

## **IS THE NEW EUROPE ANTI-COMPETITIVE ?**

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## IS THE NEW EUROPE ANTI-COMPETITIVE?

Until the 1990's it seemed as if Europe was experiencing constant growth. Despite the problems on the way such as the petrol slumps or "Bloody Sunday" in October of 1987 which certainly dampened growth, the markets themselves were considered as a guarantee of an enduring economic power. This climate of confidence was accentuated by the fall of the Berlin wall which, as well as dissolving a large source of international tension, allowed for the glimmer of extension of the European market to the whole continent.

Today, Europe, as prosperous as it is, is starting to suffer from a lack of competitiveness in the face of the strong competition coming from emerging markets.

Awareness of this was first raised by Member States in 2000 and as a result the "Lisbon Strategy" was adopted in the same year. The strategy aimed to make the European Union "*the most competitive, dynamic and knowledge-based economy in the World by 2010, capable of enduring economic growth along with a qualitative and quantitative improvement in jobs and greater social cohesion*". However, it is concerned solely with objectives. Contrary to the balanced objectives of public financing fixed by the Stability and Growth Pact implemented at the same time as the Euro and complementary to the single currency, there are no corresponding sanctions. This is why the "Lisbon Strategy", which sets out attractive measures in order to increase competitiveness (through the modernization of social protection systems, the extension of the activity period, the improvement of training, the promotion of research and technological development...) essentially remains a declaration of good intention.

In the second instance, certain States – not only France – reacted in a defensive manner by trying to protect their national interests. In France, the "No" in the referendum on the European Constitution can be explained by not only internal politics but also the successful anti-market viewpoint. Advocates of the "No" vote were heard the most because they questioned the principles of "free and undistorted competition" which have been set in stone since the Treaty of Rome of March 25, 1957.

This debate is still very current to the extent that reference to competition as an objective of the Union was recently withdrawn from the text of the future Treaty, which replaces the late European Constitution. The removal of this provision was requested by the French President who denied "*Competition as an ideology and a dogma*". Despite all the European leaders not sharing his view on this subject, the requested amendment was still passed unanimously. The authority of the European Commission, which plays the same role as the FTC, has not changed. However, the objective of free competition is relegated to a simple Protocol annexed to the Treaty. The modification is apparently of little juridical value but it has political significance. Competition is, along with monetary policy, the sole and unique Community

competence which is truly federal. It is therefore not insignificant that its place in the Treaty has been diminished.

Does it mark the return of protectionism and the end of the idea of a completely integrated internal market as imagined by the Founding Fathers of Europe? I don't think so. I would like to show that the European market is just as open to companies as the American market, if not more so.

But for all that, one cannot deny that new concerns have arisen as a result of competition from emerging markets that have led Member States of the EU and Europe itself to question the protection of its own strategic interests.

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## **A. AN INTEGRATED INTERNAL MARKET**

The market is based upon two underlying ideas.

- The first is the opening of boundaries through the free movement of persons, capital, products and services;
- The second is “free and undistorted competition”. This allows for any company to grow across Europe without hindrance, and all citizen-consumers to benefit from the advantages of the market in terms of free choice of goods and services and the maintaining of its buying power.

This policy doctrine of a “market for citizens” directly inspires European policy in competition matters. The freedom of circulation greatly increased the number of commercial companies on the market, and their recognition aims to facilitate their economic development and the promotion of growth and competitiveness of Europe as a global site.

The integration of the internal market is guaranteed through strict control of the risk of abuse of a dominant position by the European Commission and the European Court of Justice (ECJ), effective abuse through antitrust practices and, more recently due to the extensive application of companies' freedom of establishment.

### **1. The control of Concentrations**

The Commission, which has control of the Community dimension of concentrations, was until recently, stricter than the FTC as shown by the refusal of the merger between GE/Honeywell Bull in 2001. The European Court of First Instance (CFI) confirmed this prohibition in a decision in 2005 where it was stated that even if the Commission committed an error in its analysis, it was right to consider that the company created by the merger could have been able to abuse its dominant position in several markets thereby depriving customers of the benefits of price competition.

European competition law would like to be adjusted towards the defense of consumers' rights rather than competitors' rights. In addition, the Commission's approach emphasized quantitative aspects of the industry sector, rather than the real strengths of the market which could possibly be mitigated by the "potential efficiencies" in, for example, the fields of innovation and technology. The ECJ in several cases in 2002 judged that the Commission needed to develop its economic reasoning. The Commission reacted immediately. The result was the adoption of new regulations in 2004. Consequently there is no longer a big difference between the American approach and the European approach. However, the Commission's approach is still stricter than the FTC's. For instance, in June 2007, the European Commission prohibited, on the basis of the new EU merger Regulation, the proposed takeover by Ryanair of Aer Lingus, two low-cost air carriers. In the same way that it decided against the GE/Honeywell's proposed merger, the Commission concluded that the merger, since it was aimed at combining the two leading and closely competitive airlines operating from Ireland, would have harmed consumers by removing competition and creating a monopoly or a dominant position on the European Market.

## **2. The fight against anti-competition practices**

The same observation can be made with regards to anti-competition practices. The example of the Microsoft case shows how avidly the European Commission supervises the opening up of competition. Microsoft supplies 90% of the world's stock of PCs; it is therefore not a minor player. And yet after a tug of war with the Commission that lasted seven years, and after having been ordered to pay a heavy fine, the ECJ last month confirmed that Microsoft would be required to allow its competitors access to the necessary information in the development and open source communities in order to ensure that the competitor's products are compliant with Microsoft products. Neelie Kroes, Competition Commissioner immediately declared it: *"a day of victory for consumers"*.

This declaration illustrates the spirit in which the Commission sees its role as a competition authority. As said above, the Commission defends the rights of consumers more than the rights of companies. This is because the Commission, which has not always supported States, needs to justify its legitimacy directly to the citizens.

It is this same spirit that incited Viviane Reding, European Commissioner for Information Society and Media to promote the adoption of a regulation that imposes mobile phone operators to drastically drop the tariff for cross-border communications. The aim is to lower the price of communication whilst traveling across Europe to as close as possible to the fixed national level and to not exceed a maximum of 20 Euro cents. This courageous decision, much appreciated by the public, led the President of the Commission to state that *"the single market is first and foremost for the benefit of the consumers"*.

It is also a consumer problem that inspires the hounding of cartels and the condemnation of those who are discovered - often after several years - to pay hundreds of millions of Euros in fines. In the most serious cases fines have increased to nearly a billion Euros. The amount is similar or even higher than the fines inflicted in the US as shown by the very recent record fines of 353 million Euros levied on British Airways and Korean Airlines by the UK and US competition authorities for their part in a web of global conspiracy in airline travel. For example, in the case of the cartel that installed and up kept lifts and escalators in Belgium, Germany, Luxembourg and the Netherlands, the Commission, in February 2007, fixed fines of up to 990 million Euros. The Competition Commissioner highlighted that in that particular case the effect of the agreement grossly inflated the costs of constructing and maintaining housing and hospitals.

Another example of the determination of the European Commission to fight against antitrust practices is shown by a Statement of Objections (“SO”) send by the Commission to Intel in July 2007. In this SO, the Commission outlines its preliminary conclusion that Intel has engaged in the abuse of a dominant position with the aim of excluding its main rival, AMD, from the x86 Computer Processing Units (“CPU”) market. Although the Commission’s SO does not prejudge the final outcome of the procedure, this example is all the more interesting as the FTC has, until now, not deemed it necessary to investigate the Silicon Valley’s company’s alleged abuse of a dominant position. This is in sharp contrast to the approach of the European Commission which – if the abuse is confirmed – could, in theory, impose a fine of up to 10% on the turnover of Intel (or 3,5 billion Dollars (!) based on 2006 sales of 35,4 billion Dollars). European authorities like to emphasize, especially in the strictest of cases, the link that exists between European regulations and the protection of citizens; as if the promotion of the economy was not a sufficient enough motive to justify their actions.

### **3. Freedom of movement of companies on the single market**

As strange as it might seem, for a long time companies only benefited from very limited freedom of movement – unlike citizens. On one hand, commercial companies from one Member State were not recognized in the legal order of other Member States. This would affect their legal capacity in the other States. On the other hand, cross-border transactions were practically impossible. For example, cross-border mergers meant the liquidation of the company absorbed with all of the legal consequences and tax penalties that result. Notably, capital gains and profit, amongst others, would become immediately taxable.

Developments in jurisprudence and regulations have remedied this situation. As of 1999, the ECJ fully sanctioned the freedom of establishment of companies in the strict sense of the EU Treaty which sets out that any company can create a subsidiary, a branch or a franchise in another Member State.

This freedom of “secondary” establishment (different from the freedom of “primary” establishment which allows for the possibility to transfer the registered

office of the company from one Member State to another as if it was on national territory) is envisaged by the Court in a very developed manner. Without going into details, the Court firstly found against Denmark (decision “Centros” in 1999) for having refused to register the subsidiary of a company because the company was registered in the UK but did not practice there. Its sole reason for registering abroad was to escape the strict Danish legislation. In another case (decision “Uberseeing” in 2002), the Court held Germany liable for having denied a company to follow proceedings against another company as the latter was not registered in Germany. Finally, a case in 2003 (decision “Inspire Art”) judged that a Dutch law that required foreign companies of “pure form” to be subject to specific constraints compared to Dutch companies, infringed the freedom of establishment.

Companies can now spread out across the internal market as if it were there domestic market. As a result of a 2005 directive (which is supposed to be implemented into domestic law by the end of this year) companies can also carry out cross-border mergers in analogous conditions to national mergers.

Last but not least: the *Societas Europaea*, created in 2001. Despite the imperfections in the Statute, the SE forms the first federal model of a European company. As it has both “primary” and “secondary” freedom of movement it means that the registered office can move from one Member State to another, without any insurmountable legal barriers or dissuasive fiscal penalties. A hundred companies have chosen to become an SE (Allianz SE, Scor SE and soon Porsche, Daimler Chrysler and perhaps even Suez-Gaz de France or EADS). This reform led the ECJ to develop its jurisprudence even further and it now prohibits States from refusing to register a company that results from a merger with a foreign company (decision “Sevic” in 2005).

## **B. NEW CONCERNS RELATING TO THE FEAR OF LOSS OF ECONOMIC AUTONOMY**

Traditionally, the Member States of the EU have sought to maintain their businesses within their territory, if only in order to protect employment and to preserve taxable income. In a number of States, such protection has always been part of the norm, ever since entire business sectors have been operated by State monopolies, in the areas of energy and industry, but also for postal services or the transport industry.

With the phenomenon of privatization, such protection no longer exists. Furthermore, following complete liberalization through the Maastricht Treaty of 1992, capital movements by those from another Member State or from outside Europe have made the European market the most open in the world. The effects have been felt everywhere, notably in France, where companies listed on the CAC 40 exchange are semi-owned by American investment or pension funds.

However, in the context of increasing competition especially from emerging economies, today this opening-up has been perceived by the majority of States – with

the notable exception of the UK – as a threat to their economic, and therefore political, autonomy. Undoubtedly, the media has made much of the French government’s declarations of 2005 on economic patriotism, but within Europe, this attitude is not the privileged domain of France alone.

Many States are reticent in relation to permitting any extension of opportunities in the cross-border takeover market. Furthermore, States’ “golden shares” in businesses, providing them with a strategic interest, is being increasingly called into question. In the same way, some EU governments are striving to convince their European counterparts that Europe should adopt a strict approach to sensitive investments by non-European sovereign wealth funds. Finally, the EU itself is seeking to impose the principle of reciprocity in relation to energy investments, particularly in respect of Russia.

### **1. The Directive of April 21, 2004 on takeover bids and the temptation of national withdrawal**

When, in 1989, the Commission made its first proposals relating to takeover bids, the intention was to benefit the proliferation of businesses that wanted to invest outside their national borders. The proposed directive therefore provided for limitation of recourse in the context of defensive anti-takeover measures, while ensuring transparency in respect of procedures intended to protect shareholders, employees and other interested parties.

However, it was a further 15 years until the Directive was finally agreed, and from 2003, the attitude of the Member States changed. The fear of leaving their national businesses open to predatory companies from other Member States, from the US and above all, from emerging economies, led them to reduce, like shrinking violets, the impact of the Directive. The Directive even provided the opportunity, despite originally having the opposite intention, of reinforcing anti-takeover measures liable to be implemented against hostile bids. The Directive has been limited by two kinds of provisions: first, provisions which were previously deemed necessary (suspending special rights attaching to certain shares, e.g. multiple voting rights, restrictions on share transfers, etc.) have now become optional; and second, the Directive sets out a new rule of “reciprocity” which exempts all companies from making agreements with shareholders as to defensive measures, where the company making the offer is not subject to the same obligation.

Finally, most States (excluding the UK and Sweden), in transposing the directive into domestic legislation, have added new defensive alternatives. Such is the case in France, where, although the Arcelor takeover by Mittal was an open battle, share warrants have been added to the armory of anti-takeover measures available.

Against this backdrop, it is no surprise that Member States have been targeted by the European Commission because of their desire to protect their own market leaders. The French government was initially criticized for its promotion of the GDF-Suez merger, in hindering the offer by Italian ENEL for Suez. Subsequently, the

transaction was approved after investigation by the European Commission, but subject to certain remedies. Whilst supporting the restructuring of the French energy companies, the Commission looked at ways in which the companies in question were to ensure, through remedies, competition concerns in order to secure the sustainable development of energy markets, with, as always, the ultimate goal of protecting consumers.

It is also possible to cite the case of the intervention by the Spanish government in preventing the takeover by German E.ON of its energy company Endesa. Or the Polish government's opposition to Italian bank Unicredit's attempt to take control of a local bank, and the Italian government's effort to thwart the takeover bid for the highway company Autostrada, to name just a few. By contrast, the UK has not raised any objections to the acquisition by Spanish foreign investors - Ferrovial - of the largest airports in the country, including London.

Such State protectionism has not in any way prevented the propagation of cross-border rapprochement, encouraged by the implementation of the euro currency. 2006 was even a record year with more than 37,000 mergers and acquisitions, representing a value of 3,800 billion Euros. Furthermore, this amount has practically doubled during the first five months of 2007, compared to the same period in 2006, with 934 billion Dollars worth of transactions. Even if the sub-prime crisis slows this progress, the States' concerns have nevertheless not changed the vigor of the market.

## **2. Member States' strategic interests and the question of "golden shares" for state entities and of emerging countries of "sovereign wealth funds"**

Nevertheless, the issue of the preservation of States' and Europe's own strategic interests remains. In a decision of October 23, 2007, the ECJ criticized the "Volkswagen law", adopted in 1960, where during the company's privatization, public shareholders were provided with privileged rights to maintain public control of the company. The law effectively capped voting rights of shareholders at 20%, regardless of the actual level of shareholding. This enabled Federal Germany and the state of Lower Saxony, with limited investment, to exercise substantial influence over the company, which has over 330,000 employees. The ECJ's view was that the rights specific to the State entities were unjustifiably harmful to the principal of the free movement of capital. This long-awaited decision clears the way for Porsche's takeover of Volkswagen, who currently holds over 31% of the shares, and then the transformation of Porsche into a *Societas Europaea*.

The Community's market principles are thus compelling its States which, in Europe once maintained control of numerous large companies, to relinquish their privileged status. But circumstances have changed. The words of those who believe that the emphasis should lie on the need for protectionism – over and above national defense – of strategic sectors, are better heeded today than ever before by European Authorities and the Court. As such, the latter has acknowledged that Community law

does not in principle prohibit the maintenance of exorbitant dominance for the benefit of State entities, in respect of privatized companies.

By way of example, “golden shares” held by a Member State in a company thus enable the submission for approval the surpassing of certain thresholds, the appointment of representatives to a management or supervisory board, or even opposition to the sale or the use as securities of certain relevant company assets.

But the legitimacy of States’ “golden shares” is subject to very strict conditions determined by jurisprudence. They must be justified by “*reasons of pressing general concern, related to the exercise of public authority, public order, security or to the public well-being*”. They must also be proportionate and based on objective, non-discriminatory and publicly disclosed criteria. In the case of Elf Aquitaine, the predecessor of Total, the Court considered that these criteria had not been met. In contrast, it accepted in 2002 that Belgium had the right to oppose any sale by two national companies of energy channeling, which could have been potentially harmful to the national interest. Even if the jurisprudence on golden shares is very restrictive, it should be asked whether States plan to interpret EU case law with a view of using this protective measure in a more extensive way.

In the same way, some EU governments are striving to convince their European partners to adopt an EU common approach to sensitive investments by sovereign wealth funds, such as those in China, Russia and the oil producing Gulf States. The issue was raised at the G7 meeting in October 2007. No recommendation was made as a result of the meeting. However, the concern remains, and it is a common concern on both sides of the Atlantic. There is no need to look any further than the opposition of the US when a state-run Chinese firm tried to take over a US oil company in 2005, or the opposition to a Dubai firm wishing to buy US seaports in 2006. In the same way, New Zealand opposed effort by Dubai investors to take over a major airport concerns raised in the US concerning sovereign wealth funds are now echoed in Europe.

The goal is not to prohibit the investment of billions by sovereign funds in assets in the West, but to demand greater transparency. As governments, business and the public are asking “who are these guys?” In that respect, Europe and the US seem to have the same approach. Of course, in the EU, differences of opinion appear between France and the UK. As shown by an article of the Financial Times, at the time of the Lisbon Summit which approved the new European treaty on October 19, 2007, “Britain would oppose any EU-wide legislation to regulate sovereign fund investment in Europe, fearing it could become a Trojan horse for what it regards as a broader French-style protectionism”. Apart from the cultural differences, it is the first time since the creation of the internal market in 1993, that Europe feels vulnerable in relation to the freedom of movement of capital at the basis of the market.

### **3. The emergence of the concept of “reciprocity” vis-à-vis investments by third party States in the European strategic arena**

It is primarily in the energy industry that Europe's vulnerability has naturally been felt most. The biggest issue is natural gas. Natural gas trade between Russia and Europe has brought benefits for all concerned. But the might of companies such as Gazprom, which is closely connected to the Russian State and whose market capitalization value is bordering on the amount of France's budget, and the ill-will of the Kremlin in using energy as a political weapon, have provoked a reaction from the EU. The result is that the gas trade is subject to contention and suspicion, especially among new Member States such as, notably, the Baltic States which are highly reliant on Russian energy supply and have a complex set of relationships inside or with the former Soviet Union. Consequently, in order to rebalance its energy relations with Russia, the EU (which is dependant on Russia for 25% of its oil and gas consumption and for 35% of enriched uranium use) strives to put pressure on the Kremlin so that European firms have access to key energy resources and investment in Russia, as a precondition to allow Russian energy companies to hold control on European energy companies.

Article 296 of the European Treaty<sup>1</sup> allows Member States to oppose foreign investment, but only in the domain of defense. This provision, which is a reminder of the law "Exon-Florio", has indeed a more limited scope. To compensate for this shortage, without infringing the principle of non-discrimination between investments, the European Commission proposed to emphasize a "reciprocity" principle with regards to the investments of energetic companies from third party countries. In a confidential working paper whose conclusions were leaked in September 2007, the Commission proposed a number of procedures aimed at restricting foreign companies' access to the EU's energy sector, notably the gas and transmission sector.

The "reciprocity clause" would bar third countries (Russia and Saudi Arabia for instance) from acting where European companies face severe restrictions on investment. Europeans fear that Russia, through Gazprom, or other resource-rich countries, through state-owned investment funds, could gain control of the European energy supply. Gazprom has investments in most of the 27 EU countries. Gazprom has direct access to gas consumers across the EU as a result of its bilateral agreements with German, French and Italian companies. In the meantime, Russia has still not ratified the Energy Charter Treaty as in so doing it would be obliged to open up its energy sector to EU investment. Neelie Kroes, Competition Commissioner, has been asked by EU leaders to investigate the possibility that Gazprom's increasing role could impede the opening-up of the energy market. President Putin complained. Ms Merkel is reported to have replied that Gazprom should consider it "*an honor to be treated like Microsoft!*"

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<sup>1</sup> According to 1.(b) of this article "*Any Member State may take such measures as it considers necessary for the protection of the essential interests of its security which are connected with the production of or trade in arms, munitions and war material; such measures shall not adversely affect the conditions of competition in the common market regarding products which are not intended for military purposes*".

In return for the accelerated liberalization of the European energy market several States have difficulties admitting that they need to stand together to demand strong requirements to enter into the market with state-controlled companies as powerful as Gazprom.

The issue of reciprocity is a complicated one. Originally reciprocity functioned as a means of trade liberalization. It was the US who initially brought it into trade policy, notably through the bilateral Treaty of Amity and Commerce with France in 1778 which contained provisions for reciprocal trade concessions in order to secure free flow of goods and ships. In 1815, the US adopted the Reciprocity Act, which included a clause eliminating US discriminatory tariffs in accordance with the principle of reciprocity. This clause was introduced in all subsequent trade agreements between the US and countries such as the UK and Latin American countries in the 19<sup>th</sup> Century. During the same period in Europe, the principle of reciprocity helped the fostering of free trade through bilateral agreements. However reciprocity may be used as a tool for protectionism as well. Some trade agreements concluded at the beginning of the 20<sup>th</sup> century, for instance, most of the Tariff Acts in the US contained a reciprocity clause with the view of allowing the President to impose duties on certain goods in so far as foreign countries discriminated against American products. Reciprocity may indeed be oriented toward a “tit for tat” policy and thus lead to protectionism.

It remains that European States are rightly more and more aware of their common interests regarding energy supply. Even if European use of the concept of “Reciprocity” is prudent, it is understandable that they wish to engage in a more balanced relationship with Russia as an energy supplier. In a speech given on the occasion of the 2<sup>nd</sup> International Energy week in Moscow on October 23rd, 2007, Andris Piebalgs, Energy Commissioner, stressed the necessity “*that all companies have to play by the same rules, irrespective of whose they come from...*”

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A “sort-of” conclusion:

1. The functioning of the European market, one of the most open in the World, has been completely transformed by competition law strictly applied by the Commission, with the support of the ECJ. Therefore one cannot say that Europe is anti-competition.
2. However, we cannot deny that at the moment when, after 30 years of debates, the *Societas Europaea* is coming into force, Europe is experiencing a kind of paradox where competition policy foundations and freedom of movement of capital are subject to debate and there is an equal desire to protect “national champions” and their European counterparts.
3. Without questioning the acquisition of economic liberties in the Treaty of Rome, Europeans are becoming aware of how to protect their own interests not only in the domain of defense but energy as well. Through the renewed

idea of reciprocity, Europeans hope that the upside of allowing investment in the energy domain by foreign States such as Russia will be the investment of European companies in Russian companies. The “Reform Treaty”, which should enter into force in 2009 after ratification by the 27 Member States, brings some new provisions in this respect: it introduces for the first time a specific article on energy. However, in order for this Article to be useful and for the renewed concept of reciprocity to be really efficient, European states will need to show certain common interests and create – sooner rather than later – an active common energy policy, both of which can definitely not be found in the Reform Treaty.

In order for this to happen, States need to show the same political will that led them engaging in the building of Europe more than 50 years ago.

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