

Germany

COMPETITION Dominant position

Public utility found to be guilty of abusive pricing

Bavarian Ministry of Economy and Transport
11 January 1994
5597 b-W/2b-61855 1

Section 22(1) of the German Act against Restraints of Competition¹ (comparison of Gas Prices) states: An enterprise is market-dominating within the meaning of this Act insofar as, in its capacity as a supplier or buyer of a certain type of goods or commercial services . . . (2) it has a paramount market position in relation to its competitors . . .

Section 22(4) of the Act provides for the supervision of abuses of a dominating market position by the cartel authority.

Section 103(5) of the Act states: In the cases defined in subsection (1) the cartel authority may take the measures described in subsection (6), having regard to the purpose and meaning of the exemption, in particular the objective of the achievement of a supply as safe and cheap as possible.

(1) insofar as the agreements or the manner of their implementation constitute an abuse of the market position obtained as a result of the exemption from the provisions of this Act . . .²

An abuse within the meaning of sentence 1, clause 1, shall be present in particular, where . . .

(2) a public utility imposes less favourable prices or business conditions than public utilities of the same kind, unless it proves that the difference arises from distinguishing circumstances which are not attributable to it, provided that clause 1 above shall remain unaffected hereby, or . . .

The public utility concerned is engaged in the territorial distribution of gas. Within its territory of distribution it is protected by agreements on territorial demarcation and concession agreements.³ The Bavarian Cartel Authority examines whether the gas prices charged by the Bavarian public utilities are within the limits permitted by anti-trust law. The Bavarian Cartel Authority determines the average consumption by reference to the charts established by the Federal Association of the Gas and Water Economy concerning, for example, the 'self-contained house', the 'house with six apartments' and the 'house with 12 apartments'. On the basis of the consumption and the cost factors the Bavarian Cartel Authority establishes the annual costs of the heating energy and the operating costs of gas heating. The operating costs are compared with the operating costs which the use of heating oil would produce. Formal proceedings concerning abusive pricing will be initiated, if the price demanded by the public utility exceeds the calculated costs of oil heating by more than 10 per cent. Accordingly, when concerned with the exercise of its discretionary power in the control of abusive pricing in the sense of sections 103(5) second sentence and 22(4) second sentence of the German Act Against Restraints of Competition, the Bavarian Cartel Authority will only deal with a substantial abusive behaviour. The Cartel Authority demanded from the public utility concerned the indication of the prices of gas charged for the houses indicated above. It established that the costs for the heating of a house with six apartments exceeded the costs of a competitive oil heating by 15.18 per cent and in the case of the house with 12 apartments by 22.49 per cent, and that the costs of the public utility concerned for the heating of such houses were considerably higher than those of other public utilities engaged in the distribution of gas. The Cartel Authority demanded a lowering of the prices of the public utility concerned. The public utility refused to do so, asserting that it was not in a dominant position and subject to the supervision of abusive pricing, in particular because it would compete in the market with suppliers of heating oil.

Held: (1) A public utility engaged in the distribution of gas is market dominating within its territory of distribution. There is no unitary heat market which would include the suppliers of heating oil and which would justify a modification of this assessment of the market position of the public utility.

(2) The competition with regard to new customers between the public utility engaged in the distribution of gas and suppliers of heating oil cannot modify the assessment of the market dominating position which is based upon the existence of concession agreements and agreements on territorial demarcation concluded by the public utility with regard to old customers.

(3) There is an abusive pricing by the public utility if the annual operating costs of gas heating concerning houses with six and 12 apartments exceed those of oil heating considerably (15 respectively 22 per cent).

(4) When assessing the similarity of enterprises the behaviour of which in the market is compared, an exact similarity is not asked for, but the similarity of the economic function of the enterprises from the point of view of the customers.

(5) A basic price system based upon performance does not justify excessive prices for sale in particular market segments.

1 WuW 1994 at 473.

2 Subsection 1 exempts public utilities from the application of the general prohibitions of cartels contained in the Act with regard to, *inter alia*, concession agreements and agreements on territorial demarcation.

3 On agreements on territorial demarcation and concession agreements see Vahrenwald, 'Gas Supply in Germany and Anti-trust Law' (1993) 6 OGLTR 174 at 176 and 178.

The Ministry ordered the public utility to lower the gas prices for the distribution to houses with six and 12 apartments and to purchasers of similar quantities. Further, the Ministry identified the upper limits of these prices and threatened the punishment with a fine of up to DM1 million for any case of a violation of the order and, additionally, a fine of the threefold amount of any profits obtained in consequence of such violation.

Market Dominance

The Ministry found that the public utility was a market dominating enterprise. It stated:

. . . it is decisive whether the establishment of the gas price is determined by effective competition through substituting energy carriers. In order to answer this question it is necessary to ascertain the relevant market. When building a house, the builder has to decide which heating shall be installed. He is involved in the creation of the demand in the market for heating installations which is characterised by a substantial competition. Then the tenants . . . will conclude their own contracts with public utilities. In such cases the energy users do not choose the energy carrier . . . After the conclusion of the contract with the builders . . . the public utility assumes a legally and factually ensured market dominating position with regard to purchasers and tenants of built houses which have no other possibility to realise the need of heat in another way than by means of the built-in gas heating. Thus the public utility is not subject to an effective competition by substituting energy carriers . . . Even if public utilities engaged in the distribution of gas were subjected to competition by the substituting energy 'heating oil', the establishment of the gas price of the public utility concerned is nevertheless subject to the anti-trust control of abusive pricing according to Section 103(5) of the German Act Against Restraints of Competition . . .

Abusive Behaviour

The Ministry stated:

As a presupposition for the comparison of prices and conditions the law requires the consideration of a market which is comparable to the relevant market. The concept of the 'comparable market' is based upon the thought to establish the prices and business terms in the relevant market under the condition of effective competition by using as a standard the prices and business terms which have been established in a comparable market in competitive conditions . . . Such a market is the market for heating oil . . . Proceeding upon the competitive price for heating oil the gas price has to be established by means of appropriate additional charges and reductions which very likely would have ensued if public utilities were subjected to an effective competition . . .

The abusive pricing of the public utility concerned derives also from the comparison with the prices of other public utilities engaged in the distribution of gas. The Ministry stated:

If other public utilities . . . would not be impeded from market access by reason of the agreements on territorial protection concluded by the public utility concerned, they could sell gas at lower prices even in its territory of distribution so that the purchaser would choose the reasonably priced product. In the case of effective competition thus the public utility concerned as the more expensive undertaking would not be in the position to maintain its prices. Thus its behaviour is abusive . . . because the public utility concerned demands less favourable prices in the sense of section 103(5) 2nd sentence clause 2 of the Act than other public utilities . . .

The presupposition of a comparison of prices according to this provision is the similarity of the enterprises. The Ministry explained:

This does not mean that only prices and business terms of completely similar enterprises could be compared; the legislator intends to exclude a comparison of considerably different enterprises. What matters is the economic function of the enterprise from the view of the customer; thus similar in this sense are all those enterprises which offer the sale of gas to end users. Differences in the territorial structure of the public utilities have not to be taken into consideration in the examination of the similarity but, if at all, within the scope of the examination whether a verified price difference is based upon facts which are not attributable to the enterprise.

Thus a comparison of prices is not only admissible between neighbouring public utilities but also between undertakings with spatially separated territories of supply . . .

In principle, the comparison with only one other public utility may be sufficient to establish the allegation of an abuse . . .

In the case of a price differentiation based upon an intra-brand comparison, in principle no particular threshold has to be exceeded in order to justify the reproach of an abuse . . . Accordingly, in competitive conditions, even small additions to the price in relation to a competitor's price will, generally, not be accepted . . . There are no factors recognisable according to which the higher gas prices of the public utility concerned with regard to the undertakings compared could be based upon separate factors which would not be attributable to the public utility concerned (Section 103(5) 2nd sentence, clause 2 of the Act).

Finally, the Ministry rejected as not based upon the law the assertion of the public utility concerned that a basic price system founded upon efficiency may justify higher prices in particular segments of the market.

Comment: The supervision of abusive pricing of public utilities engaged in the distribution of gas has recently been discussed, in particular with regard to public utilities in the former German Democratic Republic which suffered from overmanning. It was criticised that the supervision would hardly be compatible with the constitutional guaranty of the freedom of trade and of the right in property, in particular the supervision would oblige a public utility to lower the price under its cost price.⁴ However, since competitive conditions do not permit an enterprise to claim that its costs prices be guaranteed, it is not conceivable that public utilities should have the right in the maintenance of their position in the market.⁵ The directive of the Bavarian Ministry of Economy sustains the practice of the cartel authorities according to which the management of a public utility is obliged to work rationally and cost effectively. Some guiding principles can be drawn: First, the legal term of the market dominance will be established with regard to the relevant market. Concerning substituting energies, the customers' view has to be taken into account. Accordingly, the relevant market does not include heating oil which means that public utilities engaged with the distribution of gas will generally be market dominating. Second, the verification of abusive pricing focuses upon the concept of the comparative market. This means that similar markets with effective competition have to be considered. Here the Bavarian Cartel Authority considered as appropriate the comparison with the competitive market of heating oil and asserted that the comparison of the cost price of the gas and the oil heating would be appropriate subject to corrections concerning particularities and differences in the market with regard to heating oil by means of extra charges or deductions. Third, a public utility is not justified to charge substantially higher prices than other public utilities unless the higher prices can be based upon circumstances not attributable to the public utility. Fourth, the principle of free economic activity does not justify a public utility's pricing policy according to which general prices based on performance may justify overpricing in particular segments of the market.

4 Schöning, 'Zur kartellrechtlichen Missbräuchlichkeit unrentabler Energiepreise', BB 1993, 1463 at 1465; see the Directive of the Cartel Authority of Brandenburg of 22 April 1992, WuW 1992 at 781.

5 Wolf, 'Energiepreise zwischen Kosten und Wettbewerb', WuW 1994, 415 at 422.

Arnold Vahrenwald
Rechtsanwalt
Munich

Latin America

PRIVATISATION Petroleum Industry

Summary of regional privatisation programmes

During the 1960s and the 1970s, Latin America watched the rise and expansion of large state oil companies. Nowadays, however, it is the home of various kinds of enterprises, ranging from the most liberal, like the Argentinians which opened their oil industry to the private initiative, to the most orthodox, like Mexico, a country that still maintains such activities under severe state monopoly.

As another example, in spite of keeping the oil-related activities under the state control, Venezuela employs a mixed system, associating with third parties to develop the natural gas exploitation, production and refining, as well as export projects.

Information obtained with the Latin American Entrepreneur Mutual Assistance ('ARPEL') reveal, for instance, that private partners will invest approximately US\$10 billion in projects on those areas, from 1994 to 2002.

Venezuela, Brazil and Mexico are, respectively, the three largest owners of (proven) oil reserves in Latin America; Brazil ended 1993 with 3.8 billion barrels. Production follows the same ranking and Brazil appears to produce 720 thousand barrels per day.