington (2006), common entry barriers upon liberalization are often (1) customer inertia, (2) incumbent control of key inputs that entrants require for profitable operation, and (3) the prospect of aggressive pricing by incumbent suppliers. Pro-competitive regulation is aimed at removing the entry barriers as soon as possible to unleash the full force of competition, rather than handicapping incumbents or favoring certain competitors. Such policies should include, among others, ready access by consumers to information, reducing switching costs, adequate data gathering and monitoring, the establishment of appropriate conditions and prices for access to infrastructure, and an increase in the level of oversight and enforcement.

In Europe and in the Netherlands, it looks like we learned these lessons along the way rather than in advance. Information and transparency requirements in the energy sector were tightened in the course of the lib-

eralization process, and are only recently up to par. Monitoring was taken up more on the initiative of the regulator(s) than as a result of legal requirements. The requirement to unbundle the former incumbent distribution companies in the Netherlands was only introduced when the game was already underway, and only recently did the regulator gain full independence from public participants (in a market that is still publicly owned to some extent). A more pro-active and forward-looking approach towards the right combination of competition and regulation, even in a forerunner country like the Netherlands, would have saved society much trouble, and would have contributed to consumer welfare at an earlier stage.

And, if we look at the current situation in other markets in transition, like the health care industry and the railway industry, it appears we may be making the same mistakes all over again. It was during the liberalization of the health care industry that it was realized that public information and transparent criteria to assess quality (which may require regulation) are important for consumers in their choice and switching behavior. And only recently did a draft European Directive specify independency requirements for railway regulators.

Cost-benefit analysis

As the relation between market and government is continuously subject to change in various industries, the Social and Economic Council of the Netherlands (SER) suggested in its advice of March 2010¹⁴ that, in case of major changes in policy, an analysis of the effects should be standard procedure in the development and implementation of new policy. The analysis should investigate the advantages and disadvantages of various alternatives. A broad spectrum of alternatives could be possible: improving enforcement, taking away barriers to entry, privatization, shifting tasks to the government or to the market, strengthening the information for consumers, etc.

The analysis should not be a simple calculation model that delivers a straightforward answer, but one that identifies the advantages and disadvantages, risks and opportunities of various alternatives. Part of the analysis would be, insofar possible, a cost-benefit analysis in terms of consumer welfare. The aim is then to choose a mix of policy instruments that delivers the highest consumer welfare.

The SER's recommendations are in line with the efforts of the government in the Netherlands to develop an integral framework to weigh the pros and cons of new policy and laws.¹⁵

If one takes the SER's recommendations and the letter of the Minister of Economic Affairs, Agriculture and Innovation as a starting point, a cost-benefit analysis of the alternative coordination and supervision mechanisms (competition and/or regulation, and the various forms of regulation) and their instruments should be part of any effect analysis or integral framework to weigh the pros and cons of various policy options. The examples shown indicate that there is ample room for improvement.

Conclusion

Practice shows that there is merit in taking a complementary approach towards competition and regulation, particularly in industry and service sectors that are in the process of deregulation or will always be subject to some form of regulation. In the case of new policy, much can still be gained by performing a cost-benefit analysis in advance to find the mix of competition and regulation that yields the best results in terms of consumer welfare. Learning by doing is fine, thinking before doing is even better.

COMMENT

MAARTEN PIETER SCHINKEL*

Beware of vernacular architecture for the new NMa!

At the dawn of Dutch market regulators moving in with the NMa, Jaap de Keijzer welcomes them with a rough sketch of what the future house of 'De Nederlandse Marktautoriteit' – a great find! – could look like.¹⁶ A new house for a new meaning of the acronym; it only seems appropriate. But what should its layout be? It must have many chambers: for energy and transport, now telecom, and soon maybe water. Better build some spare ones as well. How about the competition law specialists? Will they necessarily occupy the main floor – or soon move out to the ministry of justice anyway? Does the office of the Chief Economist get the upstairs rooms with a view, or rather the basement? And consumers? They should probably be given their own hall, shouldn't they?

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De Keijzer argues for large spaces for the regulators. Now, he says that he intends to tease Pieter Kalbfleisch with this, and provoke some discussion. Yet, factoring this in, I remain concerned the design needs more thought, or otherwise his building may not work. At this stage, we should beware of vernacular architecture, that is, architecture without an architect. Frank Lloyd Wright defined it as: ‘Folk building growing in response to actual needs, fitted into environment by people who knew no better than to fit them with native feeling’.²

The creation of the new NMa is an opportunity to erect a modern palace of market oversight. To take it, we need to renovate upwards from solid foundations and with a strong plan. I offer five things to keep in mind.

1. In his introduction, De Keijzer says to favor more regulation in part because ‘regulation is inherently more difficult than competition policy enforcement.’ My initial scribble in the margin was: ‘So?! *Quantum physics, that’s difficult!*’ Reading on I found this logic rooted in a deeper issue. For example, where some of the pros and cons of competition law enforcement versus regulation are mentioned in the third section, regulation is said to be attractive because it would be more predictable and suffer less from asymmetric information between the regulator and the industry. Now, this may be the case for regulation and competition policy as we know it, but the relevant comparison for the design of a new joint agency is, of course, that permanent regulation is much more information-intensive than a well-timed intervention by competition decision. The information and time requirements to regulate well – certainly in fast moving markets – are a major drawback of regulation, not a selling point! Shifting the emphasis from competition policy to regulation in the new NMa will burden the agency with (asymmetric) information problems, not alleviate it.³
2. Competition policy and regulation *can* form a happy marriage – although I would agree it may be a marriage of convenience rather than out of love. As in any good partnership, it is just a matter of having a joint cause – welfare – and an efficient division of labor working towards it. For the latter, the comparative advantages in information requirements mentioned are central. Where there are no great structural obstacles to competition, so that it can in principle work pretty well on its own, light touch competition law enforcement suffices. It is just to ward off anticompetitive behavior – collusion, monopolization – with forceful intervention where necessary, to keep the process going. Only in sectors in which competition cannot work – natural monopo-

lies, structural market failures – are more invasive forms of regulatory intervention brought in. The very example of the stock exchange that De Keijzer gives illustrates this: whereas there is a lot of competition – between stocks and between brokers – on a successful stock exchange, such an exchange itself can easily become a dominant platform on which everybody wants to be listed – which calls for tight regulation.

3. There is *professional guidance* in any potential conflict. Having agreed that competition law enforcement and regulation are basically complementary approaches, the interesting subtleties – very important for the design of the new NMa – arise, however, where they nevertheless work against each other. Typically, this can happen where regulation – naively or lobbied – unwillingly creates barriers to entry that protect incumbents. The OECD has a program of many years in which it encourages the constant reassessment of regulation using a detailed framework of cost-benefit-analysis.⁴ The latest app is the Competition Assessment Toolkit, Version 2.0, 2010. It integrates perfectly and is user-friendly.
4. In principle – albeit not in practice – in Europe, regulation and competition law enforcement *do* touch in the control of excessive pricing as an abuse of dominance. It's all about how you define excessive – which we have indeed largely avoided. But why shouldn't prices above regulated cap values not be considered excessive? If they are not, isn't the cap too low? Note that this is importantly different in the U.S., where monopolization only concerns attempts to obtain or maintain dominance, not exploit it once you have it. This crucial difference should be kept in mind when drawing on insights from U.S. scholars for European design issues. In fact, I would conjecture that the lack of success by European competition authorities in bringing exploitative abuse cases can be explained in large part by the absence of U.S. example.
5. It is essential to distinguish between what we know about how to set up a good competitive regime, and how it is eventually done in practice. In between are political choices, influenced in various directions by vested interests.⁵ Of course, we knew that (perfect) information is central to (perfect) competition. And we have long been aware that small switching costs *can* have large consequences. What we can learn from the Dutch health care experience is that good liberalization pays attention to detail – because that is where the devil is. But we should not compromise future designs because of past construction errors, other than to make sure that at least these errors are not made again.

I think it suits Pieter Kalbfleisch that he apparently lost sleep over allegations that the NMa behaved as a regulator. The NMa was not made to regulate, yet was increasingly forced into that role. However, it shouldn't be possible for market parties to embarrass a competition authority in this way. We are now in the process of commissioning a new design for the Netherlands Market authority: that will master the various market oversight instruments jointly. Let us hope the job will be awarded to a good team of professional architects.

COMMENT

CATHY VAN BEEK AND REIN HALBERSMA *

Cost-benefit analysis of competition policy versus regulation: a reply

Introduction

The anecdote at the start of Jaap de Keijzer's essay is likely related to the 2009 merger case of two hospitals in Zeeland. This merger was ultimately approved by the Netherlands Competition Authority (NMa), but not without stringent remedies, among which a price cap for otherwise liberalized hospital services. This merger case was a memorable one, not just for the legal precedence, but also for the intense and sustained collaboration between the NMa and the Dutch Healthcare Authority (NZa), both between the case-teams and between the Executive Boards. In no other health care merger case was the level of interagency communication so intricate and the level of media scrutiny so intense as in this case. Pieter Kalbfleisch vigorously explained to the media why this merger could not be blocked, but also why remedies were imposed.

The suggestion that the NMa had not acted as a competition authority but rather as a regulator in the Zeeland hospital merger, was phrased by many observers, e.g. by lawyers Meersma and VerLoren van Themaat.¹ Regardless of the question whether the NMa or the NZa is best equipped to administrate a price cap in a consummated merger, it is noteworthy that

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the legal recourse for firms against the current self-imposed merger remedy is much smaller than if the price regulation had been imposed by the NZa during a significant market power (SMP) proceedings following the merger.

De Keijzer makes many excellent points regarding cost-benefit analysis for deciding between competition policy and regulation. The NZa is both a competition authority and a regulator, and we adhere to these principles both in theory and in practice.² In this contribution, we address two additional points that arise when doing cost-benefit analysis in practice. The first point is the distinction between prospective and retrospective analysis. The second point concerns decision-making under uncertainty. We illustrate both points with practical examples.

Prospective versus retrospective analysis

De Keijzer already hints at the difference between prospectively setting a regulatory framework, and retrospectively imposing a cartel fine. Looking at the various regulatory and competition policy tools within the NMa's mandate, one can make a distinction between dominance abuse and cartels on the one hand, and regulation and mergers on the other hand.

Dominance abuse and cartels fall within the category of retrospective decision-making. Although in practice, this may entail difficult and approximate calculations, it is, in principle, straightforward to measure the markup of monopoly or cartel pricing above the competitive level of marginal costs. Also, determining a proportional fine in relation to the price distortion and the abusive or colluding firms revenue is straightforward in principle, if not in practice.

Regulation and mergers fall within the category of prospective decision-making.³ To provide firms with proper incentives and regulatory certainty (both essential and complementary ingredients for competition and innovation), regulatory agencies and competition authorities strive to design transparent decision frameworks from which firms can derive guidance on which measures they will face depending on their conduct and performance. In merger cases, market share safe-havens and the efficiency defense also provide firms with the opportunity to create welfare-enhancing organizations. We agree with De Keijzer that such prospective analyses are inherently more difficult than retrospective analyses.

Decision-making under uncertainty

Both prospective and retrospective analyses become an order of magnitude more difficult when the facts are uncertain. There are two types of decision-making errors one can make under such uncertainty: Type I and Type II errors. Type I errors are equivalent to convicting the innocent, whereas Type II errors correspond to releasing the guilty. In retrospective analyses such as dominance abuse and cartels, the costs of punishment and social stigma of a Type I error are usually much greater than the costs of a Type II error – hence the presumption of innocence and a strong bias for making Type II errors rather than Type I errors.

For prospective analyses such as regulation and, in particular, mergers, one could argue that the irreversibility of a consummated merger should shift the balance to a bias for Type I errors over Type II errors. After all, when a merger gets blocked by mistake, the firms can always try again a few years later when circumstances have changed and the facts can be reassessed to obtain a different judgment. Erring on the side of caution becomes all the more important for markets in transition, such as healthcare markets, where anticompetitive mergers can diminish a fledgling amount of competition before it has even started. Interestingly, Pieter Kalbfleisch has been on the record as having quite the opposite preference: namely a preference for Type II errors even in merger cases.⁴

Conclusion

Cost-benefit analysis is a great tool for deciding between competition policy and regulation. When the facts are uncertain or the analysis is prospective, one has to choose between making Type I and Type II errors. For markets in transition, the irreversibility of consummated anticompetitive mergers might outweigh the usual presumption of innocence.

Notes

ARTICLE

- 1 The opinions expressed here are my personal views and do not represent the official view of the Netherlands Competition Authority.
- 2 In the UK, there is not one but several designated competition authorities: the Office of Fair Trading and the regulators of the major economic sectors of communications (Ofcom), gas and electricity (Ofgem), water (Ofwat), railways (ORR) and air traffic services (CAA). Under the concurrency arrangement in the UK each regulator has the power to apply competition law in its sector.
- 3 The exception is the Estonian Competition Authority. Since 1 January 2008 the previous Estonian Competition Board, Estonian Communications Board and the Energy Market Inspectorate have been merged into the Estonian Competition Authority, dealing with supervisory activities in the areas of competition supervision, fuel and energy, electronic and postal communications (www.konkurentsiamet.ee).
- 4 Dennis W. Carlton and Randal C. Picker, *Antitrust and Regulation*, National Bureau of Economic Research, Cambridge, 2005, Working Paper 12902.
- 5 Joaquín Almunia, *Competition v Regulation: where do the roles of sector specific and competition regulators begin and end?* Center of Regulation in Europe (CERRE), Brussels, 23 March 2010.
- 6 *Bij rolverdeling tussen markt en overheid telt resultaat*, letter of 11 February 2011 from the Minister of Economic Affairs, Agriculture and Innovation to parliament (Eerste en Tweede Kamer).
- 7 *Synthese rapport evaluatie Mededingingswet*, Berenschot, Den Haag, 30 mei 2002 (www.nmanet.nl).
- 8 *NMa-rapportage Economische Machtspositie Schiphol*, Nederlandse Mededingingsautoriteit, The Hague Haag, 15 February 2010.
- 9 Decision of 1 June 2010, District Court The Hague, case number 105.000.856/01, Municipality Rotterdam (port authority Rotterdam). It is fair to say that claimants were not able to prove excessive pricing, so the jury is still out.
- 10 End user price regulation ('Vangnetregulering'), Electricity Act, article 95b, sub 3 & 4, Gas Act, article 44, sub 3 & 4.
- 11 *Monitor consumentenmarkt elektriciteit en gas*, Nederlandse Mededingingsautoriteit, Den Haag, February 2011 (www.nmanet.nl).
- 12 Letter of 9 February 2011 from the Association for Consumers (de Consumentenbond) to the Minister of Finance, with respect to mortgage interest (www.consumentenbond.nl).
- 13 Regulation, Competition and Liberalization, Mark Armstrong and David E.M. Sappington, *Journal of Economic Literature*, vol. XLIV (June 2006), pp. 325-366.
- 14 *Overheid en Markt: Het resultaat telt!*, advice of the Social-Economic Council in the Netherlands (Sociaal-Economische Raad), The Hague, March 2010.
- 15 *Integraal Afwegingskader voor beleid en regelgeving (IAK)*, Tweede Kamer, 2009-2010, 31731, nr. 6.

COMMENT 1

- 1 De Rijksoverheid, 'Meer slagkracht en minder overlap door fusie toezicht,' Nieuwsbericht, 25-03-2011.
- 2 Paul Oliver, *Dwellings*, Phaidon Press, London, 2003, page 9.
- 3 See, for example, W. Kip Viscusi, Joseph E. Harrington and John M. Vernon, *The*

- Economics of Regulation and Antitrust*, 4th edition, MIT Press, 2005.
- 4 OECD (2008), Building an Institutional Framework for Regulatory Impact Analysis (RIA): Guidance for Policy Makers, Version 1.1. For some context to the 2010 SER publication 'Overheid en Markt: Het resultaat telt!' on which De Keijzer draws for his cost-benefit analysis, see van Damme en Schinkel (eds.), *Marktwerking en Publieke Belangen*, KVS Preadvies, 2010 Chapter 1.
- 5 See Michal Gal, 'The Ecology of Antitrust Preconditions for Competition Law Enforcement in Developing Countries,' *Competition, Competitiveness and Development*, UNCTAD, June 2004, 20-38.
- COMMENT 2
- 1 Klaas Meersma and Weijer VerLoren van Themaat, *Fusiebesluit van de NMa legt lastig dilemma bloot*, Het Financieele Dagblad, April 14th, 2009.
- 2 Nederlandse Zorgautoriteit, *Theoretisch kader liberalisering vrije beroepen*. 2008.
- 3 It is interesting to note that for the NZa, significant market power (SMP) cases do not require the existence of abuse, but only the existence of dominance. This transforms SMP cases into prospective analyses.
- 4 Peter A.G. van Bergeijk and Erik Kloosterhuis (editors), *Modelling European mergers: theory, competition policy and cases studies*, p.33.

PART

6

Competition and moral
sentiments

Competition vs. cooperation: Between the devil and the deep blue sea

TOM R. OTTERVANGER*

Introduction

Competition legislation has been in the books for over 100 years, with the first statute being the 1890 US Sherman Act. The concerns about market power and restraints of trade go back even much further to old common-law precedents, without any penal character, relating to commercial transactions. Competition rules have by now seen the light in over 100 jurisdictions, in more or less similar wording. Their actual application varies from country to country, depending on the level of economic development, the political climate and the local legal culture. In Europe alone, there have been over a 100 important court cases concerning the interpretation of the law. Competition policy is part of overall economic policy. Enforcement and compliance have a big impact on the business community. Antitrust laws have been labeled by the US Supreme Court as the ‘Magna Carta of free enterprise’.

Despite all this, those active in the field, be it private practitioners, agency officials, academics or judges, are faced with new questions almost on a daily basis. The open norms, prohibiting without much further ado ‘restraints of trade’ or ‘restrictions of competition’, leave more grey areas than most other legal fields. Uncertainty and shifting ideas are sometimes difficult to cope with for companies that have to abide by the rules at the risk of invalidity of contracts, fines, damage claims, and negative publicity. It is, however, the inevitable outcome of the nature of competition regulation. At the same time, it provides a challenging environment to work in, something which Pieter Kalbfleisch, having joined the agency on the eve of the so-called ‘modernization’, has always visibly enjoyed.

* Prof. mr. T.R. Ottervanger, member of the Amsterdam Bar (Allen & Overy LLP), Professor of European Law and Competition Law (Leiden University). ‘Between the devil and the deep blue sea’, is taken from a Jazz standard, no doubt appreciated by Pieter Kalbfleisch, performed among others by Thelonious Monk and Django Reinhardt.

A chapter in a *Liber Amicorum* is not a legal textbook, nor is it meant as an in-depth analysis of some complex question. The tribute is a convenient opportunity to serve some light food for thought on issues of common interest of the author and the recipient amicus. Perhaps the most fascinating topic is the everlasting tension between competition and cooperation or solidarity. How should the agencies in a given case reconcile these two potentially conflicting values? Effective competition is seen as the lifeblood of our economic system, leading to lower costs and prices, more choice and innovation. At the same time, cooperation between competing firms may be neutral and escape the cartel prohibition altogether, or even generate benefits that outweigh the anti-competitive effects. There is no clear distinction between these categories. In this regard, it is not helpful there is no clear consensus about the goals of the system. There was none in the beginning, nor today.

Objectives

A leading American commentator once observed, ‘if you struggle with the interpretation of the Sherman Act, you may be tempted to try to ascertain the Congressional intent underlying it; no matter how much you research the history of the Act, however, you are unlikely to find convincing answers’.¹

In case law, in policy statements and in literature, one finds a variety of objectives. While the dispersal of private economic power (monopolies, or at the end of the 19th century combinations of firms in the form of trusts) plays a role, the protection of SMBs (to keep alive a system of independent small producers), the general protection of economic freedom (but not unfettered), the protection of the *process* of competition, the promotion of market integration, and, last but not least, the maximization of efficiency and consumer or social welfare are equally relevant. These objectives are somewhat, but not completely, overlapping, and testing conduct against these concepts is far from easy.

Competition rules do not exist in a vacuum. As rightly observed by Whish, competition policy is an expression of the current values and aims of society and is as susceptible to change as political thinking generally is.² In the EU, the competition regime is inextricably linked with those provisions in the Treaty that are aimed at the creation and proper functioning of the internal market. Competition law was not seen as a goal in itself. The rules were introduced as a means to an end: the integration of national markets, and the gradual disappearance of national dominant

positions and government-owned monopolies. The ultimate end being to achieve social and economic progress and democracy.

Cooperation between firms, whether cross-border or at the national level, may, depending on the circumstances, prove instrumental in the process of market integration. Competition law is, after all, complementary to other rules. As a result of the Lisbon Treaty, the principle that the internal market include a system of undistorted competition, which used to be part of the main principles of the EU Treaty, has recently been transferred from the Treaty itself to a Protocol – the legal effect has remained the same, but, together with the strengthening of the role of non-economic, general interest goals, it symbolizes the increasing doubts, confirmed by the financial crisis, about the blessings of a free-market economy.

Not so long ago, in the 1990s, in large parts of the industrialized world, including the UK and the Netherlands, practices that are now qualified as immoral cartels were allowed – for example, an occasional discussion between two or more competitors on future strategy or investments was not seen as objectionable, let alone as a (quasi-)criminal offence. Apparently, society did not think of anti-competitive conduct as ‘wrong’ in a sense that would justify punishment in order to prevent future infringements. The purpose of competition rules, like any other rules which forbid certain conduct, is to uphold certain principles – in our case, those of a market economy in a liberal democracy. They must be distinguished from other rules of economic regulation in a well-organized society, as, for example, a scheme of taxes or burdens that are ‘... designed to put a price on certain forms of conduct and in this way to guide men’s conduct for mutual advantage’.³ It is interesting that in the Netherlands (and elsewhere) with its market-oriented, open and successful economy, these generally accepted principles that seem inherent in such a system apparently were not deemed to be worthy of protection by the law, leaving conduct with cross-border effects to regulation and enforcement at the level of the Community.

Moral sentiments

These principles relating to free trade go back a long way. In his book *The Wealth of Nations* of 1776,⁴ philosopher Adam Smith searched for an economic order based on principles of freedom and equality, so every person could maximize his own product – together, the whole population would maximize the aggregate product and keep each other in check by the

power of competition. The basis for his thoughts on the reconciliation of the private good and the common good through freedom rather than coercion can be found in an earlier work, *The Theory of Moral Sentiments* of 1759.⁵

This first book contains a lengthy study about human nature and moral laws, and caused a sensation when it was published. His ‘new age’ vision on happiness is worth recalling: as to real happiness, so Smith writes, the poor are in no respect inferior to those who seem above them – in ease of body and peace of mind, all are on the same level; the beggar who sunbathes on the side of the road possesses that security that kings are fighting for. But, although happiness does not come from power and riches, greed leads us to pursue wealth and greatness and ‘keeps in continual motion the industry of mankind’. The eyes of the rich are bigger than their stomachs, which will receive hardly more than a peasant. And this is, in a long and humorous description of human folly, where *the invisible hand* comes in for the first time. The rich, who consume little more than the poor, are, by employing others, led by an invisible hand to distribute the necessities of life and thus, without knowing it, advance the interests of society. *Selfishness regulated by competition* leads to prosperity and social harmony; but with a role to play for the government in protecting certain public interests – no complete *laissez faire*: monopoly power, for example, should be opposed. Obviously, society in the 18th century was primitive compared to today’s world but much of Smith’s ideas are surprisingly modern and have been important in shaping our ideas of what constitutes a liberal democracy and what is the role of competition.

Flexibility

Recent case law by Europe’s highest court underscores that, in the EU, competition policy is wider than just serving the interests of efficiency and consumer welfare, whatever these concepts exactly mean in a specific case. According to the Court, in two judgments, competition rules aim to protect not only the interests of competitors or consumers, but also the structure of the market and, in doing so, competition as such.⁶ In the first case, a reference for a preliminary ruling by a Dutch court in an appeal from a cartel decision by the NMa, the Luxembourg Court found that there is no need to establish a direct link between the allegedly anti-competitive practice and consumer prices. In the second case, a direct appeal against a Commission decision concerning a restriction in parallel trade in pharmaceuticals, the Court confirmed that it is not necessary for find-

ing anti-competitive conduct that final consumers are deprived of the advantages of effective competition in terms of supply or price. If this is true for Union law, it applies to domestic Dutch law too.

Some might say competition law, serving a variety of goals, is vague and the open norms are too difficult to apply. Perhaps enforcement should therefore be limited to clear-cut, effective hardcore cartels, while global competition and rapid technological progress have made all the rest obsolete. I would, however, argue that the rules are fine as they are. Of course, legal norms should be clear and relatively stable to be effective. But competition rules have some built-in flexibility as a result of the economic and political nature of the legislation. Interpretation of the rules follows developments in society, as has been the case in the past on both sides of the Atlantic – especially in the US, where the interpretation and enforcement priorities vary with the membership of the Supreme Court and with each presidency. While maintaining as leading principle that competition is key to prosperity and should be encouraged – with special attention for market power and collusive or monopolistic barriers to enter a market – there is room for fine-tuning in individual cases. And for weighing the pros and cons of cooperation. The agencies should be open to discuss and, where appropriate, reject tailor-made solutions.⁷

Examples can be found in two Dutch cases from the 1990s dealing with competition issues in the agricultural sector and in the pension sector respectively. Both show the tension between, on the one hand, cooperation and solidarity and, on the other hand, competition. And both are examples of a form of private enforcement *avant la lettre*. In the Netherlands, there was no *visible hand* of a national public enforcement authority at the time, and the European Commission did not show much appetite for examining the issues at stake, so national courts referred the cases to the Luxembourg court (where I had the pleasure of pleading on behalf of the defendants in the agricultural matter and on behalf of the plaintiffs in the pension case).

Agriculture has, to some extent, benefited from special treatment, but questions still arise today as to the application of the competition rules to various forms of cooperation between usually relatively small producers of agricultural or horticultural products. The *Oude Luttikhuis* case⁸ concerned a dairy cooperative. *Vis-à-vis* third parties, the cooperative functions as an independent enterprise active in various markets of consumer products and of raw materials (e.g. for the pharmaceutical industry). *Vis-à-vis* its members, the dairy farmers on whose account the cooperative produces and sells, no real market exists. The cooperative had agreed to buy all the

milk produced by its members, who gave it the exclusive right to the milk. According to the statutes of the cooperative, members would have to pay a certain fee, some would say 'fine', others would call it an indemnification, in case they would terminate membership. At the time, raw-material shortages in the Benelux drove up the prices, and hundreds of farmers wanted to terminate the relationship with 'their' cooperative in order to be able to join another cooperative or sell their milk on the free market. All over the country, litigation was initiated.

One of the key issues was whether the termination fee was compatible with competition law. The Court of Justice held, first, that the legal form of a cooperative is not anti-competitive and is even favored by the authorities, because it encourages modernization and rationalization and improves efficiency. However, clauses tying members to their cooperative must be limited to what is necessary in order to ensure that the cooperative functions properly and has a sufficiently wide commercial base and stability. Excessive fees could have the effect of restricting competition. So the national courts basically had to undertake an economic analysis to decide whether fees were excessive. The Court clearly favors a flexible interpretation of the cartel prohibition. The solidarity between farmers may prevail over the requirements of competition. What applies to farmers, applies *mutatis mutandis* to other sectors, such as the transfer rules for professional sports.

The *Albany* case⁹ concerned the obligation under Dutch law for employers to affiliate their employees to a compulsory pension fund, if so requested to the government by collective agreement between the employers association and the trade unions concerned. The Court looks to the Treaty as a whole, which clearly, in various provisions, requires the Community to promote social protection, cooperation between member states in the social field, and a dialogue between management and labor. While recognizing that certain restrictions of competition are inherent in collective labor agreements, it found that the social-policy objectives of such agreements prevail. Therefore, the agreement at issue, establishing a compulsory supplementary pension scheme would fall outside the scope of the cartel prohibition.

In the US and in Europe, collective bargaining is encouraged but may result in conduct that conflicts with antitrust laws favoring free competition. Therefore, the Supreme Court created a non-statutory exemption, most recently discussed in *Brown v. Pro Football Inc.*¹⁰ 'the implicit labor antitrust exemption applies, where needed, to make the collective bargaining process work'. In a 60-page judgment, the Court of Appeals for the

Ninth Circuit last year held that the non-statutory exemption did not apply to a profit-sharing agreement between large supermarket chains in Southern California that was used during a strike as weapon to prevail in a labor dispute.¹¹ Applying a *per se plus* or *quick look minus* analysis, examining the case ‘in light of logic and rudimentary principles of economics’,¹² the Court concluded, first, that there was nothing that warrants a departure from the well-established rule that profit-sharing is anti-competitive and, second, that profit-sharing lies completely outside the matters regulated by labor law.

Balancing act

Although, as an outside observer and practitioner, I do not always agree with the enforcement priorities of the NMa, it is fair to say that under the leadership of Pieter Kalbfleisch, the NMa has been transparent and has worked constructively towards practical solutions that do justice to the role of competition policy in today’s society. An example is the merger between de facto the only telephone directories, a market with high entry barriers and hardly any buyer power.¹³ The deal was approved essentially because the NMa established that the new ‘monopolist’ would be disciplined by online alternatives. Also, when the only two hospitals in a part of the province of Zeeland created a near-monopoly on the market for hospital care, with high entry barriers and relatively little buyer power, the NMa approved the transaction, after behavioral remedies were offered dealing with quality, price and accessibility.

Another example is the section in the NMa’s 2009 Annual Report devoted to the dilemmas the NMa is faced with when dealing with ‘public interests’. In this section, the NMa tries to answer the question how, when reviewing cases, it should assess public interests and carefully and critically weigh these against potential antitrust objections. This concerns the application of the exceptions to the general prohibition of anti-competitive arrangements as provided for in Article 101(3) of the TFEU and Article 6(3) of the Dutch Competition Act. A broad interpretation certainly would make, as stated by Herman Wijffels, the work more interesting and more socially relevant

The annual report does not give an answer. Other competition agencies are faced with the same dilemma. In a joint report by the Nordic authorities, published in October 2010 and entitled ‘Competition Policy and Green Growth’, various issues are explored, such as the implications for competition of environmental policy instruments. The report under-

lines that environmental policy and competition policy share the common long-term objective of preserving and increasing social welfare, and it encourages competition authorities to ensure that restrictive practices do not undermine 'green growth'. It also states that environmental benefits could be used to defend horizontal practices otherwise deemed restrictive, but only if environmental impact is translated into clear costs or cost savings for society – only concrete, no vague arguments can be accepted. Another agency, the OFT, also published a Discussion Paper in 2010 dealing with the question of what benefits may qualify for the exception to the prohibition. It states that broadening the benefits to include, for example, environmental interests such as CO₂ reduction, 'fair trade' or financial stability, may certainly ensure that competition policy does not block desirable social goals and does not deny consumers real gains. However, the OFT also sees considerable disadvantages: for example, considering public interests would blur the distinction between competition policy and industrial policy, and would create enormous quantification problems.

There is no easy solution. In an article published in the spring of 2010,¹⁴ I posed the question of whether there is room in competition policy for certain general interest. I referred not so much to all sorts of public policy matters such as culture, care, broadcasting, discrimination, crime, sports etc, but narrowed my question down to those issues that directly affect the future of the planet and the people: biodiversity, climate change, scarcity of energy and water, human rights. To more and more corporate professionals and those working in the corporate world in general, Corporate Social Responsibility (CSR), integrated in the core activities of every firm, is becoming the only method to conduct business in this century.¹⁵

Obviously, companies should never engage in anti-competitive collusion, as they should never engage in corruption. But that is not to say that competition that is socially and environmentally responsible should not be promoted.¹⁶ Competition is a means to an end; competition policy is part of our dynamic system of liberal democracy and, certainly in the Union, is complementary to other goals, including a sustainable development of social and economic activities and the quality of life. Codes of conduct of trade associations of particular sectors may contribute to achieve certain CSR goals where this is not possible for individual firms. Obviously, there are conceptual hurdles and issues about quantification. And is it natural that agencies will be – and should be – skeptical about subjective intentions of those bringing forward moral argument to justify potential restrictions of competition.

Outlook

Despite – or perhaps because of – the fact that the precise objectives have always been somewhat equivocal, antitrust has survived dramatic changes in society and in the economy. The courts have been able and willing to interpret the rules flexibly, as shown *inter alia* in the Dutch agricultural case. Finding the criteria to balance the benefits of competition in a rapidly changing society against the values of cooperation will remain the essence of competition law. So, there will always be tension between the devil and the deep blue sea. But hopefully, the agencies will have an open mind for social and economic developments, and for new ideas about growth and welfare. It is to be hoped that Pieter will continue to participate in this debate.

COMMENT

KEES HELLINGMAN*

Moral sentiments and competition law

Between the devil and the deep blue sea: Tom Ottervanger urges us to navigate carefully between two equally dangerous alternatives. Many people seem to feel a *fatal attraction* to either competition or cooperation, but if we make a choice for one while completely losing sight of the other, we will end up being swallowed by a monster.

As Ottervanger points out, the preservation of Planet Earth may require a new shift in the balance between competition and cooperation, be it as a matter of survival or as a moral duty to future generations.¹ At the same time, he rightly remarks that the noble objective of sustainability often serves as a disguise for narrow economic interests. Competition authorities must always be sceptical. The NMA's experience with organisations of North Sea shrimp fishers forms a good illustration of this.²

A sceptical attitude towards cooperation is not received with much applause these days. The virtues of the market are no longer taken for granted by the government. Before the last remains of the Dutch cartel paradise have been removed once and for all by the actions of a robust and

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independent competition authority, the justification for a strict prohibition of cartels is already put into question from the side of small and medium-sized businesses. I even doubt whether cartels are now generally qualified as *immoral*. *Unlawful*, yes. But not deeply felt as wrongdoing, on the same level as ordinary theft, fraud or corruption. At the same time, competition authorities themselves came to adhere to an economic approach according to which dominance is looked upon with much less suspicion than before.

Still, there *are* moral arguments that underpin the value of competition and ask for protecting the competitive process as an end in itself. I am convinced we will need those arguments to safeguard the stature of competition law in the long run. Repeating that competition makes us better off as consumers, even if this is true most of the time, is not enough to turn the tide. The utilitarian perspective has to be supplemented by a deontological perspective, which connects competitive markets and political democracy as mutually interdependent elements of an open society in which human rights are well respected.³

Building blocks for this view are to be found in the work of Adam Smith and in the work of the Austrian and Ordoliberal schools. Within the framework of this comment, however, the sentimental journey along these ideas is rather like a visit of Japanese tourists: there is only time for a few snapshots.

First, my favourite Adam Smith quote: *'It is not from the benevolence of the butcher, the brewer, or the baker, that we expect our dinner, but from their regard to their own self-interest.'* Surely, this is not a commandment to be selfish.⁴ What Smith tells us is that, in everyday life, it is not necessary to worry about the moral implications of banal decisions like buying bread. In fact, it would be asked too much of a human being to look for the baker that would deserve his support the most. We can rely on the invisible hand that guides us to serve the common good together with our own interest. That is, under competitive conditions. So we can save our sympathy and generosity for situations where we feel it really matters. There is a place for Corporate Social Responsibility after all.

The Austrians have taught us to look at the market as a playground. Competition is a discovery process, driven by entrepreneurial endeavours, with unknown results. The journey is more important than its destination, efficient outcomes are a fortunate by-product but failure is part of the game. When successful, entrepreneurs have the right to benefit from this (temporary) advantage.

In the Ordoliberal view, the market economy is a necessary but not a sufficient condition for a democratic society. However, both markets and democracy are fragile or even self-destructive. Industrialisation goes hand in hand with monopoly power and monopoly profits. Private power and private wealth can and will be used, not for competition on the merits (*Leistungswettbewerb*) but for ‘impediment competition’ (*Schädigungs- und Behinderungswettbewerb*, or *Monopolkampf*) and for organising pressure on the state to grant protection. Democracy could be taken hostage, hence the need for an economic constitution and *Ordnungspolitik* to fight cartels and prevent the flowering of monopoly power. Where dominance is inevitable, it should be operating ‘as if’ conditions of *vollständiger Wettbewerb* would apply.³ There is no reason to have mercy with exploitative behaviour, since it is not only the result but also a major cause of foreclosure, providing the means for it.

The Court of Justice still applies these lessons today. It takes the protection of the competitive process for its own sake seriously. This may help dedicated leaders of competition authorities like Pieter Kalbfleisch to keep doing their jobs properly in the future. I can only share Ottervanger’s wish that Pieter will continue to participate in this debate after his term at the NMa has ended.

COMMENT

M.R. MOK*

Let us reconcile the devil with the deep blue sea

‘**B**etween the devil and the deep blue sea’ points to a choice between two undesirable situations. This label could be attached to the choice between the famous (former) Dutch Cartel Paradise on the one hand, and a society in which *every contract, combination or conspiracy in restraint of trade or commerce would be illegal* on the other. The latter situation does not exist anywhere, not even in the USA, after more than 120 years of the Sherman Act (from which the italic words were quoted). The Cartel Paradise has indeed existed at one time in The Netherlands, but the departure from that Paradise already started in 1962, when EEC-Regula-

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tion 17 became operative. In 1998, a domestic competition law on the same pattern as the EC law was passed, and a national Competition Authority (NMa) was established. On that basis, first Kist and then Kalbfleisch started the hunting that sent many inhabitants of the Cartel Paradise (mainly hardcore cartelists) to the Devil. In spite of Competition Rules (and perhaps thanks to fishing quotations), there are still fish in the Deep Blue Sea.

Competition law is not a goal in itself, because competition is not; it is but a (very useful) instrument for the organisation of markets in order to achieve efficiency and social and economic progress. Ottervanger added: 'and democracy'. I am not sure of that. In China, a certain degree of competition is allowed, but not as a means for the introduction of democracy.

In some circumstances, we can do without competition, or are even better off without it. In a modern economy, competition may be the normal situation, but there are exceptions. Sometimes it is possible to define them, as has been done for European law in the well-known Block Exemptions, but in other cases, specific circumstances make an exception desirable. Article 101(3) TFEU describes those cases.

Ottervanger is right when he talks of the open norms of competition law; Article 101 (3) is an example. The notion that competition law leaves more grey areas than most other fields however seems exaggerated. Open norms are to be found in several other fields, for instance Private Law. Well-known open norms in the Dutch Civil Code are 'the standards of reasonableness and fairness' in Articles 6:2 and 6:248 and the definition of 'tortious act' in that Code is also very flexible.

Co-operation between firms remains always permissible, as long as it does not touch competition. However the boundaries are not always that sharp. Consider this example. Two bus companies compete in a public tender of bus lines. Firm 1 wins the operation of one line, firm 2 that of another line. Firms 1 and 2 arrange to buy the buses together, in order to obtain a price reduction. Furthermore, they agree to combine the maintenance of the buses, which will also save money. That seems to be an innocent co-operation. After five years, there is a new tender of the lines. The two firms are satisfied with the existing situation. They subscribe in such a way that there is a good chance that the existing situation will continue. This agreement, however, constitutes a restriction or distortion of competition. That often is the problem of co-operation. It starts with harmless mutual help, but gradually managers and personnel of the firms will know each other well, and then the temptation arises to extend the relations in a way that restricts competition. I chose an example from the

public transportation sector, because it seems to me that often this sector is not very suitable for competition.

Ottervanger mentions that the 'NMa' in its 2009 annual report deals with the notion of 'public interests' in connection with Article 101(3) TFEU. Public interests can also play a role in the field of the permissibility of certain monopolies. In the old days, The Netherlands had, like many other countries, a postal monopoly which was a State enterprise. For the sake of competition, this monopoly was ended and replaced by a number of private firms. Unfortunately, this action took place in a period in which the old mail service encountered the strong rivalry of new means of communication, such as fax, email, and sms. Whereas the old monopolist offered regular and reliable services, was customer-friendly and reputed to be a good employer, the actual private mail firms are inferior in all these aspects. Their main interests are increasing their market share and lowering their costs. From a point of view of desirability of a market economy, the new situation is an improvement, but from a point of view of public interests, it was a demonstrable deterioration.

I share Ottervangers' opinion that, in terms of public interests, when determining the nature and extent of competition policy, we should think primarily of fundamental issues ('the future of the planet and the people'), but nevertheless other issues should not be neglected as they may be important in everyday life.

Notes

ARTICLE

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| <p>1 Thomas D. Morgan, <i>Cases and materials on modern antitrust law and its origins</i>, 2nd ed., American Casebook Series, West Group, 2001, p. 25.</p> <p>2 Richard Whish, <i>Competition law</i>, 6th edition, Oxford, 2009, p. 19.</p> <p>3 John Rawls, <i>A theory of justice</i>, Harvard University press, 1971, p. 314.</p> <p>4 Bantam Classics, 2003.</p> <p>5 Edition 1759, through Leiden University Library. A summary and discussion of Smith's ideas can be found in Leo Strauss/Joseph Cropsey, <i>History of political philosophy</i>, 3rd ed., University of Chicago Press, 1987.</p> <p>6 Case C-8/08, T-Mobile 4 June, 2009;</p> | <p>Joined cases C-501/06P, GSK, 6 October 2009 (n.y.t).</p> <p>7 For instance, with respect to so-called crisis cartels, there may be exceptional circumstances in which an industry with high capital investment faces such severe problems of structural overcapacity that a limited form of cooperation should be possible – consumers may, in the long run benefit, from a healthy, innovative industry and so will employees. And so may specialisation, for example in the health care sector, restrict competition while at the same time improving the quality of the services.</p> <p>8 Case C-399/93, 12 December 1995, ECR</p> |
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- 1995, 1-04515 (also Cases C-319/93, C-40/94, C-224/94 of the same date). The Commission, in its 2004 Notice on the application of Article 101(3), sees this case as an example of an ancillary restriction. However, in Case T-112/99 (18 September 2001, *Metropole*) the CFI (now General Court) treats it under a different heading.
- 9 Case- 67/96, 21 December 1999, ECR I-5751 (also Cases C- /96 and C /96 of the same date).
- 10 518 US 231,237 (1996).
- 11 State of California v Safeway e.a, 17 August 2010.
- 12 The Court does not show much respect for the contribution to antitrust of economic expertise. It refers to Alan Greenspan as someone appointed for five terms by four Presidents who admitted having made mistakes; and to Richard Posner who, according to the Court, '...reversed a lifetime of reliance on the Chicago's school approach'.
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Consumer welfare versus sustainability in competition policy

JOHAN GRAAFLAND *

Introduction

Capitalism has produced great benefits for society. The invention of the market economy revolutionized the world after 1800. Between 1820 and 2001, real annual income per capita rose by about 1,900 % in the Western world from USD 1,204 (1990 international Geary-Khamis) to USD 22,825 (UN, 2006). At the beginning of the capitalist era, when Adam Smith published his famous *Wealth of Nations* (1776), life expectancy in Western countries was 25 years. Today, it is almost 80 years. As a result, world population has grown exponentially from about 800 million in 1800 to over 5 billion in 2000.

However, in the 21st century, we are confronted with severe limits to economic growth. Due to the growth in income and world population, worldwide energy consumption rose from 207 quadrillion Btu in 1970 to 495 in 2007, and it is expected to rise to 739 quadrillion Btu in 2034 (EIA, 2010). World temperature has also increased, particularly between 1975 and 2000 (Gerlagh, 2010). During 1970 and 2007, biodiversity in all vertebrate species (the so-called living planet index) declined by 30% (WWF, 2010). Furthermore, if we take into account economic depreciation of the value of natural resources, welfare seems to have *decreased* rather than increased over the last decade. This is reflected by the so-called Index of Sustainable Economic Welfare (ISEW). For example, whereas consumption in Belgium rose by 75% between 1975 and 2007, the ISEW hardly increased. Actually, it reached its top in 2000, and then declined by more than 30% since (FOD Economie, 2008).

If I consider my personal situation, similar trends appear. Both my family household's income and energy consumption increased during the last 20 years. As a percentage of net income, energy costs increased slightly from 3.9% in 1990 to 4.2% in 2009 (see Table 1).

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TABLE 1 Personal household income and energy use

Year	1990	1995	2000	2005	2010
Net real monthly household income (as % of income in 2000)	88.4	93.5	100	111.7	113.1
Percentage energy costs	3.9	3.8	3.7	4.2	4.2
Use of gas (m ³)			2,109	1,877	2,550
Use of electricity (kWh)			4,156	4,870	5,449
Average temperature in the Netherlands ^a (in Celsius)	11.1	10.4	10.9	10.7	9.0

a Source: KNMI

Between 1990 and 2000, our family grew from two to six members, but the share of energy costs, surprisingly, did not increase. Furthermore, in 1997, we moved from a small but energy-intensive home to a larger but more energy-extensive home. Yet this move, too, did not drastically affect the trend in our energy consumption. I still have data on the volumes of energy consumption of the last 13 years. If I look at gas consumption and electricity, both seem to have been growing. The increase in gas consumption in 2010, however, can be considered accidental, because of relatively cold weather in both January and December 2010. A regression analysis shows no significant upward trend.¹

These trends leave little doubt that the priority in Westerns countries should shift from material consumption to a broader concept of sustainable consumption. Sustainability means that we take responsibility for future generations. According to the famous economist Pigou (1932), the care for future generations belongs to the tasks of government. This also has consequences for economic policy and, more specifically, competition policy. Regulation of competition by the NMa traditionally aims at stimulating competition in order to increase consumer welfare in terms of price and quality of available products. Although it recognizes that social and environmental concerns may also affect consumer welfare in a broader sense, there is a continued focus on traditional growth of consumer surplus. The NMa feels uncomfortable with the task of including social and environmental objectives in its strategies, since this would involve making political choices for which it has no mandate. Ideally, it would only take into account non-economic values, if politicians clearly decided what

policy goals should be considered and what the role of self-regulation should be to realize this goal (NMa, 2010). However, since it is rare that lawmakers or the government actively intervene in the NMa's day-to-day work, decisions or strategies, the NMa faces public pressure to take into account sustainability objectives as much as possible. This creates several dilemmas for the NMa on how to balance sustainability and consumer welfare in practice.

In this article, I examine the question of whether and how the NMa can deal with these types of dilemmas. Is there a way of integrating sustainability into competition policy, without reference to an explicit political intervention? In the first section, I will discuss the inherent tension between antitrust policy and sustainability. Second, I will briefly comment on the relative priorities of growth in consumer welfare and sustainability from the viewpoint of stewardship. Finally, building on the procedures that the NMa followed in the past, I will make some suggestions on how the NMa could deal with these dilemmas in practice.

Tension between antitrust policy and corporate social responsibility

Competition policy in the Netherlands follows European law, based on the EC treaty of 1957. The guidelines of the European Commission for the application of Article 101 TFEU (formerly Article 81 of the EC Treaty) states that consumer welfare is the only goal of EU antitrust law. In line with European law, the Dutch Competition Act (DCA) consists of three elements: the prohibition on anticompetitive agreements, the prohibition on abusing a dominant position, and merger control. This is not just a matter of efficiency, but also of justice. The leading principle is that every market participant should have equal opportunities, i.e. there should be a level playing field.

Therefore, antitrust policy does not stand on its own, but is part of a spectrum of policies that aim at a just and free society (Ottervanger, 2010). Antitrust law is complementary to other laws that serve the social market economy. The European treaties reflect several interests. One of the more recent interests is sustainability. Ideally, different policy goals call for different policy instruments. Indeed, EU and member states have installed various environmental laws to regulate harm to the environment. However, the EU recognizes that these laws face serious and structural difficulties in addressing the issue of sustainability. This has raised an interest in Corporate Social Responsibility (CSR) for realizing public goals.

Policymakers see CSR as a concept used by companies to integrate social and environmental concerns in their business operations and in their interactions with their stakeholders on a voluntary basis, beyond compliance to mandatory, legal requirements (European Commission, 2001). CSR is important, precisely because of the limits of the law (Dubbink and van der Putten, 2008), particularly in case of international issues that demand international law and compliance procedures (Ottervanger, 2010).

Obviously, the two policy goals – a competitive market and sustainable growth – can easily collide. Although there are many empirical studies indicating that CSR may strengthen the competitiveness of a company in the longer run (Orlitzky et al., 2003; Beurden and Gössling, 2008) by improving the company's reputation in the consumer market (Brown and Dacin, 1997; Miles and Covin, 2000) or raising the productivity of employees (Turban and Greening, 1996), this win-win relationship is not uncontested. Some studies find a neutral or negative relationship (Jones and Wicks, 1999; McWilliams and Siegel, 2001). This also holds more specifically for the environmental dimension of CSR. For example, Filbeck and Gorman (2004) do not find a positive relationship between environmental and financial performance, rather the opposite. Telle (2006), too, does not find a positive relationship between environmental and economic performance. The latter conclusion is supported by recent research by Cañón-de-Francia and Garcés-Ayerbe (2009). Estimating the effects of ISO 14001 certification (which is a voluntary standard concerning an environmental management system, which matches well the concept of CSR) on the market value of firms, they find that the relationship is negative for less polluting and less internationalized firms. Only for more polluting and more internationalized firms, the results do not suggest a clear relationship between ISO 14001 certification and market value. Since environmental investments are costly in the short run, and the long-term benefits uncertain, enforcing competition may reduce the incentive to adopt CSR. In a perfect market, individual companies will therefore have hardly any room to pursue a pro-active CSR policy, because any cost disadvantage will harm their market share. A case in point is the textile sector during the late 1990s: increasing competition and a stagnating clothing market put considerable pressure on financial returns and triggered low-cost strategies. CSR suffered as a result. For example, in the 1990s, C&A was the only clothing company that was certified for the ISO14001 standard. However, in 2000, C&A halted its efforts for ISO14001 certification in several European countries due to the heavy administrative burden: the internal and external audits required for ISO certification were putting too

much additional pressure on C&A staff, and these tasks were thus reduced to a minimum (Graafland, 2002). Van de Ven and Jeurissen (2005) therefore conclude that CSR by individual companies is only possible in imperfect markets. Hence, when the NMa aims at transforming imperfect markets into perfect markets, it may frustrate CSR.

Now, abandoning the goal of stimulating competition in order to enable companies to contribute to CSR individually will often be too costly in terms of consumer welfare. Another and more efficient way to escape this serious limitation to CSR is to apply the principle of moral displacement. This principle means that actors should organize their CSR at a higher level, which is at industry level in most cases, where competition is less severe. Hence, only if the NMa allowed some form of inter-firm cooperation, it would be possible to combine perfect competition and CSR. This kind of cooperation allows individual companies to afford the costs involved with CSR while remaining on a level playing field, since all companies face the same restrictions. However, this does not take away the dilemma for the NMa. Because, as Smith already argued, ‘People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices. It is impossible indeed to prevent such meetings, by any law which either could be executed, or would be consistent with liberty and justice. But though the law cannot hinder people of the same trade from sometimes assembling together, it ought to do nothing to facilitate such assemblies’ (Wealth of Nations, I.10.82). This distrust against inter-firm cooperation as a means to serve the own business interests at the detriment of consumer welfare creates a tension between the principle of moral displacement and the traditional goal of consumer surplus.

Weighing consumer surplus and sustainability: the viewpoint of stewardship

According to the European Commission, restrictions to competition can only be justified by improvements of efficiency, either by lowering costs, an increase in quality, or more opportunities for innovation. This focus on efficiency follows from the goal of antitrust law to increase consumer welfare. The NMa, too, believes that consumer welfare is the ultimate criterion to evaluate competition. Practices that contribute to overall welfare by improving CSR are allowed if consumers obtain a fair share of the resulting benefit (DCA 6.3). As the NMa (2009) states: an agreement is good if it is profitable for the companies involved, as well as beneficial to consumers.

However, in concrete decisions, the European court has confirmed that consumer welfare is not the only goal of Article 101 TFEU, and it has taken into account considerations of public interest (NMa, 2009). This confronts the NMa with a difficult trade-off between consumer surplus and non-economic values, because various different ethical values may be involved, such as wealth, freedom and justice between current and future generations. In Christian ethics, the responsibility for future generations is often expressed by the concept of stewardship. Stewardship is a metaphor for the responsibility of mankind toward God, the creator of the Earth, who owns all things: 'The world and all that is in it belong to the Lord, the earth and all who live on it are his' (Ps. 24: 1-2). Hence, the notion expresses that the natural environment is something that we owe responsibility for to God. The earth is given to humanity as a community and must enable future generations to sustain their lives. I think that everybody somehow is aware of this notion of the givenness of creation. There is so much that we receive for free, that we realise that we may not ruin it and have the responsibility to hand it over to future generations. As stated by the Lockean proviso, that there be enough and as good left in common for others (Graafland, 2007), and by its modern formulation of the definition of sustainability by the UN Brundtland committee (WBCED, 1987).

In some cases, it will not be possible to protect the interests of future generations or the interests of the non-human living while securing the benefits of current (Dutch) consumers. Unfortunately, there is no objective rule to trade off the interests of current consumers in the Netherlands and future generations or current generations living in other parts of the world, let alone that of non-human beings. In addition, the standard method of cost-benefit analysis that tries to calculate total welfare effects of policies using the willingness (or proxies thereof) to pay fails for various reasons. The consequences of an action, and, hence, the costs and benefits it generates are difficult to predict and subject to different degrees of uncertainty. Furthermore, cost-benefit analyses assume that different values can be reduced to one basic value, namely welfare. Values are, however, often incommensurable and pluralistic in nature, relating to several generic goods rather than only to a single one (Anderson, 1993). Another problem is the aggregation of the willingness to pay prices. Cost-benefit analyses often give less weight to the interests of future generations by applying a discount factor, but provides no ground for determining the value of this factor. Furthermore, the interests of non-human beings can be given a lower weight than the interests of human beings, but again, cost-

benefit analyses cannot provide a satisfactory answer to the question of what this weight should be. In Christian ethics, the life of animals and other parts of creation have an intrinsic value, independent from the value they have for humans. These issues of fairness cannot be justified in utilitarian terms (Hausman and McPherson, 1996).²

Notwithstanding these difficulties of comparing consumer welfare and other values, it seems that, in current competition policy, consumer surplus receives too much priority. In Christian ethics, the value of increasing purchasing power for people who are already rather wealthy is ambiguous (Graafland, 2010). As long as the increase in consumption meets the basic needs of poor people and reduces poverty, it substantially contributes to well-being. Poverty does not only cause great material misery, but also social isolation and lack of self-respect. But once basic needs are met, the marginal value of additional consumption diminishes. Since consumer welfare in the Netherlands is comparatively high, the value of increasing consumer surplus is relatively modest. Therefore, the trade-off between consumer surplus and sustainability shifts towards the latter, particularly as the quality of the natural environment is worsening due to the human production and consumption patterns. This makes rethinking the role of the NMa urgent.³

Past experience of the NMa

When sustainability and corporate social responsibility become more important in the future, the potential number of cases where CSR conflicts with competition may increase. Ottervanger (2010) presents several examples. In the past, the NMa has encountered several cases where the traditional task of preventing imperfect competition potentially provided conflicts with sustainability.⁴ Based on these cases, we take stock of the implicit rules that the NMa seems to have followed in the past.⁵

A well known case is Stibat, a foundation of Dutch companies that took responsibility for the (cost-increasing) collection and recycling of used batteries. In this case, the dilemma was softened by the fact that the responsibility for collection and recycling of used batteries followed from a legal obligation. Hence, there was a democratic basis for the goal of this collective action of companies. Taking into account that the collective system generated logistic efficiency in comparison to collection and recycling on an individual basis, the NMa therefore provided exemption for the inter-firm cooperation (extended in 2002; case 3142). However, it did not grant exemption for Stibat's proposal to oblige the participating compa-

nies to charge their customers the full amount of the costs of the battery removal (case 51). Stibat argued that this price component would have no effect on the total price that companies charge to their customers and would leave competition unaffected. The NMa reasoned, however, that some companies might not charge the battery removal costs to their customers as a way of promoting their products, and that therefore a uniform price raise would reduce competition.

A very similar case concerns a collective system of financial contributions of consumers to the joint collection and processing of scrapped domestic appliances and home electronics (case 2495). On 18 april 2001, the NMa decided to give exemption to the foundation Witgoed (domestic appliances), the foundation Bruingoed (home electronics) and the NVMP (association of undertakings involved) under Article 6(3) of the Dutch Competition Act (which corresponds to 101(3) TFEU) for this system. However, the exemption was refused for the obligation of producers and importers to charge their customers the full amount of this environmental contribution. Later, in 2005, the NMa, however, also granted exemption to the forward shifting of the costs of the collection and processing system, but only for the amount that was caused by the historical stock of appliances, arguing that the system provided sufficient guarantees that the consumer would not be disproportionately burdened by these costs.

A third case concerns an inter-firm agreement in the shrimp-fishing industry, where fisheries and retailers jointly decided to set fishing quotas in order to protect fish stocks (case 2269). However, the NMa argued that the EU had set no fishing quota for this type of fish, indicating that the shrimps were not considered in danger of disappearing. Therefore, it rejected the sustainability argument of the fish producers and retail organisations, and concluded that there is no ground for self-regulation of fishing output by organisations of fishers and should therefore be prohibited.

Lessons

These three cases show the dilemmas that NMa faced were not that difficult, because there were hardly real conflicts between two or more moral standards.

Starting with the last case, it was not difficult for the NMa to downplay the environmental value of the cooperation of the fish industry by referring to the fact that EU policy indicated no threat to the shrimp stock. This took away the conflict between environmental values and consumer

surplus, and it allowed a traditional solution that puts consumer surplus first. In the other two cases, the dilemma was more serious. However, again, in both cases, some conditions softened the dilemma. First, the collective action proposed by the companies was backed by a legal obligation of companies to take responsibility for the environmental effects of their products. Hence, the NMa itself did not have to judge the value of the public good being served by the collective system. Therefore, the problem boiled down to judging what kind of system would serve welfare most. Second, in both cases, a detailed analysis of the market situation and the system proposed produced a feasible solution that allowed acknowledgement of the principle of moral replacement without too much risk that the consumer surplus would be harmed. Still, keeping in mind Adam Smith's warning, in both cases, the NMa had to take into account the possibility that the collective system might induce anticompetitive types of cooperation in the future that could harm consumer surplus. Apparently, it judged that the probability of this danger was sufficiently small to accept this risk.

From these experiences we can draw the following lessons on how the NMa deals and can deal with balancing the welfare of current (Dutch) consumers and broader welfare effects on current and future generations:

- In case of collective actions of companies that are defended on basis of protection of collective goods while maintaining a level playing field, the NMa cannot simply dismiss the initiative by reasoning that collective actions go against consumer interests.
- Experience shows that the NMa has indeed been willing to go further and to consider the possibility of allowing collective actions of companies that serve sustainability, even if there is a risk of a small reduction of competition.
- The NMa should make a substantial analysis of the truth of the claims used by the companies to defend their initiative. If this analysis shows that the claim is invalid, the dilemma is solved and the case can be treated in a standard way putting consumer surplus first.
- In case the threat of harm to collective goods is real, the NMa must judge whether collective action of companies will be an effective instrument to protect the collective good. The fiercer the competition among companies, the more difficult it will be for individual companies to prevent harm to the collective good without a collective system. In case companies are operating in a market that is not subject to fierce competition, individual companies have more opportunity to take responsibility for the protection of the collective good without resorting to collective actions.

- Self-regulation through collective action is acceptable if a detailed analysis of the market system and the characteristics of the collective system shows that the possible anticompetitive effects of the cooperation among companies are relatively small.

The potential conflict between sustainability and consumer surplus could even be diminished further by additional institutional innovations. For example, the law could be extended by an article allowing an extra fine (on top of the normal regime) if companies that have been allowed exemption from DCA because of sustainability, turn out to use these contacts also for secret anticompetitive agreements.

Finally, in case that none of the above cases holds, in other words, if the NMa is faced with a real dilemma because of a conflict between sustainability and consumer surplus, it should leave the decision to the responsible policymakers. The government should stay in charge in making political trade-offs if consumer welfare collided with other fundamental values.

COMMENT

NOUT WELLINK*

Consumer welfare, sustainability and trade-offs

The analysis of Johan Graafland, which I have read with great interest, addresses a topic of major importance. Indeed, in this century, sustainability is one of the world's fundamental problems. It is also a long-term issue. De Nederlandsche Bank, as a prudential supervisor, is familiar with protecting consumer interests spanning as many as 60 years. Think only of the EUR 850 billion in pension assets entrusted to pension funds and life insurers. For sustainability, however, the horizon lies much further ahead.

Graafland starts his well-documented analysis by describing the trade-off between the welfare boom of the past two centuries on the one hand, and the simultaneous degradation of nature in terms of biodiversity as well as the economic depreciation of natural resources on the other. Be-

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sides, prosperity has also brought pollution, health risks and global warming. Many emerging countries with huge and expanding populations are rapidly catching up on welfare. It is increasingly evident that our material prosperity is becoming a threat to current welfare around the world, but especially that of future generations. Even now, global warming is suspected to aggravate storms, hurricanes, floods, and droughts, resulting in severe human and economic losses. The strain of commodity scarceness is also evident. Actions taken to foster sustainability, and current and future technical progress will soften many of the adverse effects of the drawbacks mentioned. In fact, one may say without exaggeration that our planet and its biodiversity are exposed to systemic risk.

As Graafland mentions, a widely accepted principle in economics is to take the interest of future consumers into account when analysing the impact of policy decisions. This notion is apparent in the commitment to reduce government deficits and public debt so as not to shift financial burdens to future generations, sovereign wealth funds where revenues from non-renewable energy stocks are saved for future generations, and the intergenerational risk-sharing principle of the Dutch defined-benefit pension system. And then there is the ethical argument for sustainable behaviour as embodied in, for instance, the Biblical notion of stewardship. All this puts a heavy responsibility on the current generation.

The obvious question is why current human behaviour fails to meet the need for sustainable conduct. Of course, the so-called external effects known from economic theory prevent most consumers from behaving themselves: they would bear the costs of sustainable conduct – or the loss of giving up unsustainable consumption – without reaping much of the benefit, while irresponsible consumers benefited from their free-rider behaviour. This kind of market failure should typically be *tackled* by government policy. The many measures that have indeed been taken have, in the eyes of many, lacked vigour and rigour. Stronger public support would also be helpful. In turn, countries also suffer from external effects, as became apparent during the recent UN Summit on Climate Change – a type of market failure which could be solved by multilateral agreements and firm adherence to these agreements. This requires true statesmanship. Obviously, consumers and countries may individually choose to behave sustainably, but this will most likely be limited, given the absence of a proper incentive. Some firms behave sustainably on a non-compulsory basis in order to create a ‘green’ image for themselves, also known as Corporate Social Responsibility (CSR).¹ A voluntary CSR plan may put an individual company in an unfavourable competitive position. Therefore, a

more efficient way is to apply the principle of moral displacement, where actors should organize their CSR actions at a higher level, in most cases the industry level, so that intra-industry competition damage is avoided. Industries bear the costs of sustainable behaviour but may benefit from an improved public image.

Graafland thoroughly discusses the dilemma the NMa faces when firms in an industry agree on a CSR type of cooperation: there is a trade-off between general consumer interest (more sustainability) and competition (possible impediments to competition due to cooperation). The anti-trust authority encounters many such trade-offs,² while DNB as central bank and supervisor faces others.³ Typically, some economic theories suggest a positive relationship between both targets, while others propose the opposite, and equally typically, the empirical evidence regarding the sign of the interrelation is ambiguous. This is also what Graafland finds for his CSR-competition trade-off. In the sustainability versus competition case, governmental sustainability policy would be supportive, as it would provide a legal basis for taking sustainability into account as a consumer interest. Indeed, mandatory internationalisation of external effects need not impair the level playing field.

Two types of trade-off – competition versus solvency, and competition versus financial stability – concern both NMa and DNB, the institutions led by Pieter Kalbfleisch and myself, respectively. Traditionally, competition was seen as a threat to solvency, in that competition reduced supernormal profits that could be used to increase bank capital (Keeley, 1990; Hellmann et al., 2000; Hauswald and Marquez, 2006). But more recent theories and empirical evidence suggest that competition, in fact, contributes to the economic soundness of banks (Koskela and Stenbacka, 2000; Barth et al., 2004; Boyd and de Nicolo, 2005; Beck et al., 2006; Carletti et al., 2007; Schaeck et al., 2008). These theories hypothesize that competition improves banks' efficiency. More efficient banks apply better screening and monitoring procedures, thus reducing their shares of non-performing loans, while weaker banks face worse adverse selection problems. 'If banks were strengthened by the gymnastics of competition, the banking system would be stronger and more resilient to shocks.' (Padoa-Schioppa, 2001, p. 16). One of the counterarguments is that competition may reduce the incentive to invest in relationship-building, as relationships are expected not to last very long anyway. Indeed, competing banks may save screening (and rescreening) costs by taking over clients, which are already screened by their current home bank. The debate continues (Berger, 2008).

The second trade-off faced by both NMa and DNB is that of competition versus financial stability. A number of theories assume that competition reduces financial stability. The traditional ‘charter’ or ‘franchise’ value view of banking predicts that a less competitive banking system is more stable, as profits contribute to bigger capital buffers against fragility and provide incentives against excessive risk-taking (Marcus, 1984; Chan et al., 1986; Keeley, 1990). Competition may also reduce the willingness to help competitors with temporary liquidity shortage via the interbank market and the payment system (Allen and Gale, 2000). Concentrated banking systems with large banks are often seen as less competitive (but that conclusion is rather debatable, see Claessens and Leaven, 2004). Large banks may reduce their fragility, as they are better able to diversify (Diamond, 1984; Ramakrishnan and Thakor, 1984; Boyd and Prescott, 1984), but a counterargument is that diversification may interlink banks and make them more similar, with negative net effect on systemic stability (Wagner, 2008). Banking systems with many banks (pointing to more competition, which again is debatable) may reduce the supervisory effort per bank, impairing the overall banking system’s stability (Allan and Gale, 2000).

Other theories predict that competition increases financial stability. In more concentrated banking markets, seen as less competitive, banks use their market power to raise interest rates on loans. As a consequence, borrowers will choose riskier activities, to be able to pay those interest rates, with a higher probability that loans will stop performing, resulting in a more fragile banking system (Boyd and the Nicolo, 2005). A concentrated market with large banks induces banks to take more risk, as they expect to be saved being too big to fail (e.g. Mishkin, 1999). The fact that large banks tend to be more complex defeats the argument that it is easier for supervisors to have just a few banks to monitor. All such theoretical arguments rest on the debatable assumption that concentration reflects lower competition. As yet, the final word on the impact of competition on financial stability has not been spoken (Beck et al., 2010).

NMa and DNB may find themselves disagreeing (although each with consumer interests in mind) when a bank or insurer is in danger and a merger or acquisition may offer a solution. Either would increase certainty about savings and future benefits, but the resulting concentration may reduce the competition that helps keep prices low and quality high. I recall with pleasure the concerted efforts on ‘Protocol between DNB and the NMa concerning concentration in the financial sector in emergency situations’ (bearing both our signatures), which replaced an earlier Protocol of

a similar nature when it came into force in the beginning of this year. It underlines the pleasant and fruitful cooperation between our two institutions. May it also be sustainable.

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Notes

ARTICLE

- 1 This is confirmed by the outcomes of a regression analysis for 1997-2010, which are summarized in the following table (t-values are reported between brackets):

	Time trend	Temperature	F-statistic	R ²
Gas use	16 (1,44)	-186 (2,22)	3,86	0,41
Electricity use	143 (12,10)	0 (0,00)	73,93	0,93
- 2 For a more complete overview, see chapter 7 in Graafland (2007).
- 3 Earlier the SER advised the Dutch government to revise the criteria for exemptions to the prohibition of inter-firm cooperation in order to take more account of social and environmental interests, but the government chose not to follow this advice (SER, 2003).
- 4 There are also cases where other social-economic values were at stake. An example is the so-called 'milk dime' case where Dutch supermarkets proposed to raise the consumer price by 10 cents to support Dutch farmers troubled by the foot-and-mouth disease. The NMa forbade this action, because in this way the supermarkets force consumers to assist these farmers. Another recent case is the merger of two hospitals in Zeeland in order to maintain a minimum quality of care because of returns to scale. This would create monopolistic power, because no other hospital exists in Zeeland. In this case the NMa consulted

all relevant actors in the sector (doctors, client councils, client networks and large insurance companies) and all of them agreed that the merge was desirable for maintaining the required quality. The NMa gave its consent after the hospitals offered to apply a maximum price policy based on the national average price of medical treatments as well as to realise some quality improvements deemed necessary, thereby guaranteeing a favourable quality price ratio for consumers (NMa, 2009).

- 5 In 'Richtsnoeren samenwerking ondernemingen' (The Hague, 2005) the NMa has published several guidelines on how it will assess various types of inter-firm cooperation.

COMMENT 1

- 1 Companies applying CSR integrate social and environmental concerns in their business operations and in their interactions with their stakeholders on a voluntary basis, beyond compliance to mandatory, legal requirements.
- 2 For instance, competition against innovation, competition against solvency and competition against financial stability. The latter two are discussed below.
- 3 E.g. (micro) solvency against macro-economic stability, price stability against (micro) solvency, competition against solvency and competition against financial stability.

PART

7

Competition and art

La maladie imaginaire

JULES THEEUWES*

Introduction

Pieter Kalbfleisch, chairman of the board of the The Hague Philharmonic, knows that it is hard, nay impossible, to run a symphony orchestra as a profit-making business. As was documented in a December 2010 *NRC* newspaper article, all Dutch symphony orchestras operate at a loss, and need substantial subsidies to make ends meet. Depending on the orchestra, average subsidy is between € 50 to € 150 per ticket per performance. The newspaper article was written preceding a policy discussion in the Dutch House of Representatives on the government's plans for deep cuts in cultural subsidies.

Watching the rock star status of André Rieu and his Johann Strauss Orchestra, epitome of Dutch cultural export success, one has to conclude that some performing art companies make a profit some of the time, while most music, dance and theatre companies run at a loss all of the time. It is said that the latter have a perfect excuse. It is said that they suffer from Baumol's disease; a disease that makes losses as unavoidable as sunrises in the morning. This disease explains the necessity for permanent governmental subsidies and philanthropical help, and gives the industry a strong argument as to why performing arts cannot operate in a competitive market. It is not explained why the Johann Strauss Orchestra does not suffer from the disease, while all others do. The disease is, to a large extent, nonexistent. It is to paraphrase the title of Molière's 1673 showpiece of the French theatre 'une maladie imaginaire'.

A full-fledged pandemic

Baumol's disease is widely spread. Not only are performing arts seen suffering from it, but also the health sector and education. It is also a popular disease, in the sense that it is often quoted in public discourse. A quick

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check in LexisNexis searching for 'Baumol' reveals that, in the last six months, Baumol's disease popped up twice in a Dutch newspaper in the context of the health sector. In a third article, Baumol is proposed as the perfect candidate for a future Nobel Prize in Economics. Two quotes on Baumol's disease may not seem much until it is contrasted with another economic term such as 'zoektheorie' (search theory). This term was quoted by nobody in the last six months even though the Economics Nobel Prize recently handed out was precisely for three economists having invented search theory.

So what exactly is Baumol's disease? According to Mark Blaug (2001) it is 'the jewel in the crown of cultural economics'. The original formulation is in William Baumol and William Bowen's article from 1965, and it reappeared in their joint book publication a year later (Baumol and Bowen, 1966). There is a simple version of Baumol's disease that hits you like a glass of undiluted vodka on an empty stomach, and there is a more complicated version that you need to mull over like a good glass of Italian wine. Both versions are misleading, with the simpler version being more misleading than the complicated one.

The core message of both versions is that it is impossible (simple version) or much harder than in other industries (complicated version) to increase labor productivity in the performing arts. The simple version works by way of example. Take Mozart's String Quartet in D major K499, known as the 'Hoffmeister' string quartet. It takes roughly half an hour to play the four movements and it requires four string players. One could try to increase productivity playing it faster and finishing it in 20 minutes, by leaving out a third of the notes or by dropping one of the string players. It would not be the same piece though. It took a combined 2 hours of work to play this quartet in 1786 when Mozart wrote it for his friend Hoffmeister, and it still takes two hours in 2011. No productivity increase in more than two centuries. Similar arguments can be made for all performing arts. 'Alas poor Yorick' cannot be left out of Hamlet, the Dying Swan has to dance for all the time it takes to die and the Ring of Nibelungen will always go on forever. The point of the simple version is that performing arts is a peculiar industry in contrast with all those other ones where productivity increases steadily over the years. At the end of the 19th century, Dutch farmers could hardly feed themselves. Thanks to steady increases in productivity over the years, Dutch agribusiness is now a profitable and competitive industry that feeds the world. The Concertgebouw (Amsterdam's concert hall) was subsidized by an assembly of Amsterdam notables when it was founded in 1881, and is still subsidized more than a hundred years later.

The more complicated version takes reasoning of the simple version to its logical end. Assume for the sake of argument, as do Baumol and Bowen (1965), that there is a productive industry (manufacturing) and an unproductive industry (arts). In the productive industry, the output per man-hour increases with 4 percent per annum. In the arts industry, output per man-hour does not change. The average productivity increase economywide is 2 percent (giving both industries equal weight). Assume further that workers can work equally well in both industries, and that labor moves freely between sectors. In addition, there is no price inflation. Baumol and Bowen assert that wages will rise with the average economywide productivity increase of 2 percent in both industries. This results in the per unit labor cost in the productive (manufacturing) industry to decrease with 2 percent as the wage increase of 2 percent falls behind of the 4 percent productivity increase in that industry. The fall in unit labor cost can be used in this industry to reduce prices, increase profits or both. In the arts industry, the per unit labor costs will go up with 2 percent because the wage increase is 2 percent and there is zero productivity growth. The arts industry either has to increase prices or, which is more often the case, will operate at a loss. A company that structurally runs at a loss year after year cannot survive in a competitive environment. Rather, it requires ever-increasing financial help from government and private philanthropists or sponsors.

Note that the cost disease extends to other service industry as well. It is also claimed that, similar to the art industry, productivity can hardly be increased in the health industry. Severe Alzheimer patients need to be taken care of 24 hours per day, 7 days per week, and it does not seem possible to automate or mechanize care and increase its productivity (Theeuwes, 2005). Similar constraints can be found in the education system or in most of the service industry, such as restaurants and barbers. As balding men waiting in the barber shop knew a century ago, and still know today, the haircut of a man with lots of hair always takes forever.

Looking elsewhere

Contemplating the extended version of Baumol's cost disease long enough makes one realize that there must be something wrong with it. By definition, half the industries in the economy have a productivity growth below the national average. According to the Baumol hypothesis, this would imply that half of the economy suffers from cost disease, which is obviously not true. In all major economies, the service industry amounts to two-

thirds or even three-quarters of the economy. Baumol suggests that the service sector in particular suffers from lagging productivity growth. If that were really true, all major economies would have structural cost problems, which they have not. In a later article, Baumol retracted some of his more extreme predictions (Baumol et al., 1985).

The simple truth exposed in the example of the Mozart Quartet always requiring four players during half an hour probably explains the attractiveness of Baumol's contribution and its popularity in public discourse. There is nothing wrong with the example or its logical conclusion. But it is barking up the wrong tree. It is not in the number of musicians or their playing tempo that one should look for productivity improvements. Productivity improvements in the performing arts are to be found elsewhere.

Look at a performing arts company as a firm producing performances. An arts company production period is a 'season' and in each season a number of 'productions' is made and each production is performed a number of times. Economists make a distinction between the short run and the long run. In the short run, capacity – such as size of the concert hall – is given. It could be a thousand seats, and that is the maximum size of the audience per performance. Give the hall size, the performing company can increase the productivity of its orchestra or its troupe of actors or dancers by changing the length of the season, by playing off-season, by changing the number of productions during a season, and by varying the number of performances per production.

The production of each new play or ballet requires substantial initial costs. There are the rehearsals, new costumes, a fancy décor, and a publicity campaign. Once the initial costs are spent, average cost per performance will decrease with more performances. There are obviously limits to the number of performances that can be repeated, but as long as there are customers willing to pay a price that is higher than the always diminishing average cost, it is a profitable proposition. This is how entrepreneurs in the profitable part of the performing arts make their money. That is how musicals have become booming business in the Netherlands in the last decades.

Also note that performing arts are the perfect place to extract large chunks of consumer surplus or, in this case, audience surplus, by price discrimination. Different seats are charged different prices and different groups (students, pensioners, sponsors) pay different prices. Sensible price discrimination increases profitability. Performing-arts companies could be like airlines whereby each passenger in the plane has paid a different ticket price, thus extracting from each as much as possible of what he or she is willing to pay.

There is also the long run. In the long run, capacity can be changed. A new concert hall or theater can be built, one that is larger than the previous one. Or one could go the way that movie theaters went: building multiplexes that house up to 20 screens or megaplexes with more than 20 screens. There is some of the multiplex element in the Concertgebouw having its main and smaller halls, but it is not yet like the Pathé cinemas in Amsterdam (where, by the way, one can also watch performances by the New York Metropolitan Opera). The point here is not that concert halls and theaters should be like the movies, but that rather than shortening the time it takes to play Beethoven's ninth it can increase productivity by increasing numbers of eyes that see and ears that hear Hamlet, Cecilia Bartoli or Swan Lake in a given year.

Quality is an important characteristic of performing arts, which, within limits, can be changed over time. With enough cost pressure, quality does change. Empirical evidence shows that art production does adapt to avoid increasing costs. When deciding about what production to put on the program, it is always possible to reduce costs by choosing simpler plays with smaller casts, repeating earlier productions and going for 'best sellers' that attract larger audiences. It is always cheaper and more profitable to repeat the 1981 theatre legend 'U bent mijn moeder' in which Joop Admiraal, alone on stage, played his old mother growing senile, than to put the Gijsbrecht van Aemstel on the program, attracting dwindling audiences and requiring large numbers of speaking and mute actors and even more noblemen, nuns, virgins and refugees. One could also use cheaper performers. Cost-cutting is clearly limited as audiences will stay away if the production becomes too cheap, but, at the same time, the audience does not always notice when last year's décor, freshly painted, is used again.

It's no pianoforte anymore

In spite of what Baumol's disease suggests, there have been major technological advances in the performing arts over the years. Over time, concert halls and theater halls have been better designed, and lightning and sound systems have improved dramatically, all of which meant that larger audiences could enjoy performances in a better way. Looking over much longer periods of time, instruments and playing techniques have changed. The modern piano is a different instrument than the pianoforte Mozart used for composing.

The most important productivity change in the performing arts over the last decades is caused by the vast broadcasting and recording possibili-

ties that extend consumption of a single performance to thousands and even millions of consumers. In recent years, these possibilities have exploded through the internet. Naturally, a digital version of Norma is a different opera than Norma in the flesh. But it is a very close substitute. With advancing technology, a DVD projected on a large home screen with a pitch-perfect audio system is a very close substitute indeed. With a digital version of Norma featuring Maria Callas one can increase consumer surplus from the relatively small audience size that watched her in the Scala to millions of fans worldwide. The simpler version of Baumol's disease concentrates on increasing the productivity on the production side. This is impossible, but it is also not relevant. Productivity increases are only relevant when they increase consumer welfare, and that is exactly what the extended recording, broadcasting and internet possibilities have done and are still doing for the performing arts.

The more complicated version of the Baumol cost disease model makes two questionable assumptions. The first concerns wage-matching in the arts industry. Given the substantial erosion over time of the relative earnings of workers in the performing arts sector, matching is obviously not happening. Earnings in the performing arts are lagging behind. Of course, there are superstars in the performing sector earning many times the so-called Balkenende norm (maximum pay within the public sector), but, by and large, earning a decent living in the performing arts sector is not easy. Certainly considering the intensive human capital investment that is required to become an accomplished artist. Artists are assumed to sacrifice income for the pleasure of belonging to the arts scene. In spite of the relatively lower earnings, there is still an excess supply of people trying to get into the arts world. In any case, whatever threatening cost increases might arise, it has been avoided by keeping earnings relatively low, rather than matching with the rest of the economy.

The second questionable assumption concerns the options of passing on the cost increase through higher ticket prices. Over time, real income has risen considerably, and with it, cultural consumption has also gone up. In any case, the audience at performing arts performances is usually skewed to the right. Meaning that, in the distribution of income, education and age, they are mostly on the right side of that distribution. Richer, higher educated people appreciate the arts and have the means to pay for it. Whatever cost increase there was, could have been passed on, at least partly, in higher admission prices.

Finally, the expected permanent cost explosions and increasing losses due to Baumol's disease have not been found in the data, which is a con-

clusion in articles reviewing the evidence, such as Throsby (1994) and Abbing (2005). It is even the conclusion of an empirical study done by Bill and Hilda Baumol (1980). This does not say that performing arts have been doing well and dandy over the years. What the data show is that losses are not so much due to Baumol's cost disease as due to causes such as dwindling audiences or dwindling government subsidies or philanthropic support, which is a point already made for the Dutch performing arts by Berend Jan Langenberg (1992), and before him by J.D. Hilferink (1972). Empirical studies also show that, over the years, performing arts companies have reduced labor inputs, changed repertoire, and adopted other cost-reducing strategies.

Curtain call

To sum up: one of the main arguments for subsidizing performing arts and keeping them out of the competitive market has been Baumol's disease. This argument is wrong, or at least, it is not valid in the way it is often used. There are many ways in which a performing arts company can change its production process and its products and go for a profit (or smaller losses). There are technological and productivity advances possible in the arts sector, certainly in terms of increasing consumer welfare. There are many examples in the performing arts industry that, every day, make the point that profitability is feasible. There are clearly competitive markets for performing arts: musicals, popular music, popular theater, stand-up comedians, circus, popular dance, magic, movies. They all make it in a competitive market. Which makes one wonder about the others that do not succeed. The difference between the group that makes it and the group that does not make it, corresponds with what is considered, to put it in very simple terms: low art and high art. High-art companies are usually the ones that run at a loss.

In their original article, Baumol and Bowen (1965) also discussed this high-end and low-end aspect of the performing arts sector. In that part of their analyses, they noticed that some performing arts companies are not on earth to make money but to provide society with quality art: quality as an end in itself and at any cost. When more subsidies are poured into these companies, they will only use it to increase the quality of their performance, to build more lavish productions, and to hire higher paid top artists. Aiming for the highest quality, there is an endless need for subsidy. In their quest for quality, they end up in a situation where their marginal cost is way above their marginal revenue, implying that each ad-

ditional customer rather than adding to profit only adds to losses. Their endless quest for quality explains why these companies are not keen on cost-cutting or finding ways to make more money.

Why subsidize high-art companies? In terms of market failure, always the economist's main reason for government intervention, there is for sure the positive externality of arts argument. High-art performing companies contribute to national identity, culture and civilization. Without the Concertgebouw Orchestra, the Netherlands would be a bleak place to live. Surveys in which the population is asked about their willingness to pay for high art show that many citizens are willing to pay taxes to finance the availability of high-art performance, even when they themselves have no intention to ever consume it.

Even though there are valid reasons to subsidize high art with taxpayers' money, the unsolvable question remains: by how much? It is not only hard to measure how large the positive externality is (although survey questions certainly will help), but one also quickly realizes that providing performing arts with more subsidies will always be used to increase the quality of their productions, and it is hard to tell at what point quality increases cease to be sensible.

What this article hopefully made clear is that Baumol's disease should not be an argument in deciding about subsidies. And neither should the chairman of the board of the The Hague Philharmonic use it as an excuse. Even though it is a popular hypothesis in society at large. Baumol's disease is sufficiently pessimistic to have the same attractiveness for society as the dire prediction of increasing poverty due to population growth by Malthus in the 19th century and the end of the world predictions made by the Club of Rome in the 20th century and by Al Gore in the 21st century. Societies love predictions of imminent misery. In spite of all its weaknesses, Baumol's disease might even still be a great idea. At least that is what Mark Blaug (2001) concludes: 'If greatness lays not so much in being right, but in stimulating others to find what is right, then Baumol's [...] model is one of the great ideas in economics'

COMMENT**RENÉ JANSEN*****Regulate or participate?**

From March 1994 until October 2009, I have almost daily been involved in competition policy and competition supervision at the Ministry of Economic Affairs and the NMa respectively. From late September 2003 until October 2009, I enjoyed an almost daily and very close collaboration with Pieter Kalbfleisch in the leadership positions of the NMa.

We talked a lot about competition, which speaks for itself. In fact, we talked mostly about competition and organizing competition regulation. We also talked regularly about art and culture. The vicissitudes of the Hague Philharmonic and the 'Pure Jazz' festival were obviously recurrent subjects in our conversations.

A subject Pieter Kalbfleisch and I professionally almost never talked about, however, so I realize in retrospect, was the combination of these two topics: (performing) arts and competition. It rather was – and still is – a non-priority issue in the supervisory practice of the NMa, to put it mildly.

Arts, culture and competition are not complete strangers to each other. So I have both for the Ministry of Economic Affairs and the NMa grappled with the issue of resale price maintenance on books. This also applies (in very different degrees of intensity) for issues such as clearing listings of (public) TV broadcasting (in relation to copyright legislation); the public performance of BUMA-STEMRA and SENA (organizations of authors', performers' and record producers' collective rights management) and investigations in the concert and ticket industry. The last topic to mention here concerns tariff arrangements of self-employed professionals such as interpreters and translators, and professional musicians participating in Foundations on Dutch Orchestra Substitutes (Remplaçanten Nederlandse Orkesten).

There you are ... 'musicians' and 'orchestra'! So, in fact, there is a certain link with the performing arts after all!

The main conclusion in my opinion all the same remains that art and (economic) competition have had only had a marginal significance to each other. When I read the invitation to contribute to Pieter's *Liber Amicorum* precisely on this issue, I initially was slightly surprised and startled.

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It would not surprise me if the latter also happened to Professor Jules Theeuwes. I believe to have seen that reflected in his essay.

Jules Theeuwes wrote a fascinating essay on the topic Performing Arts and Competition. He gave his essay on the 'Baumol disease' the title 'La maladie imaginaire'. Theeuwes takes us into a convincing argument that – despite the theory of Baumol – there is indeed room for labour productivity-increasing measures by undertakings (such as orchestras) in the world of performing arts. Thus, these undertakings do not have Baumol's disease and are not necessarily subsidy dependent, for them there are no intrinsic barriers to enter competitive markets.

I interpreted Theeuwes' essay mainly as a business analysis. An analysis leading to the conclusion that doing business in a market for 'high level' performing arts is possible, and that entrepreneurship can lead to a profitable (or less onerous) undertaking. From the perspective of a former competition regulator, however, the essay by Jules Theeuwes ends right at the spot where the economic competition between undertakings begins.

A serious question to ask could be whether the lack of NMa's attention for companies operating in the markets of performing arts is a grave omission. My own opinion on this issue is that the answer would be a negative one; it is not a serious omission at all! No, our society is not harmed by the NMa's invisibility in the performing arts sector. There are no indications that consumer welfare is being harmed. The basic conditions in the sector to assume a valuable contribution by an intensified supervisory practice by the NMa in the near future are far from being met. All criteria in NMa's priority setting schemes would indicate: take it easy!

I recognized a comparable conclusion in a letter to Parliament by the former Minister of Economic Affairs, titled 'Our creative capacity: letter on culture and economics' ('Ons creatief vermogen: brief cultuur en economie', 26 augustus 2009). The Minister concludes in his letter that creative sectors (the cultural sector being one of them) and economics are too much of a separated kind. Some indicated key elements are the poor performance on product and services marketing, an excessive subsidy and government dependency and underdeveloped entrepreneurship.

So, in fact, there might be a valuable contribution, after all, NMa officials can give to the future strength of performing arts undertakings: active participation in strengthening the entrepreneurial mindset.

Once again, NMa staff should take as an example the dedicated contribution of Pieter Kalbfleisch in his spare time outside office opening hours. His contribution as Chairman of the Board of the Hague Philharmonic; next to that his voluntary participating in the organizing committee of the Pure Jazz Festival.

The emphasis of NMa's contribution in the near future to the performing arts should be a non-official one: participate instead of regulate! Besides that, and this counts for all of us, let's not forget to visit the theatres!

COMMENT

PAUL GLAZENER *

An imaginary cure?

Jules Theeuwes has written an inspiring essay on the subject 'Competition and the Performing Arts', entitled *La maladie imaginaire*. In it, he argues that Baumol's disease from which the performing arts are said to suffer is an imaginary disease. In his view, there are many ways in which performing arts companies can change their production process and increase their profitability. Therefore, Baumol's disease is not a valid argument to subsidize the performing arts.

As is more often the case with contributions by economists to discussions about competition law, Theeuwes' essay is interesting and well written, but it is not really helpful in answering the question.¹

The issue on which we have been asked to form a view is the relationship between competition and the performing arts. The reason, of course, being that next to his work as chairman of the board of the NMa, Pieter Kalbfleisch is an ardent lover of classical music, as demonstrated amongst others by his post as chairman of the board of the Hague Philharmonic. As far as I know, the NMa never has had to take a decision applying competition law to the (performing) arts sector. The NMa is not alone in this; there are very few decisions by competition authorities in this area. And yet, the Hague Philharmonic and other classical orchestras in the Netherlands are doing quite well and belong to the international top in their field. So rather than examining whether the performing arts are suffering from a disease, I propose to examine whether the application of competition law to the performing arts is likely to have any significant benefits.

One of the rare cases concerning the application of competition law to the performing arts dealt with the question whether an opera singer can be considered an 'undertaking' within the meaning of (then) Article 85 (1)

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EEC. The European Commission found that artists are undertakings within the meaning of Article 85(1) when they exploit commercially their artistic performances.² However, the Commission added that artists had to be 'highly successful' before their agreements had appreciable effects. The other competition cases decided by the Commission were all State aid cases. They involved aid to support theatre, music and dance performances and performing arts organisations. The beneficiaries of the aid were considered undertakings on the ground that they carried out economic activities. The aid involved State resources, it was selective and it could have an effect on competition, and, in the more significant cases, also a (potential) effect on trade between Member States, so all the conditions for the application of the State aid rules were fulfilled. In all cases, the aid was approved.³

The opera singers were four of La Scala's leading singers. They had been members of a cast which had performed 'Don Carlos' in Salzburg. The performance had been recorded by Unitel and the singers had exclusive contracts with Unitel in which they had undertaken not to take part in any other film or television production of the opera. It is not clear from the Commission's decision how the case ended but it is not difficult to apply the competition rules in this case. An agreement like this should be acceptable as long as the scope and duration of the exclusivity is proportionate to the investment made by Unitel, and allows the latter to recoup that investment. The real question seems to be whether the agreement can be considered to have appreciable effect.

Other agreements which may occur in the performing arts sector are cooperative agreements between performing arts organisations. Baumol has explained that performing arts organisations are generally unable to achieve productivity gains from an artistic standpoint, but they have the potential to do so in terms of operational, administrative and overhead expenses.⁴ Agreements between performing arts organisations allowing them to achieve such efficiency gains should be unproblematic from a competition standpoint. Even if they have the potential to restrict competition, this is clearly outweighed by the benefits. In fact, it is difficult to imagine an agreement between orchestras or theatre companies where the restrictive effects would have the upper hand. This might be the case for 'hard core' cartels but I cannot imagine what orchestras would stand to gain by fixing prices or sharing markets. Such vulgar topics are simply not relevant competitive parameters for arts organisations. They compete on the artistic quality of their performances, which is left untouched by cooperative agreements.

The State aid rules then? They prohibit State aid because it can distort fair and effective competition and harm the economy. However, pursuant to Article 107(3)(d) of the Treaty on the functioning of the European Union ‘aid to promote culture ...where such aid does not affect trading conditions and competition in the Community to an extent that is contrary to the common interest’ may be considered to be compatible with the common market. Seldom will there be grounds to prohibit aid to the performing arts. Theeuwes makes a distinction between ‘low art’ and ‘high art’. For the application of the State aid rules, it is probably more useful to make a distinction between (performing) arts that can generate sufficient revenues to pay their way and (performing) arts that cannot. Subsidizing the latter will normally not result in a disproportionate distortion of competition. It may be difficult to determine what performing arts qualify for a subsidy, and as Theeuwes writes, for how much. But the State aid rules do not have a role to play in finding an answer to that question.

It follows that, whatever disease the performing arts may suffer from, the competition rules do not provide the cure. That is good news for Pieter Kalbfleisch. Hopefully, he will have more time to devote to the performing arts after his retirement. He should be able to do so without being bothered by his former colleagues.

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Notes

- 1 The opposite also occurs: economists answering questions that have not been asked. An example of this is the annual calculation of the (alleged) benefit of the work of the NMa by the NMa's Chief Economist. This practice has started during the term of Pieter Kalbfleisch as Director-General and later Chairman of the Board of the NMa. It is a highly hypothetical exercise, based on a large set of assumptions manipulated to arrive at a very high number. I have always wondered why an eminent lawyer like Pieter Kalbfleisch has felt the need to defend the application of the law on this basis.
- 2 Commission Decision of 26 May 1978 in Case IV/29.559 – RAI/Unitel.
- 3 See for cases involving the performing arts amongst others Case N257/2007 – Spain (subsidies for theatre productions in the Basque country); Case N 324/2008 – France (*Aides d'Etat à la production de spectacles en France*); Case N336/2008 – Spain (aid to experimental theatre, music and dance performances in Andalusia); and Case N464/2009 – Hungary (aid to performing arts organisations).
- 4 Kotler and Scheff 1997

Are less government support and more competition a threat to diversity in the supply of arts?

BARBARA BAARSMAN, PH.D. *

Cecil Graham: 'What is a cynic?'

*Lord Darlington: 'A man who knows the price of everything
and the value of nothing.'*

*Cecil Graham: 'And a sentimentalist, my dear Darlington,
is a man who sees an absurd value in everything, and
doesn't know the market price of any single thing.'*

*(Oscar Wilde, 1892, Lady Windermere's Fan, A Play About
a Good Woman)*

Introduction

A high per capita GDP is of crucial importance for the arts. The higher the GDP, the higher the demand for arts and cultural products. Similarly, the higher the GDP, the higher the government revenues and the greater the scope for funding. Therefore, it is equally important to look at what brings about a higher per capita GDP. We test the following hypothesis: the more competitive the economy, the higher GDP. It appears that competition indeed is good for the arts. By stimulating the competitiveness of the Dutch economy as a whole, the NMa is simultaneously stimulating the arts. When talking about diversity in the supply of arts, competition is – however – not the most important factor. Other market failures play a more significant role in reducing artistic diversity. Still, we conclude that less government support is a threat to diversity in the supply of arts, only insofar as this support is meant to correct market failures.

The importance of being wealthy

What do the Renaissance and the Golden Age have in common? They were both times of rapid economic growth and artistic and cultural out-

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put. Back then, it was not the government who subsidized artists. On the contrary, painters, writers and other artists were fully maintained by patrons, mostly wealthy aristocrats and merchants.

The Renaissance began in Florence, where the Medici, a wealthy banking family, played a central role in patronizing and stimulating the arts. Lorenzo de' Medici in particular (1449–1492) – also known as Lorenzo il Magnifico – was responsible for an enormous amount of arts patronage, encouraging his countryman to commission works from Florence's artists. He also commissioned a great deal of art himself, and from 1490 to 1492, the young Michelangelo was under his protection.

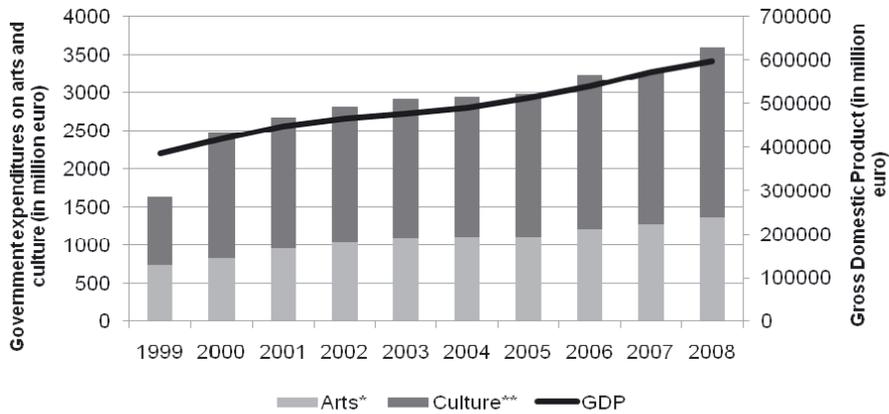
Similarly, in the Golden Age, money and art also went hand in hand. Members of the 'schutterij' (city guards) played an important role in fostering the arts.¹ They were proud of this, and paid a fair sum to see their status preserved for posterity by means of a group portrait. Rembrandt's *Night Watch* is probably the most famous example of these portraits and was commissioned by the members of the 'Kloveniers schutterij'. Rembrandt was paid 1,600 guilders for the painting, which was a considerable sum of money at the time. Rich Dutch merchants and other patricians were also the major force behind architectural developments. They commissioned new houses with ornamented façades to project their new status.

FIGURE 1 The role of the government in arts increases in time



David (1501-1504) and the '*Nachtwacht*' (1639-1642): both created without any government support; *Eiffel Tower* (1887-1889) paid for by the French government

FIGURE 2 Net government expenditure on arts and culture neatly matches GDP growth



* Net government spending on arts and arts promotion; professional performing arts, amateur arts, art accommodations, creative art, musical and cultural education, and other arts.

** Net government spending on culture, management and dissemination; museums, monuments, libraries, archives and media.

Source: CBS Statline; net expenditure equals gross expenditure minus income.

After the Golden Age, governments took on an increasingly important role in arts funding. But if the government is the main sponsor of arts, then a high GDP is of essential importance to the arts. The higher the GDP, the greater the financial scope for granting subsidies to the arts. The years between the end of the 19th century until the First World War were characterized by unprecedented economic growth. This period is called La Belle Époque, and is known for the incomparable speed and intensity of the development of arts. Cinema and photography rose to prominence, as well as new artistic movements such as Impressionism and Art Nouveau. The government played an active role in encouraging this. For instance, in 1889 the World Exposition was held in Paris with the Eiffel Tower built as a symbol of technical and architectonic progress.

After World War II, the public sector exerted an increasing influence over consumption and investment expenditure in Western economies (Peacock & Scott, 2000). This law of increasing state activity is known as Wagner's law after the German political economist Adolph Wagner (1835–1917) (not to be confused with Richard Wagner, who lived slightly earlier (1813-1883)). Frey (2000) demonstrates that this law applies to arts. Nowadays, the Dutch government spends over EUR 3.5 billion on arts and culture (cf. Figure 2). The amount spent by private individuals is un-

known. Statistics Netherlands (CBS) only details household expenditures on recreational and cultural services, and these amounted to EUR 9.7 billion in 2008. Since this number includes a broad range of activities – from visits to stadiums, amusement parks, fairs, circuses, zoos, cinemas, to ‘high’ cultural activities (visits to theatres, museums etc.) – it seems safe to conclude that the government’s funding role is very important.

This introductory section shows that a high GDP is important for the arts. Those who want to encourage the arts must also ensure a high GDP.² Discussing the arts in terms of money may appear cynical (cf. Lord Darlington’s proposition in Oscar Wilde’s play quoted at the top of this paper), but assuming that art is beyond financial value is simply sentimental (cf. Cecil Graham in the same play).

The importance of having a competitive economy

The question is, then, how to achieve a higher GDP. This section will seek to answer this question using data from the World Economic Forum. Their annual competitiveness report examines the factors that enable national economies to achieve sustained economic growth and long-term prosperity. Competitiveness – defined as the set of institutions, policies and factors that determine the level of productivity in a country – would appear to be key. What obstacles stand in the way of improved competitiveness?

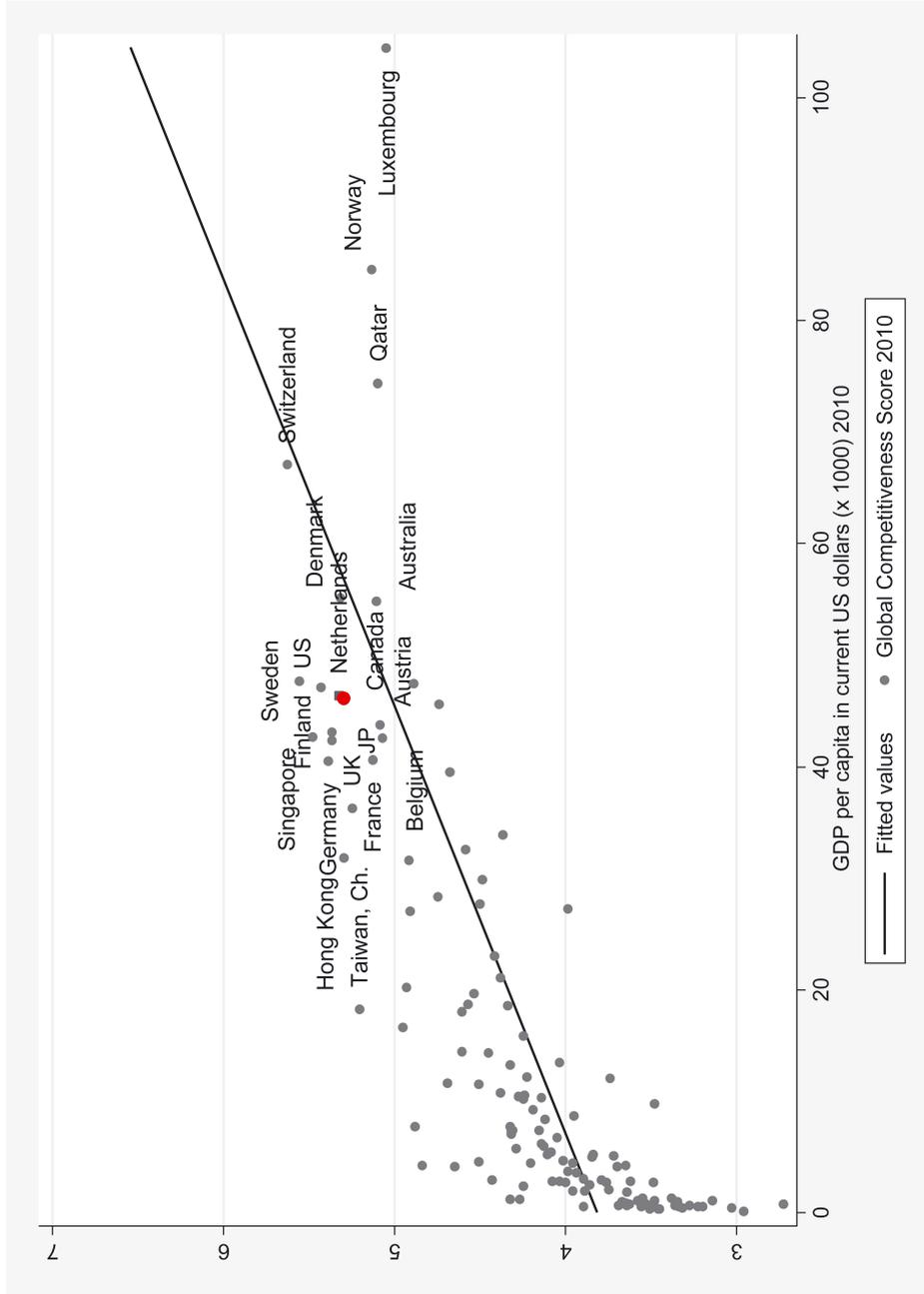
The Global Competitiveness Index (GCI) is a composite index and consists of 12 pillars,³ each of which is made up of several variables. For instance, ‘goods market efficiency’ includes 15 variables, including the effectiveness of anti-monopoly policy.⁴ A total of 109 variables are included in the GCI, and GDP is not one of these. Below, we present a simple linear regression of GDP per capita on GCI. The data set includes 129 countries. The results reveal a significant and positive correlation between the two variables (cf. Table 1 and Figure 3). Although we did not use any sophisticated econometric techniques,⁵ our results do show quite a strong correlation.⁶

TABLE 1 A simple regression shows that GCI score correlates strongly with GDP per capita

GDP per capita in 2010	Coefficient	Standard error	t-value	95% confidence interval	
Global Competition Index 2010	23.26	1.66	14.04	19.98	26.54
Constant	-82.82	7.06	-11.74	-96.79	-68.86

$N=129$; $R^2=0.6080$; $R^2_{Adjusted}=0.6049$

FIGURE 3 A high GCI score corresponds with a high GDP per capita



We performed the regression again using only those pillars that describe market efficiency. This composite index is called the Efficiency Enhancer Score (EES), and is made up of data on higher education and training, goods market efficiency, labour market efficiency, financial market development, technological readiness, and market size.⁷ The results are shown in Table 2 and Figure 4. These are quite similar to our earlier results. When we repeated the same two regressions using data from 2008, we obtained similar results. We therefore conclude that the relationship between competitiveness and GDP per capita is strong and robust.

TABLE 2 Similarly, EE score correlates strongly with GDP per capita

GDP per capita in 2010	Coefficient	Standard error	t-value	95% confidence interval	
Efficiency Enhancer Score 2010*	21.81	1.64	13.28	18.56	25.06
Constant	-73.90	6.79	-10.88	-87.35	-60.46

$N=129$; $R^2=0.5813$; $R^2_{Adjusted}=0.5780$

Fierce competition in the arts

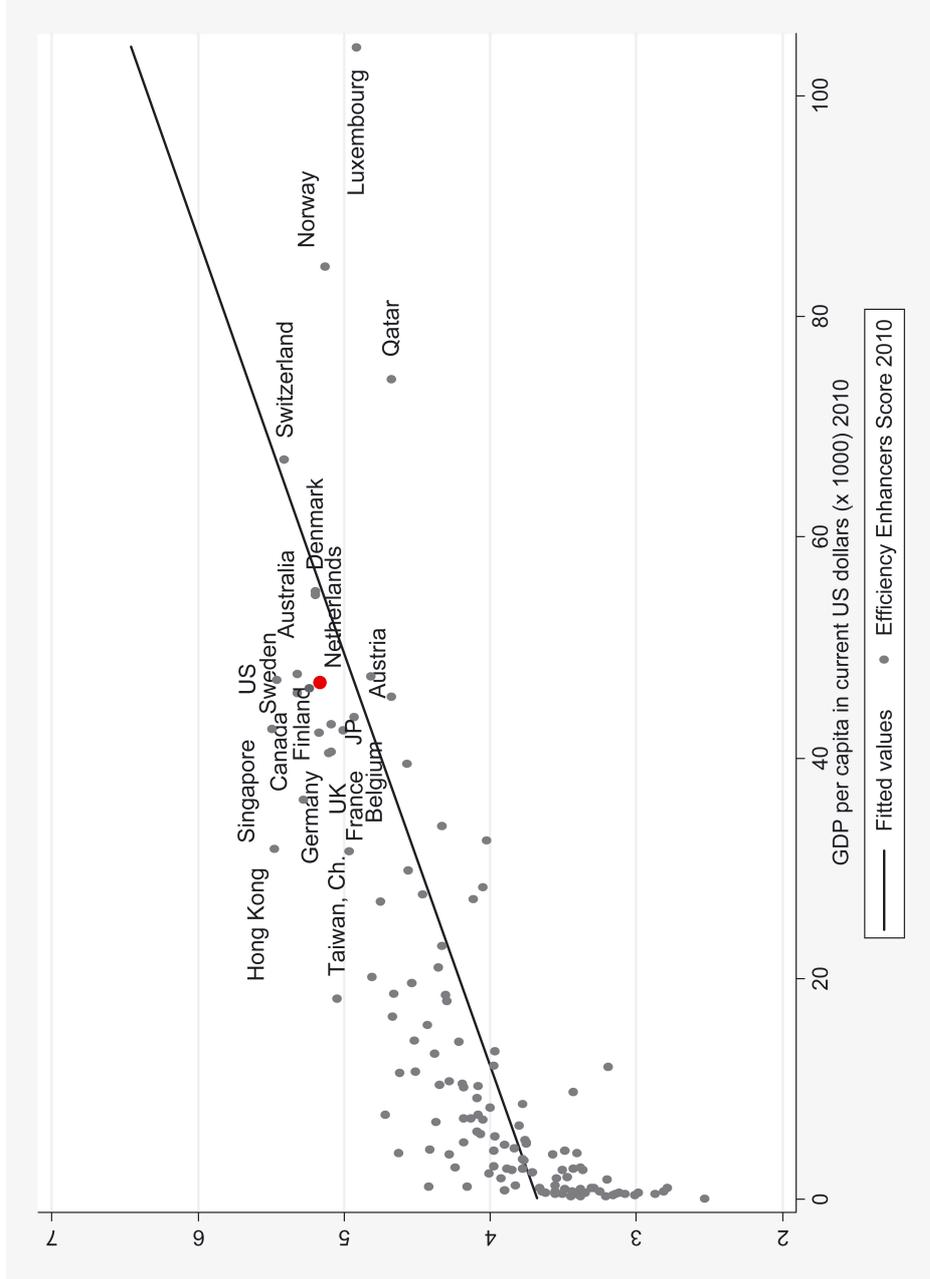
Having shown that a competitive economy is greatly important to the arts, we can now turn to the question of whether competition in the arts is good for diversity in the arts. We will first briefly address the subject of competition in the arts, both supply-side and demand-side competition.

Artists compete on the labour market (the supply side). Given the excess supply of artists, competition is fierce and intangible returns on artistic labour means that many artists accept lower wages than their qualifications might earn them on other types of markets.⁸ As a result, the income distribution is skewed: a few 'superstars' earn a high proportion of the total income in the cultural sector (Rosen, 1981). The Dutch government intervenes to distribute incomes more equitably through special funds (e.g. the special Journalistic Projects Fund, the Literary Fund, and the Dutch Literary Production and Translation Fund) or income subsidies (the Dutch Work and Income for Artists Act (WWIK) in visual arts sector).

There is demand-side competition between cultural activities, such as attending a museum, theatre, or cinema, or buying a book. In order to understand how these different activities compete, it is instructive to look more closely at consumers' time and budget constraints.

The Netherlands Institute for Social Research (SCP) studies how consumers spend their free time. The SCP looks at the following pastime

FIGURE 4 A high EES score corresponds with a high GDP per capita



activities: reading printed media, use of other media (audio, TV, PC and the internet), social contacts, social participation, going out, sports and exercise, and (other) hobbies. Studies conducted by the SCP show that since 1985, the average number of hours available per week for free time has decreased steadily. People aged 12 years and older now have just under 45 hours of free time per week. Ever more time restrictions mean greater competition between the options for spending one's free time.

Although disposable income has increased dramatically since 1985, the number of hours spent 'going out' each week has remained virtually constant, namely around 2½ hours. For the SCP, 'going out' covers the hospitality industry, cultural activities and events (sporting events, etc.). In 2005, half an hour was the average time spent on cultural activities. This relatively limited time allocation for culture means that the competition between cultural activities is quite fierce.

Apart from the restrictions on time, leisure spending is of course also restricted in terms of budget. The choices that consumers make on the basis of this restriction also indicate the goods and services that are in competition. The extent to which these goods and services are really in competition can be gauged by looking at how far customers will substitute one product for another when the price of the first product increases.

Estimates made by Goudriaan et al. (2008) show that if the price of the substitutes falls by 1%, the number of visitors to performing arts falls by 1.49%. The price of substitutes is approximated with the price index of culture and recreation (excluding audio and video carriers).⁹ Similarly, the estimate for the cross-price elasticity of cinema tickets and the price of substitutes (again approximated using the index figure for culture and recreation, but this time including audio and video carriers and DVD players) is 1.68. The cross-price elasticity of museum visits and substitutes is 1.49. Such positive cross-price elasticity means that substitutes are involved. This demonstrates fierce competition between these substitutes.

Is competition detrimental to the diversity of arts?

To conclude, consumers' time and budget constraints mean that there is fierce competition between cultural activities. Is this competition detrimental to the diversity of arts? This is not the case, according to Cowen (1998). He argues that a competitive market produces a wider variety and quality of culture, and does not just produce what is popular. Admittedly, there is plenty of popular culture too, but the market also produces 'high culture' for niche and elite audiences. In this context, Cowen & Tabarrok (1990) make an interesting comparison of economists and artists:

'Economics is often attacked for being too abstract, irrelevant, and impractical. Such attacks are the counterpart to attacks on artists for being too self-indulgent and inaccessible. As economic growth increases, economists choose to take more of their net wage in the form of choice of project. They choose to work on the peculiarities of the art market rather than serving as consultants to the business world.'

So, the higher the GDP, the more high-end culture goods and services are produced. That brings us back to our findings from the previous section: the importance of being wealthy.

Despite Cowen's finding (1998), economic theory shows that extreme competition can give rise to a phenomenon known as 'Hotelling's Law' (see box 1 for an example using ice creams on the beach). Formulated by Harold Hotelling (1895–1973), this predicts that highly competitive markets tend to produce homogeneous products, while oligopolistic and monopolistic markets tend towards heterogeneous products. When there is stiff competition, it is risky for suppliers to market distinctive items. More intensely competitive conditions encourage suppliers to aim to satisfy the majority preferences of the bulk of society. So this situation ultimately results in 'excessive sameness' in the products on offer. On the other hand, tempered competition favours openness and diversity, and hence caters better for minorities.

The conditions for Hotelling's Law are strict, however, and do not apply in real markets. For instance, it is assumed that each consumer along the beach will consume at least a minimum number of ice creams sold by the vendors on the beach and that prices are fixed by an external authority. If these conditions are not met, firms have an incentive to differentiate their products. When not everybody on the beach consumes a minimum number of ice creams, the vendors can position their products to sections where they know that there will be consumers, in order to maximize their profits; this will often mean that vendors will position themselves in different sections of the beach, occupying niche markets. Additionally, when prices are not fixed, vendors can modify their prices to compete for customers; in those cases, it is also in the vendors' best interests to differentiate themselves from each other as much as possible, so that they will face less competition from each other. In the cultural sector, neither condition is met: there is no fixed minimum level of consumption and prices are not fixed.

Most markets for cultural services are oligopolistic, and it pays to differentiate your products. That is why cultural goods tend to be so heterogeneous.

BOX 1 Hotelling's beach

Hotelling's Law can be explained by imagining a one-kilometre long beach. The people sitting on this beach want to eat ice cream, but the further they have to walk to buy it, the greater the chance that they will not bother. Assuming that these consumers are distributed evenly along the beach and you are the only ice-cream vendor, then a vendor will maximize his sales by positioning himself at the mid-point.

If a second vendor comes along, then it would seem most logical to divide the beach evenly between the two vendors, with one stationed 333 metres from the start of the beach and the other 666 metres along it. People sitting in the first 500 metres would then buy from the first vendor, with the second one selling to those more than 500 metres from the start of the beach.

In fact, however, this model only works if the ice-cream sold is considered substitutable by those on the beach and if the ice-cream vendors co-operate, or at least do not compete too hard. If a vendor is trying to maximize turnover, he will move towards the middle of the beach. By positioning himself 100 metres further along, he will attract customers from the first 550 metres. But the second vendor will think the same, and follow suit. Eventually they will meet in the middle and each will serve half of the entire market from adjacent pitches. The disadvantage is for the consumer, who on average has to walk further for the same ice cream.

More than just increasing competition

When talking about diversity in the supply of arts, competition is probably not the most important factor. Other market failures play a more significant role in reducing artistic diversity. Market failures are another much discussed aspect of cultural economics (i.e., Frey, 2005; Marlet et al., 2007; Van der Ploeg, 2006). Depending on the severity of the market failures, government intervention may sometimes be necessary. From an economic point of view, government intervention is only acceptable if it is welfare-enhancing. The government's role in this regard is one that exists by virtue of market failure. So, whereas people from the art world may take artistic value as a given and see no need to establish a link with human welfare, cultural economists consider it essential to establish that there is a real need for government support in any art project (Frey, 2005).¹⁰

What are the most striking market failures in the market for cultural goods? The first is that the consumption of art, or cultural goods in general, involves positive externalities. People who consume more cultural goods do better at school, are healthier, and less likely to engage in criminal behaviour. If left to the market, people consume too little of these goods because they do not take account of these unpriced, positive effects.

Another reason for government action is the fact that people might consume too few cultural goods because they are an acquired taste. Just like coffee and wine, you may have to try culture a few times before you get to like it. As Van der Ploeg (2006), the former State Secretary of Culture, rightly notes, cultural interest does not depend so much on whether it is high or low culture, as on the level of education of the participant. This would suggest that investing in cultural education at young ages is a valid argument for subsidizing culture, since it may overcome some of the disparities in cultural interest and cultural participation.

Note that these two market failures provide an argument for stimulating the demand for art rather than its supply. Could there be any reason for funding the supply of cultural goods? Yes, in case of so-called public goods – non-rival and non-excludable goods¹¹ – the market fails to deliver the socially optimal level. This argument applies to part of our cultural heritage, such as walking through Paris and freely enjoying all the beautiful buildings.

Another ground on which the government support of cultural goods might be justified is intergenerational value. In current markets, future generations do not have a voice, although parents (and grandparents) are probably willing to pay to contribute to the social stock of cultural capital. This applies to subsidizing the restoration and maintenance of monumental buildings and landscapes, as well as to other heritage such as art archives.

A final supply-side market failure mentioned here relates to the capital market. If certain high-risk cultural activities find it difficult to access capital, government-funded participation companies may help to secure such capital from the market, especially in combination with fiscal incentives.

We are now able to answer the other question in the title – is less government support a threat to diversity in the supply of arts? The answer is ‘yes’, although less government support is only problematic insofar as it is meant to correct market failures.

Conclusion

This paper has shown how the arts benefit from high GDP and this was certainly the case during previous creative eras, such as the Renaissance and the Golden Age. The positive relationship between GDP and the arts continues to apply today. The higher the GDP, the higher the demand for arts and cultural products; similarly, the higher the GDP, the higher the government revenues and the greater the scope for funding.

If a high per capita GDP is of such crucial importance for the arts, it is equally important to look at what brings about a higher per capita GDP. We have tested and validated the following hypothesis: the more competitive the economy, the higher GDP. In short, competition is good for the arts. By stimulating the competitiveness of the Dutch economy as a whole, the NMa – and more particularly its chairman of the board, Pieter Kalbfleisch – are simultaneously stimulating arts.

Obviously, it is too easy to state that simply enhancing competitiveness would be enough to encourage the arts. The market for arts has failed in several respects and the NMa cannot fix all of these failures – after all, NMa is not short for ‘National Market failure Authority’. However, at the same time, Pieter Kalbfleisch is committed, not just as chairman of the board of NMa, but also on a personal basis, to correct some of these market failures. He holds a number of positions alongside his work at the Netherlands Competition Authority. Four of these relate to the cultural sector (mainly music and performance arts): membership of the recommendations committee of the Foundation of the restoration ‘Bätzorgel’, chairman of the board Pure Jazz, chairman of the board of the Hague Philharmonic, membership of the recommendations committee of the Royal Theatre.

Let me finish by thanking Pieter Kalbfleisch for his effort to increase Dutch competitiveness and by expressing the hope that, after leaving the NMa, he will be able to spend a considerable amount of his free time correcting market failures in the cultural sector.

COMMENT

WEIJER VERLOREN VAN THEMAAT*

Art and Competition (law)

Art and competition. Googling both terms together results in over 80 million hits. There are millions of art competitions. Artists seem to do little else but compete. Painters compete for the best exhibitions. Opera singers compete for world fame. Orchestras, at least in the Netherlands, compete for survival, as Pieter knows only too well. If not with others, artists will compete with themselves. Always trying to improve and to explore new avenues. If one enters ‘art’ and ‘competition law’ into Google, there are much fewer hits, but still over a million. After a closer look, however, it seems that the primary relationship between ‘art’ and ‘competition law’ is based on ‘art’ being the abbreviation of ‘article’ (meaning ‘clause’). Is there any further relationship?

Supplementing Barbara Baarsma’s inspiring contribution on this subject, I would like to address two further questions. First, is competition law applicable to the arts at all? And, if so, are secret agreements and information exchanges between artists a realistic threat? Let me say at the outset that I don’t believe this to be the case. But then, as we have learned from Picasso, art is a lie that makes us realise the truth.

Before analysing whether competition law applies to art, a definition is needed. Apart from being a truth-inducing lie, what is art? Attempting to define art is a philosophical nightmare. After all, art has a few inherently inexplicable elements. But for the sake of this essay, I would like to identify the unique and thought-provoking characteristics of art and to distinguish art as a human endeavour from the performing arts and certainly from the art trade.

Whether competition law can apply to art largely depends on whether an artist can be labelled an ‘undertaking’ within the meaning of competition law. According to case law, an ‘undertaking’ is a broad term encompassing everyone and everything – regardless of legal status or financing – engaging in an economic activity. Surely, many artists are indeed involved in economic activities. A painter usually hopes to sell her paintings. An opera singer is hired by someone to perform. An orchestra attempts to attract paying audiences.

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In the *Unitel* case in 1978, the European Commission made clear that, for competition law purposes, artists are considered ‘undertakings’ if they commercially exploit their artistic performances or products. The *Unitel* case was started when Unitel, a production company, objected to the broadcast of Giuseppe Verdi’s opera ‘Don Carlos’ for the 200th anniversary of Teatro alla Scala in Milan. Four of the leading singers had already performed ‘Don Carlos’ in Salzburg and had granted Unitel the exclusive broadcasting rights. In this case, it was clear that the performing artists involved were engaging in an economic activity. The agreement had been entered into by ‘undertakings’ and therefore the competition rules applied.

But not all artists are commercially exploiting their creative work. Some artists may be selling their work out of necessity or simply to remain active as artists. *L’art pour l’art*. Arguably, a painter is not necessarily acting as an undertaking when he enters into an exclusive agreement with a public museum that wishes to exhibit his paintings, but is unwilling to pay him any financial compensation. As most painters will consider it a high honour for a museum to purchase their work, and are therefore often prepared to sell the painting at well below market value, even whether a museum’s purchase of a painting is always an economic activity is open for discussion. The competition rules do not apply to purely artistic endeavours. Hence, we may need to distinguish between the creative process itself and the subsequent act of asking for money for the end result of the creative process. The same issue arises in sporting activities. To conclude the first question: competition law may apply to artistic activities when the activity entails commercial exploitation, but the dividing line between commercial exploitation and pure artistic activity is blurred.

With regard to the second question, it is difficult to imagine how artists can successfully restrict competition with each other. Artists mainly compete on the basis of distinctiveness and originality. Even the most high-quality reproduction is never as valuable as the original. It is unlikely that artists would agree to compromise the quality or creativity of their works.

It is noteworthy that Barbara Baarsma took the example of Renaissance Florence as a booming period for the arts. Florentine Giorgio Vasari, himself a famous painter, was one of the earliest authors to use the word ‘competition’ (*concorrenza*) in its economic sense. In Vasari’s view, Florentine artists excelled because they were hungry, and they were hungry because their fierce competition with each other for commissions kept them hungry. Competition is, he said, ‘one of the nourishments that

maintain them.’ Competition amongst artists is atomistic in nature. Each artist delivers unique, heterogeneous products. Downstream in the process, where the final outcome of the creative process is commercialised as a commodity by art dealers, agents and auction houses, anti-competitive behaviour and manipulating the market is more realistic. A well known example in this field is the case in which Sothebys and Christies were found to have fixed their fees.

The artistic process itself remains something very special. Artists are extremely unwilling to make concessions that would compromise their art. But then, aren’t we all artists to a certain extent, competing vigorously on our core competences? Certainly Pieter Kalbfleisch is.

COMMENT

TJARK TJIN-A-TSOI*

Do government subsidies create artistic golden ages? No.

In her paper, Baarsma convincingly shows that economic strength and artistic innovation go hand in hand. Of course, this does not necessarily mean that the former implies the latter, although there are strong indications that this is true to a certain extent. If there is no surplus, then who will pay the artists? However, in my opinion, both economic and artistic golden ages are caused by developments that are more fundamental. Both are usually symptoms, rather than causes. For example, economic activity and art both tend to feed on new ideas and new inventions that create a new dynamics. A scientific breakthrough may lead to new ideas about the universe and our place in it. This may then inspire entrepreneurs to create economic activity, new business models based on new technologies, but it simultaneously inspires artists. These developments then start to feed on each other: economic growth, caused by increased entrepreneurial activity, leads to the accumulation of wealth that can be used to finance art, etc. Furthermore, the culture of growth, hope and optimism, creates an intangible quality that may be articulated in art. Obviously, this is just one such mechanism, but the main point here is that human society is a self-organizing organism, and golden ages in dif-

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ferent arenas tend to be correlated because they are symptoms of the same fundamental developments.

An interesting point that Baarsma makes concerns the funding of art in the Dutch golden age. In those days, funding often came from what we would now call the 'civil society' (*schutterijen*, wealthy merchants, the aristocracy). I think this is an important point that connects well with what I said before. When civil society funds and supports art, this support tends to be personal and involved. Support like this is also an integral part of society and developments therein. This is quite different from a situation where more or less anonymous governments create wholesale art subsidies. Under these circumstances, art is in danger of becoming detached and mechanical, as can be seen from the warehouses of never to be seen art that were filled during the high point of art subsidies.

When one considers the issue from this point of view, do we really believe that structural and safe government subsidies to art provide superior short-term incentives and long-term results in art? For example, do we believe that turning artists into 'public employees' somehow guarantees an artistic golden age? Or is it more likely that golden ages of ideas, science, economic growth and art are strongly interrelated? If this is the case, the best stimulus for art is creating the circumstances that create both economic growth and artistic inspiration. In essence, Baarsma makes a similar point. Therefore, I agree with her statements concerning the relation between art and GDP, but not only because economic growth creates the funds to finance art, but also because dynamism, new ideas and new developments in themselves tend to inspire great art.

Baarsma rightly points to the important role of competition in creating economic growth. Competition is one of the most important fundamental factors creating dynamism and innovation. This fact is still underrated in The Netherlands. We are part of a culture in which cooperation is more likely to be considered to be good than competition. Dutch people tend to think that cooperation made The Netherlands thrive in the 17th century. However, the Republic was at war during a large part of that century and the VOC had to compete fiercely with similar foreign entities. Competition drives innovation, efficiency and growth and thus has a major long-term impact. And yes, this is also true in art. Artists do not only compete for jobs, as Baarsma rightly states, they also compete in their art. The idea that artists are not competitive in their art and are only driven by more abstract motivations, is quite naïve. Artists are people too. Competition drives artists to new heights, just as it drives companies.

In conclusion, I would not dream of stating that less government support is better for art. When funds are available, more money to art is usually better than less. I would say, however, that the 'return' on this 'investment' is reasonably low and that golden ages of art are not created by government subsidies. They are created by golden ages in thought and economic activity.

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Notes

- 1 The 'schutterijen' arose in the 16th century, when volunteers formed vigilante groups that in times of war or insurrection took action to ensure the safety of the republic. Later they lost their function, though it remained decorum. The 'schutterijen' also served as honour guard companies, such as the festive entry in 1638 of Maria de' Medici – who was escorted from Lorenzo – in Amsterdam. Her visit was considered to be the international recognition of the Republic of the United Netherlands.
- 2 In dictatorships, a high GDP is not required to obtain a thriving arts environment. In such a regime, the dictator is able to enforce anything he wants (be it art or war). As a dictatorship not worth pursuing, that option is disregarded here.
- 3 Institutions, Infrastructure, Macroeconomic environment, Health and primary education, Higher education and training, Goods market efficiency, Labour market efficiency, Financial market development, Technological readiness, Market size, Business sophistication and Innovation.
- 4 In 2010, the Netherlands ranked second on this variable.
- 5 For instance, we did not correct for the dependence of the 12 pillars underlying GCI. Not only are the pillars related to each other, they also tend to reinforce each other.
- 6 Because we did not use advanced techniques, we are humble in interpreting the results and speak of a correlation rather than causality. However, the results are so robust that this correlation cannot be neglected.
- 7 In 2010, the Netherlands ranked eighth on both GCI and EES.
- 8 Artists are not unique in deriving non-pecuniary returns from particular forms of labour or in desiring to choose projects of high satisfaction. Academics, including many economists, also enjoy working, especially when they can work on projects of their own choosing (Cowen & Tabarrok, 1990).
- 9 According to the CBS (Statistics Netherlands), the term 'culture and recreation' covers visits to stadiums, amusement parks, fairs, circuses, museums, zoos, cinemas, the theatre, etc.
- 10 Economists take the cost of taxation into account. Spending tax money is free. One euro of taxpayers' money will cost more than a one euro (on average •1.10-•1.15), partly because of the costs of collection, but mainly because of the distorting effect of taxation – people make other choices due to taxation: if taxes go up, people tend to work fewer hours and invests less in education.
- 11 Non-exclusiveness means that it is impossible to exclude people from the use of the good. Non-rivalry means that use by one consumer is not at the expense of use by another. In other words, the marginal costs of an extra user are zero. Consumers will often be unwilling to pay for these goods on an individual basis.

PART 

Competition and sports

Competition and the influence on the professional football league of local government support

REIN WESSELING*

Introduction

Titles of essays imposed on authors are like dress codes. On the one hand, they make life easy by relieving the subjects of problems associated with selection and choice. On the other hand, writing – or dressing up – on the basis of an instruction implies a degree of uncertainty as to the actual underlying objectives of the host. The suggested title for this contribution ('Competition and the influence on the professional football league of local government support') brings this dilemma to the fore.

There is no evident connection between 'local government support's influence on the professional football league' and 'competition'. In one reading, the title is tautological since the professional football league is a competition. In another, more likely, reading the question focuses on the compatibility of local government support with EU competition law.

The latter is a topical matter, in particular in the Netherlands. In 2010, the EU Commission informed the Dutch state that it is investigating local government support for local professional football clubs in the Netherlands and its compatibility with the EU rules on state aid. The Commission investigation targets two football clubs currently playing in the Dutch *Eredivisie* (the highest or 'premier' league). They are Vitesse (established in the city of Arnhem) and Willem II (Tilburg). The Commission is also said to investigate possible aid granted to NEC (Nijmegen) and to MVV (Maastricht), a club operating in the *Jupiler League* (the second highest – but also the lowest – professional football league).

A quick empirical exercise on this basis suggests that local government support has no influence on competition within either of these profes-

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sional football leagues. Willem II is currently (February 2011) ranked 18th (bottom) of the league. It has been in this position since – I think – the beginning of the season and it took them some 20 games to achieve their very first victory. Only a miracle will prevent Willem II from relegating to the lower league.

Vitesse's situation is less miserable, but only marginally so. This is remarkable not only because of the alleged local government support, but also because Vitesse has a prominent (non-public) sponsor. This sponsorship is of the 'rich uncle'-type. The private sponsor has invested millions of euros in the club over the last months. Any potential local government support for Vitesse will be insignificant when compared to the private support, and any effect of the local support on the football league will, in any case, likely be inappreciable. In any case, and in spite of all the support, Vitesse too is ranked in the relegation zone.

MVV, as mentioned, operates in the obscure Jupiler League. No case-handler at the EU Commission's Directorate-General for Competition – apart from fanatics, who should not be working on the case – will arguably have heard of the Jupiler League, let alone of MVV. They will recognize the name of Maastricht only from the preparations for their *concours* because of the Treaty of Maastricht. MVV too could be found in the crevasses of the lowest professional league until very recently (like Willem II and Vitesse one league up).

On this basis, I was tempted to conclude that an influence on the football league of local government support can be excluded (apart from an inverse influence; local support leads clubs to the bottom of their leagues). Just before finalizing this essay on that basis, however, I noticed that MVV was now the likely champion of the so-called 'third period' of the season. It would take more than an essay to explain what this system of 'period' champions means but, for current purposes, it suffices to note that MVV is doing well (winning 5 of the last 6 games). This could obviously be the result of possible local government support after all! Consequently, I cannot avoid going into the (legal) merits of the possible effects of local support on competition.

In view of the current success of MVV, the Commission investigation into the Dutch clubs may be an extremely relevant aspect of its role in protecting undistorted competition within the internal market. It is still useful, however, to note at the outset though that the subjects of the Commission investigation are in any case remarkable in terms of priority setting. Previously, the EU Commission was informed about a situation in which the (less marginal or obscure) Spanish football club Real Madrid

sold land to the Madrid municipality and region for a reported € 480 million. The transaction took place in the early 2000s *after* the municipality had ‘re-zoned’ or re-qualified the use of this land, increasing its value dramatically. The transaction allowed Real Madrid to get rid of its €100+ million debts and to invest ‘galactic’ amounts of money in its team (signing-up football stars of the time; Zidane, Ronaldo and Beckham). The Commission was quick in announcing that this transaction was compatible with the EU state aid regime.

It would be ironic – though perhaps typical – if the EU Commission were to approve of the Madrid splurge on the basis of a legal technicality (it was suggested the land transactions were not to the detriment of state resources) only to take issue with the marginal support for a club like MVV with a total annual budget of around € 3 million. Several individual players at Real Madrid (Ronaldo, Kaka) are reported to have *base* (!) salaries of more than 3 times that total annual budget for the club under investigation.

This leads us to the theme of this contribution, which is the tension between the purely technical and rational approach of the EU institutions (Commission, Courts) in the application of the EU rules to sports and the highly irrational nature of the management of and support for (professional) sports clubs.

Professional football clubs should not be seen as ‘undertakings’

Professional football clubs qualify as undertakings in the sense of the European Treaty. The Treaty’s competition rules fully apply to such clubs. This may not be a surprise for competition-law specialists but the ‘technical-legal’ approach in defining what organizations qualify as ‘undertakings’, subject to the regular competition rules, is a central element in the tension described above.

The case law of the ECJ concerning the concept ‘undertaking’ is clear and spans the net broadly. Every entity engaged in ‘economic activities’ is an undertaking. The legal status and the way it is financed are irrelevant. Offering goods or services on the market is an economic activity. Professional football clubs participate in the supply of goods and services related to the football matches their (first) team plays. They sell tickets and may sell media rights and other intellectual property rights relating to the matches they host (depending on the manner in which the relevant competition is organized). Football clubs will also attract sponsors more broadly. On the buying side, the clubs may need to buy goods or services,

for instance, relating to the stadium or other facilities. Naturally, the clubs are also active on the job market. In these purchasing activities, too, they act as undertakings.

The basis for the Court's case law lies in its 'functional approach'. In defining entities as undertakings, the Court focuses on the actual activities of that entity rather than on the characteristics of the actors performing the activities. As a consequence, not-for-profit and non-commercial organizations too will qualify as undertakings, if they offer goods or services.

The approach leaves little room for entities selling something and not qualifying as undertaking. One of the recognized exceptions is for activities 'typically' or necessarily carried out by the state (for example, air traffic control). Entities pursuing an exclusively social objective – working on the basis of the 'solidarity' principle – also do not qualify as undertakings in the sense of the EU competition rules.

The broad scope of the concept of undertakings has the potential to lead to an overreach of the competition law provisions in the Treaty. In the area of 'antitrust' (Article 101 TFEU in particular), the Court has reduced this potential not by tampering with the definition of undertaking – apart from the exceptions set out above – but rather by assuaging the interpretation of other constituent elements in the relevant Treaty provisions. Thus, the Court has created exceptions for acts of associations of undertakings in the area of collective labor and pension agreements with labor unions. Furthermore, the Court has carved out specific regulatory activities in the public interest, even if performed by (associations of) undertakings from the reach of Article 101 TFEU.

The Court's presumption is that all entities doing something and asking a price for it are economic actors. Their behavior should be subject to the competition rules unless it is clear that they are in fact not serving their own interest but that of a broader public. Conversely, where behavior does not have a clear economic rationale, it is not evident that the behavior should be governed by the competition rules. This is all the more so where such activities are unlikely to have any significant (negative) impact on competition and, as a consequence, on consumer welfare whereas they do have the potential to increase common welfare. On this basis, the current approach in relation to the concept of undertakings is arguably too broad and the exceptions to the applicability of the EU competition rules are too narrow. This is the case for the antitrust rules, but it is even more clearly the case for the state aid rules.

What professional football clubs in the Dutch leagues are doing cannot be understood from a purely rational perspective. In fact, the investments

individuals and other shareholders and stakeholders make in football clubs would likely not pass the ‘private market investor principle’ – developed in the area of EU state aid law. What it reveals is that these clubs are not (rational) economic actors at all, and that their activities should not be considered economic activities. Like orchestras and theatre ‘companies’ they should be seen to offer some sort of public cultural good, in spite of the fact that they offer goods and services in relation to their football activities. Consequently, the EU state aid rules would not apply to football clubs – even ‘professional’ football clubs – and entities offering real cultural services (orchestras, cinemas, theatres, etc). The local government should be able to subsidize such entities without having to notify to and obtain approval from the EU Commission in all cases.¹ Local government support for local (professional) football clubs does not affect in any appreciable way the outcome of competition nor does it distort a theoretical ‘level playing field’. It does not have an appreciable effect on competition.

If the Commission is serious about this, be prepared for an avalanche of issues

It is acknowledged, of course, that on the basis of a technical-legal application of the case law as it stands the professional football clubs will qualify as undertakings and that there is limited room for local government support to be excepted from the application of the EU state aid law regime.

In addition to the general exceptions (no effect on interstate trade in particular) and the general policies of the Commission in the state aid law area, the Commission has identified limited room for acceptable support from local authorities. The first area is that for aid provided to clubs which invest in enabling young football players to combine trainings and regular education. The second main area for exceptions exists of support relating to the accommodation of the clubs, provided that it is multi-use and can therefore qualify as local ‘infrastructure’, relevant for the community as a whole. The third and last area of exceptions is that in which the local authorities are rewarded for their ‘investments’ on a commercial basis. The Commission has specifically pointed to ‘city marketing’. As I understand, this segment of the Commission approach, MVV may be rewarded financially by the Maastricht municipality if it were to change its name into MVV Maastricht. By including the community name in the club’s name MVV becomes active in the area of city marketing. In that context, the municipality may pay a market price without requiring prior Commission approval. Obvious question is how the market price of this particular service is established.

There is ample empirical evidence for local-government support for professional football clubs beyond these areas of exception. Limiting the review to the Netherlands, reference is made to a recent survey (October 2010) among Dutch municipalities, which revealed that they had supported football clubs with an estimated € 60 million a year. The report highlighted that the municipalities had refrained from providing direct financial support since granting financial support 'is not allowed under the EU state aid rules'. Instead, the municipalities reported, we have granted support by offering the clubs reduced lease rates for the facilities, favorable loans and/or financial guarantees. The ingenuity of these comments from the local governments is ironic and telling. Clearly, these 'indirect' forms of support qualify as aid under the EU rules just as much as (even) more direct financial support. Evidently, local governments and professional football clubs are not taking the state aid law regime seriously. Nor should they, as argued above.

While the abovementioned survey was limited to the Netherlands, there is nothing to suggest that the situation will be different or better in other EU Member States. And the survey was limited to *professional* football clubs, whereas amateur football clubs can also be considered undertakings, at least some of them, now that they are engaged in economic activities. They sell tickets for the matches of their first teams and they are known to pay the players in their first teams. And, finally, what counts for the professional football clubs will likely also apply to other professional sports clubs (rugby, hockey, etc.). The potential for local government support in these areas and the potential need for Commission state aid law investigations are innumerable. If the Commission were to find that petty support from local authorities for the marginal Dutch football clubs raises material EU state aid law issues this will therefore open an endless process of similar cases. The Commission Directorate-General for competition better devotes its scarce resources to cases that are more relevant for competition and for consumer welfare within the Union. The mission for the Commission should therefore be to find an elegant way out of the Dutch cases. As follows from the above, I would suggest to opt for a fundamental approach by holding that the football clubs are not undertakings in the sense of the Treaties after all. While this would clearly be contrary to the case law of the Court of Justice, the Commission can try to redirect the case law on this basis. Alternatively, the Commission could focus on the absence of an appreciable effect on trade between Member States. That solution would normally be compatible with the case law as well as the current approach of the Commission in

the state aid area. Finally, the Commission could opt for a specific policy instrument (Notice) setting out the reasons why local government support to (professional) sports clubs does not have to be notified, in spite of the facts that such clubs may qualify as undertakings in the sense of the Treaty's state aid rules.

Concluding remarks

In the context of this *liber amicorum*, it is noteworthy that the community of Haarlem has refused to grant aid to *'de koninklijke HFC'* (the 'royal' Haarlem Football Club), leading to the bankruptcy of that historical club. Pieter is known to be a long-standing supporter of HFC. It is even suggested he was active as a player there. The picture – on the basis of desktop research – is that he was a prominent goalkeeper locally, although not of the kind that participates in the game as an extra defender (he was not a *'meevoetballende keeper'*).

The sympathetic way in which Pieter is described in publicly available records of HFC is in key with the way he guided the Dutch Competition Authority during his period in office. Not participating in the disputes, but keeping the goal clean. The fact that people he has worked with during his tenure at the NMa like to qualify him as a 'good sport' is recognition of his devotion to the public good.

COMMENT

PIET JAN SLOT*

Are sports really a special case?

Wesseling starts his contribution with a reference to the characteristics of dress codes. The title of his essay causes him some uneasiness. As a commentator on his contribution, I feel equally uneasy, if not more so.

His argument is that the EU state aid rules should not be applied to financial support by local authorities to professional football clubs. His main argument seems to be that such application 'will open an endless

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process of similar cases.’ He offers two conceptual ways of addressing this issue. His first suggestion is to review the definition of the concept of undertaking in competition law in such a way as to exclude football clubs from its ambit. His second suggestion is to assume that there is no appreciable effect on trade between the Member States. A third, procedural, suggestion is that ‘the Commission could opt for a specific policy instrument (Notice) setting out the reasons why local government support to (professional) sports clubs does not have to be notified, in spite of the facts that such clubs may qualify as undertakings in the sense of the Treaty’s state aid rules.’

While sympathising with Wesseling’s plea for common sense i.e. not to create a burden for DG Competition to investigate local support for sports clubs, I have serious doubts about the proposed ways to achieve this goal.

First, let us start with the argument to adapt the definition of an undertaking in competition law. It should be borne in mind that this definition is the result of a long string of judgments of the Court of Justice. Changing this definition would require an act by the legislature. An example of such a legislative act is Article 122 of the *Zorgverzekeringswet* (the Dutch law on health care insurance), which explicitly states that health care providers are undertakings. The European legislature has not taken such action and is unlikely to do so. There is the Declaration on Sport of the Nice Council. In this declaration, the Council ‘stressed the need to take account in all action by the Community, of the social, educational and cultural functions inherent in sport and making it special, in order that the code of ethics and the solidarity essential to the preservation of its social role may be respected and nurtured.’ This will be a long way from a hard and fast rule exempting sports from the competition rules. In order to understand why a categorical exclusion of sports from the competition rules would be undesirable, one only has to read the Commission decisions in UEFA television rights and FIA formula I racing cases. Both decisions exemplify the egregious nature of the actions of some sports organisations.

The second suggestion, to assume that there is no effect on trade between the Member States, thus excluding the application of the state aid rules to professional football, has more potential. Although somewhat more promising than the first proposal, it is not without pitfalls either. This is clearly illustrated by the case mentioned by Wesseling, the Madrid – Real Madrid land transaction. It should be noted however, that the case as reported by Wesseling, does not allow a full evaluation of the facts. The

main problem is that it may be very difficult to identify criteria for the application of this principle. There is nowadays a worldwide market for football players. Beefing up the financial resources of one club will necessarily increase its prowess on the markets for international transfers for players and for television rights.

Wesseling's third suggestion is the adoption of a Commission Notice, which would exempt financial support by local authorities from notification. Wesseling's suggestion is only pointing to the instrument without identifying a possible legal or policy basis for such a Notice. Short of such a basis, the Notice will not stand the test in the Community Courts.

There may be a legal basis for a communication providing a rather generous exemption for local aid to professional football clubs. This basis may well be found in application of the market economy investor principle. According to this principle financial transfers to undertakings which take place under market conditions will not be considered state aid. A well known example is the test to assess whether or not the sale of land constitutes aid or not. Already in 1984, the Commission issued guidelines for assessing whether the injection of capital is state aid. It could well be argued that this principle should be applied to the sports industry as well. There is a European market for the players, trainers, and television rights. There are several very wealthy individuals and-or companies that invest very substantial amounts of capital in football clubs. The market is characterized by the ownership of persons, such as Roman Abramovic and Silvio Berlusconi. These individuals make their investments without expecting a normal rate of return. The behaviour of local authorities should not be held to a higher standard than that of the business tycoons. This is, admittedly, an unorthodox approach but I submit that Pieter Kalbfleisch would be willing to consider it.

COMMENT**EWOUT SAKKERS*****The influence of local government support on the professional football league – designing the right tactics for competition policy**

In his contribution, Rein Wesseling is gazing into a crystal ball: he has tried to predict the developments of football club league rankings in the Netherlands, in particular regarding professional clubs that have allegedly received local government support. The club Willem II from Tilburg that he referred to was, at the time of writing, bound to be relegated to the second division of professional football, that is to the ‘Jupiler League’. It is indeed one of the lower ranked clubs in the Dutch premier league that has allegedly received municipal subsidies, and Rein deduces a possible inverse correlation between obtaining State aid and performance on the football pitch. So, if that is true, why even be concerned about such forms of State aid, he wonders? In any event, Rein argues, whatever the nature of the aid, it is too meaningless to have any effect on trade between EU Member States. Put differently, the performance and position in the national premier league of the would-be beneficiaries is too insignificant to have any effect on football in Europe, as these clubs generally would not qualify for the European club competitions, be it the UEFA Europa League or the UEFA Champions League. The local government aid is merely survival support for these ailing clubs, which ‘Brussels’ should not be concerned with.

At the time of (my) writing – benefiting from some hindsight compared to Rein’s article – an alleged violation of the EU rules on State aid had become the subject of a preliminary investigation of the European Commission (opened on 28 March 2011), involving four municipalities and professional clubs: *NEC* of Nijmegen, *Vitesse* of Arnhem and *MVV* of Maastricht, next to *Willem II* of Tilburg. Indeed, none of these clubs were doing well in their respective leagues: *NEC* and *Vitesse* were still struggling in the premier league, whilst *MVV* was, as one would say in Dutch, a mere ‘*middenmoter*’, a mid-level performer, in the Jupiler league.

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In analysing the performances of the respective clubs, I could agree with Rein that any alleged State aid has not been a magic formula to better performance on the football pitch. But is local government support without consequence for the sport? Should there be no concern at all? Can it not tilt the level playing field of an activity that is, after all, (in Europe as well as in the Netherlands) a professional multi-million euro *business*?

Let me raise a few (rhetorical) questions with regard to aid by government intervention in sports (and in football in particular). In doing so, I will pass over one question that Rein has put forward, i.e. that only under a 'technical-legal definition,' football clubs would be regarded as undertakings in their own right. That professional clubs are indeed commercial entities actually seems rather obvious to me. Whilst performing a social function that is naturally closely related to the nature of the sport, given the amounts that clubs and players make, or attempt to make, out of selling tickets, obtaining or paying high salaries, cashing in on broadcasting rights and merchandising (in 2010, EUR 20 million for Dutch clubs alone), there can be no doubt that such clubs, even though at different levels of professionalism, operate as undertakings. This is without passing judgment on the perhaps more limited annual budgets and spending of clubs in different leagues in Europe, i.e. whether such budgets are comparatively small. Of course, there is no comparison between the spending of, for instance, Vitesse, and an average Spanish *Primera División* club. (And yet there is some comparison possible between football in Spain and in the Netherlands: did the Dutch national team not make it to the finals of the World Cup in 2010, playing against Spain...?)

The empirical data from the short period between Rein's original piece and my writing even more strongly suggests rather an inverse correlation between possible aid and good results. So where Rein says the aid would have had no impact *within* these clubs, it is difficult to prove him wrong by virtue of the recent league results (although the counterfactual is difficult to assess, i.e. if the results would have been worse in absence of any support). What is very possible, however, is that there is a relation between the aid and the *outward* impact, i.e. on other clubs in the sport and on the sport in general. To make my point: at the time of writing, a fierce battle was raging between FC Twente, PSV and Ajax over who would emerge as league champion, and thus enter the very lucrative Champions League. Suppose one of the smaller, State-aid beneficiary clubs would steal a point or two from one of these clubs in a crucial league match? It almost happened recently that NEC drew against Ajax, one of the title contenders. Note that Ajax is now listed on the stock exchange... In other

words: if clubs, and the players they can acquire and pay, compete based on the use of public funds (either partially or in whole), that could indeed affect important sportive and commercial interests of other clubs. So to compare football with a subsidized cultural activity, regardless of the artistic skills of some players, seems unrealistic. Consequently, I would take issue with Rein where he states that ‘local government support for local (professional) football clubs does not affect in any appreciable way the outcome of the competition nor does it distort a theoretical *level playing field*’ and that ‘local governments should not take control of state aid seriously’.¹ One might query whether support by private investors (think about the ‘white knight’ and the amounts invested in, for instance, Chelsea and Arsenal, which eclipse any State aid amounts in the Dutch context) is consistent with the interests of the sport in general. This would need to be considered possibly in the framework of a different type of regulation. As for State aid, however, there is an existing framework. Regarding football, the Dutch Ministry of the Interior in 2004 already recognized the costs to taxpayers, and the possibly distorting effects of forms of local aid, and issued guidelines in the so-called *Nationaal Referentiekader Steun aan Betaald Voetbal* providing advice on categories of permitted support.

Where I do agree with Rein is that controlling State aid, and deciding on its compatibility, is a matter of finding the right balance. The European Court of Justice has taken such an approach as a matter of principle in the *Meca-Medina Majcen* judgment (Case C-519/04). In that judgment it referred, in assessing competition law compatibility, to the ‘*overall context in which the decision of the association of undertakings was taken or produces its effects and, more specifically, of its objectives. It has then to be considered whether the consequential effects restrictive of competition are inherent in the pursuit of those objectives and are proportionate to them.*’ Where Rein also has a point, in my view, is that if the Commission starts to take more of an interest in State aid in sports, it needs to show a readiness to consider a wide range of issues, so needs to be prepared for ‘an avalanche’. Hence, the Commission would indeed need to show a willingness to find pragmatic solutions, for instance, by defining certain forms of aid as compatible by category, which is a well-tested concept.

In the bigger picture, whereas Rein Wesseling is basically advising the regulator to back off from looking at the distortive effects of local government support to football, I would not consider it bad if the Commission takes an interest to try to keep professional club sport clean from forms of financial doping by government support. The first beneficiaries of reducing public support would obviously be the taxpayers. But equally

important are the long-term benefits to sports itself: the level playing field in professional football, that may already be tilted, should not be made more uneven by an undue insertion of public funds.

Notes

ARTICLE

1 I obviously realize that there are already numerous exceptions in place – including the requirement of an effect on trade between Member States – and that the EU Commission applies a framework within which relevant exceptions abound.

COMMENT 1

1 A possible consequence could be, much like the Ajax/NEC example above, that PSV, my favored team from Eindhoven, would spill championship points in one of the remaining matches against Vitesse. A dreadful prospect in itself, for this author.

The impact on competition of sponsoring of the football league and exclusive media rights

JARIG VAN SINDEREN AND ROB VOSSEN*

Introduction

In January 2011, the EU Commission published a Communication on the development of the EU dimension in sports.¹ In relation to the economic dimension of sports, it contains two proposals that might be of interest for the future developments in sport. These concern the exploitation of sports media rights and public funding. The Communication states that the proposals also concern ‘consideration of the application of competition law’. Until now, competition law has not been applied very strictly when the economic activities are sports-related. The Commission only applied guidance in the case of media rights and state aid.

Many professional sports largely rely on sponsoring and government support. In this paper, we will concentrate on state aid and media rights.

We will focus on the professional football league in the Netherlands, the Eredivisie, and on ‘professional football enterprises’ (in Dutch: *betaald voetbal onderneming*; BVOs). This league is characterized by financial problems, a large competitive imbalance between clubs, and meager international performances, despite substantial government support. The Dutch teams are no longer leading clubs in the European competitions, and the national team depends heavily on players that are of Dutch origin, but play in clubs outside the Netherlands. In addition, an imbalance can be observed between the trend of the financial situation of the clubs and players’ salaries. Also, the imbalances between European BVOs are increasing. Rich clubs in large countries are able to buy expensive players

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and have a competitive advantage compared to clubs in smaller countries. Smaller clubs have to match the salaries of the best players, which is one of the reasons for the increase in the player salaries. In 2009/2010, salaries in the Eredivisie increased on average by 11% per team. This has been an ongoing trend for years. Between 2005 and 2010, player salaries increased by 58%.² At the same time, most of the Dutch BVOs are in debt, and many of them are faced with losses. These observations raise questions on the effectiveness of government spending. Has the support of BVOs by local governments had a positive impact on their performances? Is there any guarantee that these BVOs will be able to be profitable in the future? How can it be explained to the public that a considerable amount of taxpayer money is spent on clubs with a mediocre performance and expensive players?

The media rights are the subject of many a debate. This discussion has to do with the joint marketing of media rights, and with the prevention of exclusive selling of broadcasting rights of the Football World Cup and European Championship by FIFA to pay-TV channels.

Not all of these questions will be tackled in this paper dedicated to the retirement of Pieter Kalbfleisch as Chairman of the Board of the NMa. We will focus on public support of clubs and on media rights.

The outline of the paper is as follows. In the first section we give a brief overview of the situation of the Dutch Eredivisie. Then we focus on private and public sponsoring, state aid, and the financial position of BVOs in the Eredivisie. In the third section we will deal with the discussion on joint marketing of media rights by football clubs and on exclusive rights for pay-TV channels. The final section contains some proposals on how to improve the competition in the Eredivisie, and whether competition law can be applied in a more fruitful way than has been done so far.

The state of Dutch professional football

Professional football was introduced in the Netherlands in 1954. It is divided into two divisions. The highest division is called Eredivisie (honours division) and was founded in 1956. Since then, 48 out of 55 championship titles went to the traditional top three clubs: Ajax, Feyenoord and PSV.³ Before the introduction of professional football, there was a much larger variety of clubs winning the national title. It appears that, even in the early years of professional football, the competitive balance between clubs diminished as the financial budgets of football clubs grew.

Dutch clubs have been relatively successful in international competitions in the past, but in recent years, it is considered as a positive surprise if a Dutch team makes it past the group stage in a European competition, especially in the UEFA Champions League. The ruling of the European Court of Justice in the Bosman case (Court of Justice, 1995) has changed the dynamics of the transfer market for football players quite dramatically. As a consequence of this ruling, clubs can no longer require a transfer fee for a player whose contract has expired. To prevent a successful player from switching to another club free of charge at the end of his contract, clubs are now forced to renew the players contract (against a higher salary) before the old contract expires. This has no doubt been a factor in the sharp rise in player salaries. Moreover, there has since then been a strong growth of the amounts of money involved in the sales of media rights and merchandising. Perhaps it is not a coincidence that 1995 was the last time a Dutch club won the UEFA Champions League, as both these developments seem to have worked to the advantage of clubs from the larger countries, such as England, Germany, Spain or Italy. Given the relatively small size of the Dutch audience, the income from media rights and merchandising of clubs from the Netherlands is accordingly lower. In addition, with 18 clubs, the number of clubs in the Dutch competition among which these revenues have to be shared is relatively high. By comparison, the top divisions of Scotland and Belgium consist of twelve and sixteen clubs, respectively. Due to a lack of financial means, Dutch clubs today have difficulties retaining their best players and cannot afford to contract the highest category of foreign players. Most of the players of the Dutch national team play for club teams in one of the larger European countries.

Over the season of 2009/2010, the clubs in the Eredivisie have had a financially dramatic season, incurring a record loss of € 72 million (KNVB, 2010, p. 9). It appears that the most crucial factor determining the financial results of the clubs is their success in selling players to (foreign) clubs with deeper pockets. These transfers stagnated in 2009/2010, which is the main reason for the bad financial results. Of the 18 clubs that are active in the Eredivisie, only the champion FC Twente has received a clean bill of financial health from the Dutch football association. Twelve clubs fall in the intermediate category and five clubs, including the formerly internationally renowned Feyenoord, were placed in 'category 3', meaning that they are placed under tightened financial supervision of the Dutch football association.⁴ These clubs are not allowed to buy any new players, and can be given penalty points (point deductions) in the league table if

they fail to meet certain financial obligations.⁵ On the one hand, it seems valid for a football association to take measures to reduce the chance of clubs going bankrupt during the season because this would disrupt the course of the competition. On the other hand, some of these measures seem odd, as they could very well prevent the clubs from taking their own responsibility in finding their way up again. Taking risks and trying to be innovative is one of the characteristics of competitive entrepreneurship.

Sponsoring and state aid of professional football teams

Supporting the Eredivisie

All professional football teams have sponsors. However, if a club is facing financial problems, in many cases they ask for government support. Therefore, it has become quite common for Dutch municipalities to support their local professional football team.

TABLE 1 Share of the net turnover of the KNVB Eredivisie of different financial categories (2008-2010)

	2008/2009 (million Euro)	Share in %	2009/2010 (million Euro)	Share in %
Net turnover (million €)	433		420	
Media fees	53	12	54	12
Sponsor money	197	46	193	46
Tickets sales	116	27	116	28
Other	67	15	57	14

Source: Expertise centre KNVB, 2009 and 2010.

The turnover of the Eredivisie is about € 430 million. Of this turnover almost half is paid by sponsors. City sponsoring is included in this number. Media fees are 12% of this turnover, and ticket sales contribute about one-third. It should be noted that the media fees have been relatively low in recent years. The main reason for that is the change in the sale of the media rights by the Eredivisie. They have started their own broadcasting channel, and are still in the process of building their sub-

scriber base. 15% of the turnover is collected out of subsidies, gifts, merchandising, business-to-consumer activities, and food and beverages. The percentage of government subsidies other than sponsoring is included in 'other' incomes. This amount is unclear.

KPMG (2003) estimates that, over the period 1993-2003, the total amount of government support was more than € 300 million for the professional Dutch Football League (this league includes both the Eredivisie and the Jupiler League (also called 'Eerste divisie')). So in this period, an annual amount of about € 30 million in government funds is spent on supporting BVOs. This does not mean that this amount of money is directly related to the turnover of BVOs. Most of these funds (80%) are invested in stadiums, and therefore fall outside Table 1 presented above. Much of the sponsoring is also indirect, because clubs often are allowed to use the stadium against a reduced rate. This attitude of local governments can be easily explained.

The costs of a stadium and of operating a competitive professional football team are very high. It is difficult to recover the costs of the investment and the operation of a stadium on the sales of entry tickets to the football matches alone. Ticket prices cannot be too high, because watching a football game is considered more or less a public good – also because a lot of public money is invested in the sport. Attending a football match should remain affordable to the general public. Although, according to different studies, the price elasticity of sports tickets is relatively low, price increases of the entrance tickets is not often used as a means to collect extra money. Different studies (e.g. Andreff and Szymanski (2006) p. 94) estimate that the ticket price elasticity of attending a game lays between -0.2 and -0.6 . This implies that raising a ticket price might be a partial solution to improve the financial situation of the football clubs, but that is only a very small part of the whole story.⁶

So, the main sources of income of BVOs are private sponsoring and public money. The revenues from media rights will probably increase in the future. Beside these sources of income, BVOs also finance part of their costs with income from transfers. This is a rather unstable source of income, as was evident in 2010.

Professional football and the role of competition authorities

European competition law covers antitrust, merger control, and State aid. Most sports-related cases in the EU have been handled under antitrust rules, which prohibit anti-competitive agreements and practices (Article

101 TFEU), as well as abuse of a dominant position (Article 102 TFEU). The cases that the DG Comp has handled mostly concerned certain revenue-generating activities, such as media rights and ticket sales arrangements for events. According to the European Commission, a professional football club should be considered an undertaking, which operates in the market. A lot of clubs will disagree with the idea that they are 'ordinary' undertakings.

'It is important to look differently to a BVO (professional football enterprise) than to an 'ordinary' undertaking. An undertaking is usually oriented towards making a profit. A BVO wants to make as much money as possible in order to invest in a good sportive result' (translated from Dutch JvS RV) (Jos Haverkort in *Het seizoen in cijfers 2009/10*, KNVB, 2010, p. 29).

Government support to football teams is likely to distort economic competition between BVOs as well as the sports competition in the league. Both are obviously interconnected. For the EU, particularly the impact on the Internal Market cross-border competition is important. If Spanish teams are more supported by their governments than Dutch ones are, it could have a negative impact on the international competitiveness of Dutch football clubs. In reality, foreign clubs are often more privately sponsored than Dutch ones, because of the extent of the home market. This means that government sponsoring in smaller countries may help their clubs to compete with the big clubs in the bigger countries. So, there is an obvious imbalance in the competitive strength of Dutch BVOs compared to clubs from larger European countries. This is illustrated by the fact that the best Dutch football players are not playing in the Netherlands, but abroad. Still, the EC hardly interferes in cases in which government aid to football clubs is involved. There are different arguments which we can think of that might explain this attitude. First of all, football can be considered a good of public interest. Attending a match also has a social dimension, stimulates solidarity and has to do with local or national pride.⁷ On the other hand, there are also negative external effects like hooliganism and disturbance of public security. The strong public emotions involved in football may make it a risky subject of attention for the European Commission. Maybe football is still considered as a necessary entertainment for the people: *Panem ET circenses* (Bread and games) with all its positive and negative external effects. The attitude of non-intervention is also illustrated by a quote from European Commission Sport (2008):

'While the application of European competition law to economic activities in the sports sector is of great importance, the Commission and the Community Courts have recognized, and will continue to recognize, the important social and cultural roles of sport when considering cases related to sport (specificity of sport).'

A second argument might be that the effects of local support on the Internal Market are limited. A competition between different teams of different nationalities that is disturbed by government intervention may not be too problematic. It could be considered less important than keeping a national league interesting for the local public by preserving the number of clubs as seems to be the goal in the Netherlands. Looking from a perspective of results in the international competition, the impact of the Dutch government support to e.g. Ajax is rather ineffective. Clubs like Barcelona and Bayern München, which depend less on public sponsors are more successful, and are thus less inclined to oppose Dutch public sponsoring. Moreover, public support in the Netherlands typically goes to smaller clubs that do not participate in international competitions on a regular basis, rather than to the bigger clubs.⁸ Therefore, we think that local support of clubs is in the present situation a case for the national competition authorities, which should look at the effects on the competition between BVOs in the national league.

The EC allows different forms of public support. An important decision by the Commission concerns allowing the sponsoring of youth in professional sport clubs. In response to a French case, subsidies to professional sports clubs with state-approved youth training centers are allowed, as long as it also contains an educational goal.

A second form of public support that is allowed is city marketing. If a municipality pays a football club in order to promote the name of the city, DGComp does not consider this state aid, but sees it as sponsoring. Advertising the name of a city should then be explicitly associated with this sponsoring. This decision by the commission in 2005 led to awkward names of football teams. Sponsoring of the *Venlose Voetbal Vereeniging* (VVV) by the city of Venlo implied that the name had to be changed into VVV Venlo in order to get an approval of the European Commission.

Supporting clubs financially is also allowed if a club is active in society and has a social function. This argument is often used for subsidizing football clubs.

It is also allowed to help a club that faces bankruptcy. There are specific rules that should be applied (see White paper on sports, 2007).

Sponsoring stadiums is not considered State Aid, if the stadium is also used for purposes that benefit other people than just the football attendees. This is one of the reasons why stadiums are also used for concerts and other public events. This does not imply that tricks are allowed like buying a stadium for a relatively high price from a BVO and then sell it back for a much lower price.⁹ It is also important that the rents paid by the BVO's for the use of the stadium are market based. This behavior of local governments has to do with the fact that they get in a kind of locked-in situation. A stadium without a club is as bad as a club without a stadium.

Marketing of media rights

The European Commission has taken three decisions concerning the joint marketing of media rights by football clubs. The first, in 2003, concerned the sale of the media rights to the Champions League by UEFA.¹⁰ The decision entailed in short that UEFA would continue to market centrally the rights to live TV transmission of the matches, but in several, separate rights packages, so that different broadcasters would be able to buy some of the media rights.

In the following two decisions concerning joint selling arrangements of the national football leagues of Germany (2005)¹¹ and England (2006),¹² the Commission basically applied the same model as for the Champions League, accepting commitments of the leagues to offer the media rights in several packages. In the case of the English Premier League, the decision included a commitment that no single broadcaster would be allowed to buy all of the packages of live match rights.

With these decisions, the Commission was apparently primarily concerned with competition between broadcasters and safeguards against media concentration, rather than competition between football clubs. There are some notable differences between national football leagues and a competition like the Champions League that would seem to point to a different treatment of the joint marketing of media rights under competition law.

First, the UEFA Champions League is essentially a knockout competition, which means that the schedule of play is not known in advance. Clubs can be knocked out of the competition at several stages, so that broadcasters cannot be sure how many matches the clubs from their country will play, or who the opponents will be in the next rounds. In a national championship competition however, there is no uncertainty

about which clubs will participate. The schedule of play is known before the competition starts and each club will play an equal number of matches.

Second, in the UEFA Champions League, there is a large number of clubs participating in the early stages, from more than 50 countries, and a large number of broadcasters that are potentially interested in broadcasting the Champions League matches in their respective countries of origin. Considering the nature of the competition (knockout system) and the number of parties involved if the media rights were sold individually, joint selling of these rights reduces transaction costs considerably, as the uncertainty about the development of the competition and the large number of possible parties with whom a contract would have to be made form a considerable cost for interested broadcasters. In the context of a national competition however, the potential reduction in transaction costs by collective selling is much lower. It is questionable whether this would justify joint sales of media rights by all the clubs participating in the competition.

In its UEFA decision, the Commission did recognize that joint selling of media rights is not necessary for a redistribution of revenues between clubs. This could also be achieved by, for instance, an even redistribution of a fixed percentage of individually sold media rights. Redistribution of revenues is often referred to by the football leagues as necessary to maintain a competitive balance, as the matches should be more interesting for the viewers if the outcome is less predictable. It is however typically the case that the more successful clubs in the league take the largest percentages of the jointly sold media rights. This seems inconsistent with the pursuit of competitive balance. In any case, it is clear from the above that the competitive balance has not improved on the national level, or on the European level. Moreover, it leaves the question of how many clubs can be viably 'balanced' in a competition unanswered.

Recently (17 February 2011), there was also a decision by the General Court on appeal by FIFA and UEFA against a decision of the European Commission, which allowed Belgium and the UK to prevent exclusive selling to pay-TV channels of the broadcasting rights to the Football World Cup and the European Championship.

The General Court held that the Commission did not err in finding that the UK's and Belgium's categorization of all World Cup and European Championship matches as 'events of major importance' for their societies are compatible with EU law. It, therefore, dismissed the appeals in their entirety.

In particular, it found that 'prime' and 'gala' matches (such as semi-finals, the final and matches involving the relevant national team) are accepted to be of major importance for the public of a given member state and may, therefore, be included in a national list specifying the events to which the public should be able to have access on free television. As regards the other matches of the tournaments, the General Court held that the tournaments may be regarded as single events rather than as a series of individual events, divided between 'prime' and 'gala' matches. Further, the fact that certain 'non-prime' or 'non-gala' matches may affect whether a team advances to the 'prime' or 'gala' matches may justify a member state's decision to consider that all of the matches of those competitions are of major importance for society.¹³

This decision is interesting because it acknowledges the specific character of football as a good that is of public importance. It also confirms that there can be legitimate grounds for selling certain matches in a package and that the fact that FIFA/UEFA can be required to give open access to the matches. This does not imply that they are not allowed to strive for the best possible price for the broadcasting rights, but FIFA/UEFA are not allowed to sell the broadcasting rights exclusively to pay television or some other medium with limited access, in those countries which oppose it, given the fact that there is no EU-wide harmonization of which matches are of major importance to a country.

Conclusions

For many people, professional football is an important part of their life. In a competitive world, it is important for them that the team they support stays competitive. Being a supporter of a team is often also a manifestation of regional or national sentiments. Public sponsoring of a football team may be a way for local government to stimulate consensus and solidarity in their community. Also, the EU in various documents points out the public interests involved with sports in general and football in particular. This is confirmed by recent decisions of the Court. This implies in our opinion that state aid in case of football is unavoidable. However, state aid should not lead to an imbalance between different clubs, which interferes with a fair competition. Unrestricted financial support may easily lead to inefficiencies and block innovation and progress. Examples of such imbalances are: a financial compensation of a club to match private sponsoring of a competing team and the covering of annual losses, which are partly the result of a mismatch between the salaries of players and the

financial position of the club. In the Netherlands, the number of clubs hardly changes, and there are only a limited number of clubs that left or entered the professional leagues in the past years. Other than local sentiments, there is no reason why a professional football club should not be allowed to go bankrupt. A threat of bankruptcy will stimulate clubs to be more alert on their financial position, and will stimulate their innovative initiatives. In fact, a smaller number of teams of the Eredivisie¹⁴ may very well have a positive effect on the financial position of the remaining clubs, as well as on the competitive balance in the league. The demand for professional players will drop, which means that this will probably lead to lower salaries of the local players, and the turnover of clubs will increase because, for instance, revenues from the sale of media rights can be shared by fewer clubs. As mentioned earlier, the formula by which the clubs in the Eredivisie have been dividing up the revenues from the sales of media rights seems contrary to the goals of competitive balance.

These media rights are an important source of income for the clubs. It is important to note that the selling in packages, as is common practice by UEFA, is efficient because of the specific character of the international competition and international tournaments. For national competitions, there is, in our opinion, no reason to prevent selling of individual media rights. This will increase the turnover of the best performing clubs. The subsidiarity principle is important in the case of selling of these rights. As has been confirmed by a recent Court decision, different countries are allowed to make their own decisions on broadcasting issues, without jeopardizing the rights of the clubs or FIFA and UEFA.

Pieter Kalbfleisch has always stressed that the most important goal of competition law enforcement is the protection of consumer interests. The interests of football fans should be looked after by the NMa as well.

We think that the minimal role of a competition authority is to monitor the way in which football media rights are collected and distributed.

COMMENT**CHRISTOF R.A. SWAAK*****‘Daddy! Why isn’t the game on tv?’**

When we were growing up, state support of local football clubs was not really an issue. Today, in a period of close scrutiny by the European Commission of Dutch municipal subsidies to Vitesse, MVV, NEC and Willem II, the authors’ contributions are very apt. Likewise, public access to sport was not controversial. Nowadays, with the explosion of commercial tv, sports broadcasting has turned into ‘big business’. Off the field, the lucrative commercial licenses of pay-tv providers are jeopardized by the growing importance of ‘free access’ and the free-movement rules.

In its 2011 Communication on developing the European dimension in sport, the Commission makes multiple proposals designed to ‘*contribute to the promotion of European sporting issues, while taking account of the specific nature of sport*’. From the economic perspective of sport, the Commission specifically highlights the need for sustainable financing of sport, such as the exploitation of intellectual property rights, including the licensing of retransmission of sport events. While its assertion that revenue derived from this source is ‘*often partly redistributed to lower levels of the sports chain*’ lacks conviction, it emphasizes that, ‘*subject to full compliance with EU competition law and Internal Market rules, the effective protection of these sources of revenue is important in guaranteeing independent financing of sport activities in Europe.*’

This caveat on compliance could not have come at a more appropriate time. Two recent cases, at the General Court and by way of a preliminary reference at the Court of Justice, raise the specter for large sports enterprises that the era of unrestricted exclusive licensing of broadcasting rights may be over. The importance of public access to sport and the fundamental internal-market principles begin to hold sway over highly protective but thus far untested commercial imperatives.

By way of its ruling on 17 February 2011 in cases T-385/07 and T-68/08 (*FIFA v Commission*) and case T-55/08 (*UEFA v Commission*), the General Court upheld the Commission’s decision to approve the list of events of major importance for society submitted by Belgium and the United King-

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dom to the Commission. Such approval entitled the member states to prohibit exclusive broadcasting of all matches of the football World Cup finals in Belgium and all matches of the World Cup and the European Football Championship finals in the UK respectively.¹

The football organizations and the Commission debated fiercely over the national importance of viewing these football matches. The General Court found that 'prime' and 'gala' matches and matches involving a member state's national team must be accepted as being events of major importance for the public. As regards other matches, the Court observed that given the impossibility to predict which of the matches will be decisive for the outcome of the competition or the fate of the national team, a Member State's decision to declare all matches to be of major importance for society is justifiable. The Court also concluded that, although categorization of the matches as events of major importance for society would likely affect the price which FIFA and UEFA will obtain for the grant of broadcasting rights, the rights would still retain significant commercial value.

Meanwhile, in more modest surroundings, a case of potentially greater significance for broadcasters and football clubs sprang up in a seaside pub in Portsmouth, England, where a landlady, Karen Murphy began using a Greek decoder card to show Premier League football in her pub, thereby sidestepping the higher UK subscription fees (See related civil and criminal cases C-403/08 and C-479/08).

In June 2008, the English High Court referred questions on laws governing copyright, broadcasting and competition to the ECJ. Although interested parties such as Sky and Canal Plus were refused the right to intervene, the Grand Chamber hearing featured representations from multiple sides, including the Commission, the European Parliament, the EU member states, the EFTA Surveillance Authority and the governments of France and the UK. The applicant Football Association Premier League (FAPL) and several member states defended the importance of exclusive and territorial licensing rights.

On 17 February 2011, AG Juliane Kokott boldly announced in her opinion that territorial exclusivity agreements relating to the transmission of football matches are contrary to EU law. The AG found that the licensing rights have the effect of partitioning the single market into separate national markets, thereby denying the fundamental freedom to provide services.

The possible defense of the protection of industrial and commercial property and, in particular, the question whether live satellite transmis-

sions of football matches constitute rights the specific subject-matter of which require market partitioning was roundly dismissed. The sole specific subject-matter of the rights, their commercial exploitation, is not undermined by the use of foreign decoder cards. Although the resultant charges may be lower than those achieved in the UK alone, there is no specific right to charge different prices in each member state. On the contrary, the internal market logic is such that price differences should gradually disappear. Consequently, the transmission of football matches does not justify a partitioning of the internal market or the restriction of the freedom to provide services.

The long-term consequences of a possible ruling consonant with AG Kokott's opinion will certainly be disruptive and unpredictable, but the simplicity and freshness of her arguments certainly bode well for a healthy debate in the public and political arenas over how to strike the 'right' balance.

COMMENT

GERARD VAN DER WAL*

Sport and competition law: only by the rules

Fortunately, the contribution of Jarig van Sinderen and Rob Vossen is limited in scope. In the first place, the authors have limited it to football. That coincides with Pieter Kalbfleisch's lifelong interest in football and former prowess on the field,¹ although football is certainly not his only interest in the field of sport. In the second place, the article I have been invited to comment on is limited to the effects of state aid provided by local governments to professional football clubs. This seems to be a wise limitation, because a wider scope would need an entire book.

Although the article intends to focus on state aid for professional football clubs, it nevertheless goes beyond its self-imposed limitation by also considering the joint marketing of media rights by football clubs. These media rights have been assessed by the European Commission and national competition authorities on the basis of the current Article 101 of the TFEU (the cartel prohibition) and its national equivalents.² Exclusivity and exploitation of media rights continue to arise as issues in both competition law³ and other applicable European law areas⁴.

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It is tempting to address these broader aspects of law and sport, partly because it may affect the analysis of the question raised and answered by van Sinderen and Vossen, namely: '(can) competition law...be applied in a more fruitful way than has been done until now?' It seems hazardous to answer that question without taking into account other legal instruments and policies that affect the commercial aspects of sport, football in particular, and the application the Treaty provisions on state aid.⁵ The Treaty provisions on free movement of persons and Articles 101-102 of the TFEU have had, and continue to have, a noticeable impact on the commercial aspects of sport. In this comment I can only point out that this area of European law and competition law is vast.

Although the contribution of van Sinderen and Vossen does not seem to draw a distinction between the jurisdiction of competition authorities in the application of state aid provisions and the application of Articles 101-102 of the TFEU (Articles 6 and 24 of the Dutch Competition Act), this distinction is essential. The NMa has joint jurisdiction with the European Commission in the application of Articles 101-102 of the TFEU.⁶ In the field of state aid, the NMa lacks jurisdiction completely: the European Commission has exclusive jurisdiction to apply Articles 107-108 of the TFEU.⁷ Even if the conclusion of van Sinderen and Vossen were correct (i.e. that state aid provided by local governments (municipalities) is an issue that should be dealt with by national competition authorities), such state aid control by the NMa would require new legislation, because the NMa presently does not have any legal basis to act. It is unlikely that member states would be willing to extend the jurisdiction of their national competition authorities to include scrutiny of national state aid. The Commission has been reluctant to consider decentralization of the application of Article 107 of the TFEU as this might jeopardize the ban on state aid.

Until recently, the European Commission seemed reluctant to start state aid investigations of professional football clubs, although in many cases throughout the European Union, such football clubs do seem to benefit directly or indirectly from national, regional or local state aid. As far as the Netherlands is concerned, the Ministry of the Interior published guidelines on state aid to professional football clubs⁸, which closely follow the criteria and conditions of Article 107(1) of the TFEU. A clear picture of its application is, however, lacking. In view of the difficult situation of a number of professional football clubs, which is also described by van Sinderen and Vossen, the demand for municipalities to provide financial aid has grown⁹. In October 2010, the European Commission confirmed that it had started a state aid investigation of aid provided by the munici-

palities of Maastricht (to MVV), Tilburg (to Willem II) and Arnhem (to Vitesse).¹⁰

For the ban on state aid to be applied, the various criteria for the application of Article 107(1) of the TFEU have to be fulfilled. As professional football clubs undoubtedly qualify as ‘undertakings’¹¹ within the meaning of Article 107(1) of the TFEU, and as the European Commission and the European Courts are very quick to conclude that aid may (at least potentially) affect competition and trade between member states,¹² the inapplicability of the ban on state aid should be based on other grounds, if possible. The suggestion of van Sinderen and Vossen that football can be considered ‘a good of public interest’ does not seem very realistic in view of the case law.¹³ Even if it could be successfully shown that professional football is ‘of major importance for society’,¹⁴ this would not mean that football qualifies as a service of general economic interest. Moreover, it is unlikely that a government at either national or local level would be inclined to accept that only professional football is a service of general economic interest, to the exclusion of all other forms of professional sport. Criteria that establish that one sport is a service of general economic interest, and others are not, would seem difficult to find and defend.¹⁵ Van Sinderen and Vossen are apparently football enthusiasts, because they seem to get carried away with their argument that ‘[attending] a football match has a social dimension, stimulates solidarity and has to do with local or national pride’. There are few, if any, examples of a service of general economic interest that cause so many problems for the maintenance of public order, a point made by van Sinderen and Vossen as well.

A safer way to prevent the application of the Treaty ban on state aid would seem to be the subsidies that fall outside the scope of Article 107(1) of the TFEU. That has successfully been done in cases in the past: public subsidies for stadiums that have a wider use than professional football (e.g. general public events and concerts) and aid for the non-professional activities of a football club.¹⁶

Even if the ban on state aid is respected meticulously by all member states, major differences in the size of national media markets and the value of the corresponding media rights will continue to have an impact on the financial position of professional football clubs: the strongest ones with the largest financial resources will buy the best players, and ‘score’. That is called ‘capitalism’ or ‘*marktwerking*’.¹⁷ I agree with van Sinderen and Vossen that this is certainly not beyond well-founded criticism. I hope to use this argument in the future outside the field of sport.

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Notes

ARTICLE

- 1 Commission Communication on developing the European dimension in sports, Commission press release IP/11/43, European Commission, Brussels, 18 January 2011.
- 2 KNVB, 2010, p. 32.
- 3 In the last two seasons before 2011 however, the title went to the relative outsiders AZ Alkmaar and FC Twente. Feyenoord, the club Peter Kalbfleisch supports, had the worst season since the start of professional football.
- 4 Fixing this highly undesirable situation may be an interesting new challenge for our retiring chairman.
- 5 It must be said though, that Feyenoord has now managed to finish 10th in the league, even without being given any point deductions.
- 6 In the Netherlands, ticket sales even increased at the peak of the credit crises. The total number of spectators attending a game increased in recent years. (KNVB, 2010).
- 7 See e.g. European Commission (2007).
- 8 Feyenoord and PSV have not received any government support since at least 1995. Ajax has only benefited from an investment in their stadium by the municipality of Amsterdam.
- 9 In 1980, the municipality of Breda bought the NAC Breda stadium for a couple of millions of guilders. In 1989, Breda sold the stadium for a symbolic figure of 1 guilder to the football club. In 1996 the municipality of Breda bought the stadium back for 6 million guilders. NAC built a new stadium which was bought by the community in 2003 for 15 million. (see Van der Linden (2010)). This is just one example.
- 10 Case COMP/37398.
- 11 Case COMP/37214.
- 12 Case COMP/38.173.
- 13 <http://competition.practicallaw.com/6->

504-8602?email=1247446590624
&source=updateemail.

- 14 This would not necessarily involve bankruptcy of clubs, but can also be achieved by more clubs relegating to a lower division at the end of the season.

COMMENT 1

- 1 Article 3a(1) of the Television without Frontiers Directive (now replaced by Article 14 of the Audiovisual Media Services Directive) allows Member States to prohibit the exclusive broadcasting of events they judge to be of major importance for society where such broadcasting would deprive a substantial proportion of the public of the possibility of following those events on free television

COMMENT 2

- 1 He has admitted however that he was *'made the goalkeeper of his team as he was too 'wild' in the field ...'* (*Het Financieele Dagblad*, 26 July 2010).
- 2 The media exploitation of football matches has been the subject of a number of cases in the Netherlands, e.g. The Hague Court of Appeal, 31 May 2001 confirmed by the Supreme Court of the Netherlands, 23 May 2003, NJ 2003/494, KNVB/Feyenoord; NMa decision in cases 18 and 1162/14 (Eredivisie) of 19 November 2002, annulled by the Rotterdam Court, 7 March 2005, AM 2005, p. 117, note MdG. See also: L.Y.J.M. Parret, 'De race om de kijkcijfers: uitzendrechten voor sportwedstrijden in het mededingingsrecht, M&M 2000, p. 211-216; for some other countries, see: C. Hatton, C. Wagner and H. Armengod, 'Fair play: how competition authorities have regulated the sale of football media rights in Europe', (2007) ECL Rev. (6), p. 346.
- 3 Recently, for example, the decision of the Belgian Competition Council 29 November 2010 on the live broadcasting of Belgian Pro League football matches.
- 4 Recently, for example, the opinion of AG Kokott of 3 February 2011 in pending cases C-403/08 and C-429/08 (Football Association Premier League / QC Leisure and K. Murphy / Media Protection Services) of 3 February 2011; General Court 17 February 2011, Case T-385/07, FIFA / Commission, n.y.r. (similar judgments in cases T-55/08 (UEFA/Commission) and T-68/08 (FIFA/Commission) on the same date.
- 5 Currently, Articles 107-108 of the TFEU.
- 6 Articles 5 and 11 of Regulation 1/2003.
- 7 Regulation 659/1999.
- 8 Ministry of the Interior and Kingdom Relations, 'Nationaal referentiekader, Steun aan betaalde voetbal. Een wegwijzer en regioanalyse betreffende steun aan betaald voetbal'.
- 9 De Vereniging Nederlandse Gemeenten (Association of Netherlands Municipalities) has established a 'platform for professional football and municipalities' to 'follow the developments structurally and address these jointly'. The platform has already made clear that the KNVB (Dutch Football Association) should use its financial reserves to rescue football clubs with financial problems.
- 10 The outcome of the investigation remains to be seen. It cannot be excluded that the finding will be similar to the decision of 23 July 2003, C 49/03 (ex NN 51/03) – Sale of Land to AZ and AZ Vastgoed BV, OJ 2003, C 266/8, which concerned the construction of a new multifunctional stadium.
- 11 It is not uncommon for undertakings to consider themselves to be 'special' and 'not ordinary'. Often I tend to agree; however, this has little or no bearing on the application of competition law.
- 12 Commission decision of 22 June 2005, C 70/03, Measure in favour of professional sport clubs (Decreto Salva Calcio), OJ 2006, L 353/16.

- 13 See footnote 12.
- 14 Article 3 j (i) of Directive 89/552/EEC (Audiovisual Media Services Directive), OJ L (298) 1989, as last amended by Directive 2007/65/EC (OJ L 332 (2007) p. 27).
- 15 The 'Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, Developing the European Dimension of Sport' (COM (2011) 12 final) of 18 January 2011 describes 'the societal role of sport', without giving showing any preference for a specific sport .
- 16 See footnote 8.
- 17 There appears to be no single English word for '*marktwerking*'. I cannot exclude the possibility that it is a typically Dutch phenomenon which Pieter Kalbfleisch has worked hard to achieve...

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Curriculum vitae Pieter Kalbfleisch



Pieter Kalbfleisch has been Chairman of the Board of the Netherlands Competition Authority (NMa) since July 1, 2005, on which date the NMa also became a so-called autonomous administrative authority. Prior to his appointment as Chairman, Pieter Kalbfleisch had been Director-General of the NMa between September 2003 and July 2005.

Pieter Kalbfleisch studied law at VU University in Amsterdam. After his graduation in 1972, he started his career as an attorney at law in the Dutch city of Arnhem. After joining the Bar in the city of Haarlem, he made a career change. He became judge on the District Court of Haarlem and specialized in criminal and civil law. In 1986, he was appointed Deputy Presiding Judge of the District Court of The Hague. In this capacity, he specialized in family and juvenile law. Subsequently, he obtained the position of Acting President of the District Court of The Hague, which also involved a number of administrative tasks.

Prior to joining the NMa, Pieter Kalbfleisch had been Chairman of the Arbitration Board of the Bridging Fund for Drama in The Hague, as well as Chairman of the Professional Football Appeals Board of the Royal Netherlands Football Association (KNVB) in Zeist. He also was a member of the Executive Board of the Dutch Association for the Judiciary (NVvR). In addition, he served as an arbitrator for the Netherlands Arbitration Institute (NAI) in Rotterdam. Furthermore, he has worked as a law instructor and advisor to the Business Studies course and Management programs in Haarlem, and as an instructor in Insolvency Law and the Law of Procedure with the Netherlands Bar Association (NOvA).

Pieter Kalbfleisch still is Chairman of the Board of The Hague Philharmonic (Residentie Orkest), and a member of the Board of Governors of the Europa Institute of Leiden University. Since 2010, Pieter Kalbfleisch is also a member of the Deetman Commission investigating child sex abuse in the Catholic church in the Netherlands.

Pieter Kalbfleisch has given numerous speeches at national and international forums on competition law, economics of competition, and on supervision in the broadest sense of the word. He has also written articles on these subjects in national and international publications.

