REPUBLIC OF ALBANIA
THE COMPETITION AUTHORITY
-THE COMPETITION COMMISSION-

DECISION

Nr. 137, date 05. 02. 2010

FOR APPROVING THE GUIDELINES ON “EVALUATING HORIZONTAL AGREEMENTS”

The Competition Commission includes the following members:

Lindita MILO(LATI)	**Chair**
Servete GRUDA	**Member**
Koço BROKA	**Member**
Rezana KONOMI	**Member**

In the meeting on 05/02/2010, the Commission analyzed the following issue, with:

Objective:
Approval of guidelines on “Evaluating horizontal agreements” as enforced by law nr 9121, date 28.07.2003, “For the protection of competition.”

Legal Basis:
Law nr. 9121, date 28.07.2003 “For the protection of competition” as amended, article 24, points d) and dh).

The Competition Commission, after reviewing the draft guidelines “On evaluating horizontal agreements,”

DECIDED:

1. To approve the guidelines “On evaluating horizontal agreements.”

   This decision is valid immediately.

THE COMPETITION COMMISSION

Servete Gruda	Koço Broka	Rezana Konomi
Member	Member	Member

Lindita MILO (LATI)

CHAIR

Guidelines
"For evaluating horizontal agreements"[1]

I. Objective

1. These guidelines are intended to describe the principles that ought to be used for evaluating agreements of horizontal cooperation. The cooperation agreement is "horizontal in nature" if a concurrence or an accord has been reached among companies that operate in the same market levels. In most cases, horizontal cooperation happens when competitors collaborate with each other. It covers areas such as research and development, production, purchase and trade, and so forth.

2. Horizontal collaboration might cause negative effects for competition. These negative effects happen when parties decide to fix prices or production, to share markets, or promote activities that allow companies to strengthen their position in the market in a way that damages competition and brings negative effects on prices, production, innovation, and product diversity and quality.

3. On the other hand, horizontal collaboration can bring enormous economic benefits. Companies try to react to competition pressures and a changing market under globalization, under rapid technological innovations, and a generally dynamic market structure. Collaboration can be a way to deal with these pressures and share the risks, thereby hedging on costs of bringing a new product to the market in a shorter period of time. Especially for small and medium enterprises, collaboration is an important instrument for adapting to market changes.

4. The goal of these guidelines is to provide an analytical framework for most horizontal agreements. Economic criteria such as market power of respective parties as well as other factors related to market structure should be considered as key elements when evaluating possible effects of horizontal agreements on competition. Thus, an enforcement of the law is further assured.

II. Agreement classification

1. These guidelines cover joint agreements (here on after to be referred as "agreements") set between two or more companies that operate in the same level (e) of the market, e.g. production or distribution, and thus lay out the principles that should be used to evaluate agreements regarding research and development, production, purchase volume and trade, standardization, and environmental agreements.

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[1] 32001 Y 0106 (01); Commission's Memo; Guide on enforcing article 81 of the EC Treaty on agreements of horizontal cooperation."
(OJ C3, 6.1.2001; P. 2 – 30)

2. Agreements signed between parties that operate in different market levels such as distribution and purchasing, and that are otherwise known as vertical agreements, are excluded in principle from these guidelines.

3. Agreements can be evaluated during different phases of their enforcement, one example being the R&D agreements and their enforcement. In this definition we consider two factors:

a) First, the starting point of the collaboration
b) Second, the level of functional integration among different functions

A collaborative agreement that involves R&D procedures, as well as the use and exploitation of innovations that come as a result of these procedures, will be considered under a separate section called “R&D Agreements”, because successful collaboration in the R&D field is valid only when the innovation is successful. This means that R&D processes can be considered valid under these guidelines when they affect production by great margin. These R&D agreements can be seen as the starting point of the collaboration process. This evaluation may change if the agreement anticipates full integration of production and partial integration of R&D processes. In this case, the agreement is made subject to principles governing joint production processes and not R&D processes, and is therefore subject to a different section called “Production Agreements.”

4. Article 4 of the Law does not apply to agreements that have diminished importance (Regulation "On the importance of small agreements”, approved by the Competition Commission Decision no. 121, dated 09/10/2009) because they are not capable of substantially restricting competition by reason or consequences. Therefore, this guide does not account for current or future application of the Regulation "On the importance of small agreements”.

III. Basic evaluation principles

1. Article 4 of the Law applies to horizontal cooperation agreements, which have as their object or effect to prevent, restrict or distort competition. Such agreements are prohibited per se *(why).*
This is the case of agreements that directly determine the purchase or selling prices, limiting production or sharing markets, or sources of supply. These agreements are presumed to have negative effects on the market, so it is not necessary to study their actual effects on competition or the market in order to prove that they are in breach of Article 4/1 of the Law.

2. In any case, many horizontal cooperation agreements do not aim at restricting competition. However, it is necessary to study the effects of such agreements, and to do this we should not suffice the analysis with just

arguments on competition restriction by parties involved. Agreements have to affect markets in such a way that negative effects are certain to occur in terms of price fixing, production volume, quality of products and diversity, innovation, and so forth. Therefore, such an agreement is not just analyzed for the negative effects it would bring on competition, but also on the grounds of distorting the areas mentioned above.

3. The negative effects caused by the application of a horizontal cooperation agreement have to consider:

- The nature of the deal,
- The combined market power of parties involved, which determines (in conjunction with other structural factors) the level of cooperation that can affect competition in the market by great margin.

III.1. Nature of the deal

1. When evaluating the nature of the deal, one should consider factors such as the area and goal of the agreement, the competitive relation between parties, and the degree to which they combine their activities in the market and converge with each other. These factors give some indication as to how likely parties are to coordinate their market behavior.

2. There are some forms of these agreements that have little power to impose restrictions on prices and production. Such are those agreements that are centered on R&D development, or deals that aim at improving standards or protecting the environment. If these agreements are found to cause negative effects, than they relate to the level of innovation brought in the market as well as the diversity of products.

3. Other forms of deals, such as agreements on purchases or production, cause a kind of cost convergence to happen. If this process is intense enough, parties might be able to fix prices in the market and coordinate their production schedules. An intense cost convergence process can be achieved if the following conditions apply:

   a) First, the area of cooperation, e.g. production and purchase, should be calculated for a greater part of total costs in a given market.

   b) Second, parties involved have to combine their activities in the field they are cooperating up to a meaningful degree. For example, a valid cooperation degree is when parties agree to jointly purchase or produce an intermediary or important product, or buy part of their final products in bulk.

III.2. Agreements that fall outside the scope of the law

1. Some types of deals do not fall under the jurisdiction of Article 4 of the law, given their special nature. Normally, this is true for parties that cooperate but that do not coordinate their competitive market behavior. Such agreements are:

- **a)** Cooperation agreements between non-competitors;
- **b)** Cooperation agreements between enterprises that are not able to conduct a normal business operation by themselves;
- **c)** Cooperation agreements that do not affect any of the areas of competition mentioned in the law.

These categories mentioned above might be considered under Article 4 of the law only if the parties involve have considerable market power, and the agreements would reasonably crowd out smaller businesses from the market.

III.3. Agreements that are, almost always, subject of Article 4 of the law

1. All agreements that aim at fixing prices and production volume, and explicitly dividing markets and clients, fall under the provisions of Article 4 of the law.

2. For those agreements that do not fall under the areas mentioned above, than a separate analysis should be conducted by taking into consideration the following arguments:

Limitations that intervene directly in a normal competitive process are considered harmful. A direct price fixing and restriction of production makes consumers pay more for the same product, or limits their purchasing volume to an amount that falls below their desired level.

Market and client division lowers consumption choices and brings, again, higher prices and limited production volumes. For this reason, these agreements are presumed to bring negative effects in the market, and they are therefore prohibited in most cases.

III.4. Market power and market structure

1. The starting point of the analysis would be to assess the market power of parties involved in the cooperation agreement. This will determine whether the parties will be better able to maintain, create or strengthen their market power, which means the ability to cause adverse effects on the market in terms of prices, production, innovation, variety, or the quality of goods and services.

2. If the parties' combined share is small, limiting the effect arising from this collaboration is incalculable to competition in the relevant market and therefore does not require any further analysis. Given the diversity of forms of cooperation agreements and the different effects they can cause in different market situations, it is impossible to give a threshold of total sales volume combined,

over which it can be assumed that sufficient market power exists to cause any restrictive effects on competition.

3. Besides the position of parties in the market and market share that they occupy, one ought to consider market concentration as well, i.e. the position and number of competitors, as an additional factor to assess the impact of cooperation on market competition. The Herfindahl-Hirshman Index ("HHI") can be used as such an indicator, which summarizes the competitive position (market concentration) of all market competitors in bulk: With an HHI below 1000, market concentration can be characterized as low; an HHI between 1000 and 1800, as average market concentration; and an HHI above 1800 as high market concentration. A market consisting of four firms, with market shares of 30%, 25%, 25% and 20%, has a HHI of 2550 (900 +625 +625 +4000 before cooperation). If the first two market leaders cooperate, HHI will change to 4050 (3025 +625 +400). HHI after cooperation is appropriate to assess the possible effects of market cooperation. Another potential indicator would be focusing on the concentration ratio of the leading firms, which is found by summing market shares of all main competitors in the market.

4. Given a certain market position of parties as well as a specific market concentration, some other factors should be taken into consideration when evaluating these agreements, such as: sustainability of market share, entry barriers and the potential for market entry, bargaining power of buyers / bidders or the nature of the products (e.g. homogeneity, maturity).

The agreements included in the enforcement of Article 4 of the Law may be excluded if the conditions of Article 5 of the Law are met. This case is valid if the agreement:

- Contributes to improving production or distribution of products, or promoting technical or economic progress;
- Allows consumers to distribute benefits in a fair and just manner;
And:
- does not set unnecessary limits which are not relevant for achieving the objectives mentioned above;
- It does not enable the elimination of competition for a significant part of the product in question.

III.5. Economic benefits

1. The first condition requires that the agreement contributes to improving production or the distribution of products, promote technical or economic progress, is considered in relation to the static and dynamic efficiency of production, and do not necessarily relate to any kind of direct “economic benefits”. Economic benefits might be much more important than restrictive effects on competition. For example, cooperation allows companies to supply

better products at cheaper prices, and shorten innovations' time to market. The parties that enter the agreement should prove that the positive efficiencies that can result from integrating capacities or different resources can not be otherwise achieved by using other methods that are less restrictive of free competition. General declarations on improving costs are not sufficient.

2. The Authority does not take under consideration those cost reduction activities that come as a result of production decrease, market division, or market power pressures.

III.6. Fair consumer benefits

Economic benefits should not favor only the parties involved directly in the deal, but should affect consumer welfare as well. Generally speaking, it is the intensity of market competition that specifies how efficiently these benefits will be channeled to the end consumer. Competitive pressures bring lower costs, which are then followed by price decreases, or new products that reach markets faster than would have happened otherwise. Therefore, if sufficient market competition exists in the market, which restricts parties to enter the agreement, the deal will bring additional economic benefits to consumers as well as the firms entering it.

III.7. Necessity

Competition restriction has to be necessary for achieving any economic benefits. If there are other restrictions that can have a smaller toll on competition, then the pretended efficiency can not be used as a justification for limiting competition in the first place. If there are individual restrictions imposed, than one should asses market conditions and time length of the deal to decide whether the limitations are necessary.

III.8. No effort to eliminate competition

The last criteria for eliminating competition for a major part of products on hand relates to the dominant position of companies in the market. If there is a firm that has a dominant position in the market, or that is highly likely to do so in the future due to the agreement, which is a situation that brings anticompetitive consequences in the market, that firm can not be excluded from the provisions of Article 4 of the Law.

2. RESEARCH AND DEVELOPMENT AGREEMENTS

Definition

1. R&D agreements are different in form and scope. They include:

- Research and development in the form of outsourcing some activities, or in the form of join contribution to improve existing technologies; or
- Cooperation that is related to research and development, as well as marketing, of entirely new products.

These activities might take the form of a proper and formal agreement, or can be a venture controlled jointly by all parties involved. This definition is enforced in all forms of R&D agreements, including here those agreements that make provisions on the dissemination (production and sale) of results from the R&D process. This does not apply to those cases that fall under the Regulation on Concentrations.

2. Cooperation in the research and development field can improve costs that exist before the R&D product materializes, and thus brings forth technologies in a much faster pace than would have occurred otherwise. Generally speaking, R&D cooperation is expected to improve general R&D activity.

3. Small and Medium Enterprises (SME) can form a dynamic and heterogenic group, which are being continuously put at the service of big firms, mostly as subcontractors. To become competitive, SMEs need to evolve continuously and this is realized by participating in R&D agreements.

4. However, R&D agreements can harm the competition by limiting price setting flexibility, limiting production, innovation, diversity, and product quality. The Authority takes these effects into consideration when deciding to approve or reject a specific agreement.

Respective market

1. Establishing the respective market in an R&D agreement refers to the identification of those products, technologies, or efforts to develop R&D results that might deter competitive advantages for the parties involved. From one hand, innovations might bring a new product or technology that competes with an existing product or technology. This is the case where R&D brings greater product diversity, and is thus considered benevolent. Agreements related to this type of innovations apply to current products. On the other hand, innovations can bring entirely new products (such as a new vaccine for a formerly incurable disease). In this case, the respective market is the one that already exists. This logic applies to those markets whose new products serve to substitute old products (or technologies) naturally. This has been the case, for example, with CDs, which substituted cassettes.

(a) Product Market

1. When the cooperation in R&D applies to improvement of existing products, then these new versions combined with close approximations

and substitutes, make up the relevant market that applies to the cooperation.

2. If the main goal of an R&D process is to greatly alter an existing product, as much as to exclude any substitutes from replacing it, than the former and new products do not belong to the same respective markets. This means that the new product can not be fully substituted by an older one in the long run.

3. In the case where the R&D process applies to a component of a future final product, than the relevant market applies not only to the market for the component, but an evaluation should be granted to the current market of the final product as well. (For example, if car companies decide to cooperate in the building of a new engine, the market of new car production might be affected by this cooperation.) However, if the component under R&D process is technically and economically an important element of the final product, and if the involved parties are direct competitors in the market for the final product, than the respective market is the market for the final product only, not the market for the component.

(b) ***Tech Market***

1. Cooperation in R&D does not apply only to products, but to technologies as well. When intellectual properties are treated separately from the products they produce, than a respective market for technologies should be specified as well. The technology market includes licensed intellectual properties, as well as close substitutes of such technology (meaning, new technologies that clients can use to substitute the newly developed ones).

2. When evaluating the technology market, one should take into consideration future potential competition. This happens when companies do not license their technologies, but are still potential entrants in the tech market. This way they can still put pressure on other companies to raise prices for their own technologies *(see example 3 in Appendix 1)*.

c) Competing for innovation (R&D efforts)

1. Cooperation agreements in R&D might not affect competition in an existing market, nor in a market that is under heavy innovation. It is the case when the cooperation applies to the development of new products and technologies, which is expected to substitute current products or technologies; or aims for a new use, which will not necessarily substitute current products, but will bring new demand. In these scenarios, the effects of innovation on competition are very important, but in some cases they might be insufficient when evaluating current competition or potential competition in the market for products or technologies.

d) Calculating market shares

1. When calculating market shares there should be made a clear difference between current markets and potential markets with innovations. When cooperation starts, the first step of the analysis applies to the markets that will be created from the improvement or substitution of current products or technologies with more innovative products or technologies. If the agreement only applies to improving current products or further process current materials, than this market includes all products linked directly by the R&D agreement. Therefore, market share can be calculated based on the sales value of current products. If the R&D agreement aims at substituting a current product completely, than the new product will be the only one considered.

2. If the R&D agreement aims to develop a product which creates an entirely new demand, than the evaluation can not be based off of sales volume in the current market. In this case, one needs to conduct additional analysis on the effects on competition, depending on the timeline of the innovation it applies to: medium term (3 years) or long term (7 years). Therefore, these agreements are excluded from the provisions for a certain period of time after the new product is brought to market, regardless of the market share. After this period has lapsed, the market share can be calculated based on sales volume and the cut-off point of 25% market share can be used.

The Nature of the Deal

Agreements that are not included in the enforcement provisions of Article 4 of the Law

1. In general, R&D cooperation between non competitors does not limit competition. The competitive relation between parties will be analyzed in the context of affecting current markets and/or innovation. If the parties are unable to fulfill their needs in innovation by acting alone, than there is no restriction on competition. For example, this applies to all companies that join efforts to bring new knowledge, technologies, as well as other resources. The issue of potential competition will be judged on real basis. Parties can not be specified as potential competitors just because the cooperating activity allows them to conduct R&D activities. The main issue is whether each party independently has the necessary means to evaluate the know-how and other resources.

2. R&D cooperation through previous exclusive subcontractors is often done by specialized enterprises, research institutes or academic organizations, which are passive in the exploitation of results. Such agreements are mainly

accompanied by a provision of practical knowledge transfer or by a clause that specifies courses of action on possible R&D outcome. Given the complementary nature of parties in these scenarios, Article 4 of the law does not apply.

3. R&D cooperation, which does not include a joint exploitation of results through licensing, production, and/or marketing, seldom is included in the provisions of Article 4 of the Law. These agreements can harm competition in one instance only, and this is the case when the R&D product itself tremendously limits competition for innovations.

Agreements that fall under Article 4 of the Law

1. If the real goal of an R&D agreement is not research and development per se, but the creation of a hidden agreement that will bring price fixing, production limits, or market divisions, then Article 4 of the Law applies.

Market power and market structure

1. R&D cooperation agreements can cause three negative effects in the market:
   - *First,* they can limit innovation,
   - *Second*, they can be treated as a way to coordinate parties behavior in current markets, and
   - *Third*, exclusion problems might happen when time comes to exploit the product of an R&D process.

   However, these types of negative effects will show up when market participants have considerable market power, and/or the level of innovation competition is limited immensely.

2. There is no absolute threshold on a market part that tells of an R&D agreement creating a certain level of market power, and is thus included in the provisions of Article 4 of the Law. However, those R&D agreements that are finalized between parties with parts of the market combined, and that do not exceed 25% and fulfill all other requirements, are excluded from the applicability of Article 4.

3. If the R&D agreement is oriented towards improving or further processing current products or technologies, than the market effects of these products applies only to the respective market. Anyhow, possible effects on prices, production, and/or innovations in current markets happen only if the parties involved have a strong position, entry is hard, and there are only a few other innovative activities going on. Further more, if R&D is just a small component of the final product, than the effects on competition in the market for the final product are small. Two additional points need to be taken into account:

- First, the effects on prices and production in current markets are possible if strong competitors have entered in the agreement.

- Second, the cooperation can be intense in a production sense, because R&D activities are not de facto basis for a cooperation of this kind.

4. If the R&D agreement aims to introduce an entirely new product (or technology) that creates its own new market, then the effects on prices and production are even more impossible. In this case one should analyze the possible restrictions of respective innovations, such as: quality and diversity of products/technology, or even time it takes to come up with an innovative product or technology. These restrictive effects can arise when two or more companies initiate a process for producing a new product and start cooperating during the phase where each of them separately are very close to launching the new product in the market. In a similar case, innovation can be limited, even though the R&D agreement is a clean deal.

5. Most R&D agreements can have an effect on innovation, and some backward looking effects on current markets. Therefore, current markets as well as potential innovations (and effects thereof) can be appropriate to use when assessing the combined position of parties, the share of market concentration, the number of players and innovators, as well as entry conditions. In some cases, there can be restrictive price/production effects in current markets and a negative effect on the speed of developmental growth. For example, if major economic competitors in a current technological market cooperate to develop a new technology which aims to substitute existing products, than restrictive effects can show up only if:

- Parties have considerable market power, and
- If they have the upper hand on the deal itself.

This might happen if the primary competitor in a current market cooperates with a small competitor (or even a potential competitor), who has just started to market a new product/technology and might thus risk the position of the incumbent.

<u>Economic Benefits</u>

1. Most R&D agreements, independent of a joint exploitation of expected results, bring economic benefits in terms of lower costs and exchange of ideas and experience, and therefore improving the time it takes to develop new technologies and better products. If these conditions are met than the agreement is excluded from the prohibitive legal provisions even though it limits competition within the market threshold, below which the net benefit of R&D is greater than the negative effects on competition.

2. The parties involved in an R&D agreement, despite the fact that considerable market power might have been created, or if the power has been enhanced from the cooperation, have to prove that there is considerable gain to be taken from enforcing the agreement (such as shorter time to market of new products and technologies, and other similar efficiencies).

Necessity

1. An R&D agreement that puts unnecessary restrictions to gain the benefits mentioned above can not be excluded from the prohibitive provisions.

Evaluation phase and the exclusion period

1. Those R&D agreements that apply to joint production and marketing of new products and technologies require special attention and time to evaluate.

2. The assessment analysis for prohibiting an R&D agreement can not be undertaken if the agreement is not enforced first. This means that the analysis is conducted only if there are effects noted in the market that clearly apply to the parties involved, or effects in the market from the entrance of new products and technologies.

3. The efforts to capture market share with a new product or technology requires that the market gained be considerably large, and that the R&D product be very successful (which is often assured by exercising intellectual property rights). A strong market position due to the advantage of having a superior product by the initiator is not seen as an activity that restricts competition. Therefore, this exclusion applies to all R&D agreements for a period of 7 years (after the R&D product has been finalized) without any regards whether any of the parties gain considerable market share in the mean time from their new product.

Respective examples of R&D agreements can be found in Appendix 1.

3. PRODUCTION AGREEMENTS
(INCLUDING SPECIALIZATION AGREEMENTS)

Definition

1. Production agreements can differ in form and scope. They can be in the form of joint production through a joint enterprise, which means that the firm is owned by both parties and that both control some or all production facilities. Otherwise, a production agreement can be realized through a specialization or subcontracting agreement, when one party agrees to produce for the other party.

2. There are generally three types of production agreements:

    - Joint production agreements happen when two parties agree to produce a product together (either share the process, or leave it to one of the parties),
    - Specialization agreements happen when parties agree to halt production and buy that same product from the other party;
    - Subcontracting agreements happen when one party (the contractor) leaves all the production needs to another party (the sub contractor).

3. Subcontracting agreements are vertical agreements. However, there exist two waivers to this rule:
    - Subcontracting agreements between competitors, and
    - Subcontracting agreements between non competitors that include the transfer of know how to their respective subcontractors.

Respective Market

1. To evaluate the cooperative relation between two parties, one should:

First, establish the respective market for the product, including here the geographical market to be affected by the cooperation.

Second, a production agreement in one market can affect competitive behavior of parties in a market which is in the lower or upper flow, or close to a neighboring market, but that is closely linked to the market affected by the cooperation (so called "excessive effects market"). However, these excessive effects happen only when cooperation in one market brings coordination of competitive behavior in another market, which means that markets are dependent on each other even when parties hold a strong position in these markets with excessive effects.

The nature of the deal

1. The problems on competition caused by the production agreement arise from the coordination of competitive behavior of those parties that act as suppliers. This is made clear in those instances where cooperating parties, in at least one respective market, are current or potential competitors, such as in the market linked directly through the cooperation or in the market with excessive effects.

2. The fact that parties are competitors does not necessarily bring behavior coordination. Parties want to cooperate on one very important aspect of their activity, with the goal being to approximate and align costs as much as

possible. The higher the degree of approximation and alignment of costs, the higher the risk for competition restriction in terms of prices, and this is especially true for homogenous products.

Production agreements that are not included in the provisions of Article 4 of the Law

First, cooperation between firms that compete in markets that are closely linked to the cooperation market can not be considered as limiting competition if cooperation is the only justifiable method to enter a new market commercially, to introduce a new product or service in the market, or to meet a certain projection.

Second, competitive parties (that are market suppliers) can not be large in terms of market share, if both parties taken together have a small share of total cost. For example, a low degree of cost alignment happens when two or more firms agree to produce a specialized joint product, which is only a small part of the final production cost.

Third, sub contractual agreements between competitors are not included in the scope of Article 4 of the Law if they deal exclusively with purchases and sales in the market without holding back any liabilities that might otherwise have been part of the commercial relation between the parties.

Agreements that fall under the scope of Article 4 of the Law

Those agreements that fix prices for the suppliers in the market, that limit production, or divide markets or client bases, as well as have as their objective to restrict competition, are always included in the provisions of Article 4 of the law.

However, there are cases when this is not applied, such as when:

- Parties cooperate to produce directly (for example, the capacity and production volume of a company jointly owned, or products that are subcontracted elsewhere); or

- A join production enterprise realizes the distribution of the goods manufactured, sets a selling price for these products, and assures that price fixing from the joint enterprise is an effect of the diverse integrated functions.

Market power and market structure

1. The analysis starts from the parties' position in the market. This is firstly linked with the fact that weaker parties in a production agreement do not have the necessary incentives to coordinate their competitive behavior as market suppliers. Secondly, this has no effect on market competition for

the parties that have no market power, even if they wanted to coordinate their behavior.

2. There is no absolute partial market threshold that shows that the production agreement creates a certain degree of market power. However, specialization agreements that are linked one-sidedly or intermittently between parties are to be excluded, which applies even to those agreements of joint production that have already been executed between the parties, and when combined market share does not exceed 20% in a respective market. Usually, the analysis will include only those respective markets where cooperation is directly linked.

Market position of parties, the concentration ratio, the number of players, and other structural factors

1. The production agreement between parties should be evaluated if the combined market share of the parties involved is greater than 20%. In this case, the market concentration, as well as market share, is an important consideration. The greater the combined market shares between the parties, the greater the market concentration in a respective market. However, a great part of the market that is excluded from the deal does not have to have a high concentration ratio.
   For example, a market share of, say, slightly higher than 20% can be found in a medium concentrated market (HHI under 1800). In such a case, the restrictive effect is impossible. In a more concentrated market, and with a market share higher than 20%, we could have competition restriction (see example 1 in Appendix 2). However, the picture may change if the market is very dynamic, with new entrants and often changing market positions.

2. For joint production, network effects – such as links between a great number of competitors – could also play an important role. In a concentrated market, an agreement might break the balance and create a possible convergence in this market, even if parties have considerable market share, but one that is still a medium one. (See example 2 in Appendix 2.)

3. In specific circumstances the cooperation between potential competitors can create problems for the competition. However this is contained to a case where a big player competes with a potential new entrant, such as for example a current strong supplier of a good or service in a neighboring geographical market. The decrease of potential competition creates special problems if current competition is put at risk and new entrants are forced to stay out of the market.

Sub contractual agreements between competitors

Similar problems can be raised if a competitor sub contracts another competitor to produce or make a final or intermediary product. This can bring:

- Exclusion problems for the parties that have a strong position as suppliers or buyers in the respective input market (a non exclusive usage).

- Excessive effects assure that the input be an important component of costs, and that parties have strong position in the downward flow markets for the final product.

Economic Benefits

The most common forms of production cooperation agreements can be assumed to cause some economics' benefits related to scale and scope, or technological best practices even though they are considered an element of price fixing, production restriction, or market and client division. For this reason, specialization agreements – which include one sided and reciprocal specialization deals, as well as shared production agreements – are excluded by making sure that they do not contain hardcore restrictions and that the combined market share of parties in the agreement is not higher than 20%.

Necessity

In the case where the cooperation brings restrictions, whose harm is greater than the economic benefits mentioned before, the agreement will not be approved, which means that parties should not be limited in their competitive ability beyond the provisions depicted in the production agreement.

There is no competition limitation

The cooperation agreement is not excluded when there is high potential to eliminate competition in a great part of the products' market. Due to a production agreement, when one of the parties has a dominant position in the market or gains such a position after the agreement and the latter is proved to harm and restrict competition, than the deal will not be allowed.

Respective examples on production and specialization agreements can be found in Appendix 2.

4. PURCHASE AGREEMENTS

Definition

1. Purchase agreements often include those cooperation agreements that aim at a shared purchase of products. Shared purchase can be conducted by a company that is jointly controlled by the parties or by a third company where the two parties have a small ownership interest.

2. Purchase agreements are often created between small and medium enterprises to increase purchase volume and decrease the number of big time competitors. These types of deals between small and medium firms are typically in favor of competition.

3. Shared purchases can include both horizontal and vertical agreements. In these cases, an analysis that applies to both phases is needed. First, horizontal agreements can be evaluated using the guidelines described in this guide. If the first evaluation results in a conclusion that the agreement in the shared purchase is accepted, than a second evaluation process starts to assess the vertical agreement finalized among suppliers and individual buyers. One such example could be an association created by retailers to purchase in bulk. The agreement to buy in bulk and save on scale and scope should be primarily evaluated as a horizontal agreement between retailers, and such an evaluation should make use of this guide to proceed further.

Respective market

There are two types of markets that can be affected by shared purchases:

- The first one is the market in which the cooperation between parties is linked directly to them (such as the respective purchase market)

- The second one is the sale market, e.g. in the downward flow market the agreement parties are as active as the sellers of those products.

The only difference in the specification of “sale markets” is that the substitutability is set by the supply side and not the demand side. In other words, suppliers’ alternatives are vital in the identification of those restrictions that harm competition for buyers. These can be analyzed, for example, by assessing suppliers’ reaction to a small but temporary price decrease. If the market is known, market share can be calculated as a percentage for each purchase made by interested parties over the total amount of sales of a given product or service purchased in a respective market.

An example is given in Appendix 3

The nature of the deal

Production agreements that are not included in the provisions of Article 4 of the Law

Given their nature, shared purchase agreements will be completed between parties that are, as a minimum, competitors in the purchase markets. However, if competitive buyers cooperate in the same respective market of downward flow, where they are not active (for example, retail sellers can be active in different geographical markets and can not be potential competitors), Article 4 of the law will be seldom applied, excluding those instances where parties have a strong market position in the purchase market and this position can be used to harm the competitive position of other players in their respective markets.

Market power and market structure

The analysis commences by evaluating the purchase power of the parties. There is purchase power in the market if a purchase agreement, applied to a big purchase volume in a purchase market, lowers prices below the competitive level or new entrants are crowded out by competing buyers. A high degree of buyer power over the suppliers in a certain market can bring inefficiencies such as lower quality, lower innovative efforts, or below optimal supply. However, the main problem here is that lower prices can not be channeled to the bottom line consumers, but instead cause higher costs for competing sellers in the sale markets, and this is so because:

- Suppliers will try to cover the price decrease in some consumers by increasing prices for some other consumers or other competitors that have limited access to efficient suppliers.

Therefore, purchase and sale markets are characterized by interdependencies as described below.

Interdependencies between purchase and sale markets

The cooperation of competing buyers can limit competition considerably in terms of creating buyer power. Buying power is not always in favor of competition and in some cases it causes negative effects on competition, despite the fact that the creation of buyer power can bring lower prices for consumers.

- First, lower purchase costs that come as a result of enforcing buying power can not be seen as favoring competition if the buyers taken together have considerable power in the selling markets. In this case cost savings could not be channeled to the end consumers. The greater the combined power of parties, the higher the incentives of these parties to coordinate their market behavior as sellers. This can be eased if parties achieve a high degree of cost approximation and alignment for their products through the shared purchase. For example, if a big retail group buys some of their products in bulk by making a joint purchase, they will also share the total cost associated with this purchase. The negative

effects of shared purchase can be quite similar with the effects of a joint production scenario.

- Second, power in the selling markets can be created or increased through the buyer power used to exclude competitors or to increase costs for other competitors. Considerable buying power over a certain consumers' group can bring exclusion of competing buyers by limiting their access to efficient suppliers. It can also cause increase of costs for its own competitors because suppliers will try to cover the decrease in price for some consumers by increasing the price for some other consumers (such as discriminating rebates from retail suppliers). This is the only option if the selling market suppliers have a certain market power. In both cases, competition in the selling markets can be limited by the buying power.

There is no absolute threshold that shows that purchase cooperation creates a certain degree of market power. However, in many cases it is impossible for market power to exist if the parties entering the agreement have a combined market share of less than 15% both in the buying and selling market.

Economic Benefits

Purchase agreements can bring economic benefits in the form of economies of scale in volume or transport, which can bring several restrictive effects. If both parties have considerable buying or selling power, efficiency has to be evaluated. Cost savings that are caused solely by enforcing such power and that are not channeled to consumers, can not be taken into consideration.

Necessity

Purchase agreements can not be excluded if they impose restrictions that are not necessary to get the benefits mentioned above. An imposition to buy exclusively through the cooperation agreement can, sometimes, be necessary to reach a necessary volume of economies of scale. However, such an imposition will be evaluated on a case by case basis.

Respective examples on purchasing agreements are given in Appendix 3.

5. TRADING AGREEMENTS

Definition

Trading agreements include those cooperation agreements between competitors that apply to the sale, distribution, or attractiveness of their products. These agreements can have very different and broad objectives depending on the marketing functions covered in the agreement. On the one hand there is a shared sale of a product that brings a shared definition of all aspects of trade,

including price setting policies. On the other hand, these agreements are limited to some specific functions of marketing such as distribution, customer service, and advertising.

The distribution agreements are the most important ones in these types of deals. This guide covers only vertical non reciprocal agreements between competitors, if:

(a) The supplier is a producer and distributor of products and the buyer is a distributor, who is also not a producer of the products competing with any of the goods mentioned in the contract, or

(b) If the supplier is a provider of a service at a certain level of trade, when at the same time the buyer does not provide competing services in the same trade level where he/she sells the contract's services.

Respective Market

To evaluate the competitive relation between cooperative parties, there are some considerations to be taken into account:

First, one should specify the respective market for the product as well as the geographical span linked directly to that product (for example, the market to which belong the products included in the agreement).

Second, a trading agreement in a certain market could also affect the competitive behavior of parties in neighboring markets that are directly linked with the respective market included in the cooperation.

The nature of the deal

1. Trading agreements are only included within the frameworks that regulate competition if the parties involved are competitors. If these parties do not clearly compete among them in some products or services that are covered in the agreement, than the latter can not create competition problems of a horizontal nature. Also, this is enforced even in those cases where the trading agreement is necessary to allow one party to enter the market (something that was impossible to do before the agreement was signed due to cost). A specific enforcement of this principle must be applied to consortium agreements that allow parties to apply for a tender and enter a bid for projects that they can not fulfill alone, or that are not called for an offer individually. Since they are not possible competitors in the bid, there is no restriction of competition.

2. In a trading agreement between competitors, the lack of competition would be expressed in price fixing. Limited agreements for shared sale have as their

rule the coordination of pricing policies for the competing producer. In this case, they not only eliminate price competition between parties, but also limit products' volume scheduled to be delivered by participants within the system.

3. We will present two main problems that are applicable to those agreements that are not covered by a shared sale:

First, trading agreements ensure a clear opportunity to change the commercial information, especially related to marketing strategies and pricing policies.

Second, depending on the cost structure of the trading agreement, an important input in terms of the final cost for the parties involved can be common for both parties. As a consequence, competition seen from the standpoint of price-led sales can be restricted.

4. A unique aspect of distribution agreements between competitors that are active in geographically different markets is that these deals can cause or be an instrument of market fragmentation. In the case of a reciprocal agreement, the participants agree to distribute products to one another, divide markets or clients and eliminate competition between them. In this case, it is necessary to assess whether the agreement is objectively needed for parties to enter in each other's market. If this is so, the deal does not cause any competition problems of a horizontal nature. However, distribution agreements fall under the provisions or Article 4 of the law if they contain vertical restrictions such as limitations in passive sales, resale price fixing, and so forth. If the deal is not formed on grounds of reciprocity, the risk of market fragmentation is less strained. However, the agreement should be assessed when it is not built upon any reciprocity basis and builds ground for a silenced coordination between parties to not enter in each other's markets, or is seen as a tool to control access on competition in the "importing" market.

Market power and market structure

1. Trading agreements between competitors that do not aim to fix prices fall under the provisions of article 4 of the law only if the parties involved have a strong position in the market (it is not clear what this term means). In many cases, if the combined market share of parties falls under 15%, it is impossible for market power to exist.
2. If the combined market share falls above 15% than the effect of this agreement in terms of competition should be evaluated. In this context, market concentration and market segments will be important factors during evaluation. The more concentrated the market and the more information available on prices and marketing strategies to diminish uncertainty, the greater the incentive of parties to exchange such information.

Economic Benefits

1. The efficiencies that are considered when evaluating if a shared trading agreement can be excluded, will depend on the nature of the business activity. Generally speaking, price fixing can not be justified, even if it is necessary to integrate other marketing functions and even if this integration can bring essential efficiencies of sorts. The dimensions of the gained efficiencies depend *inter alia* from the importance of the joint marketing activity on the cost structure of the product at hand. Shared distribution is most likely to bring efficiencies for producers of consumer goods, which are distributed extensively, rather than for industrial products that are purchased from a limited number of users.

2. In addition, the efficiencies that are created from cost reduction and elimination, which are important considerations in competition, should not have been gained from customer and market fragmentation taken without any regard to integrating any logistic system. In this case, the agreement might not be excluded from the provisions of article 4 of the law.

Necessity

A trading agreement can not be excluded if it imposes restrictions that are not necessary for gaining the benefits mentioned above. In the case where a company has or gains a dominant position in the market due to the trading agreement, than the agreement is considered to produce anti competitive effects, and is thus not excluded from the provisions of article 4 of the law.

Please find respective examples on trading agreements in Appendix 4.

6. STANDARDIZATION AGREEMENTS

Definition

Standardization agreements have as their main objective to specify technological or qualitative requirements with which current products in circulation or future goods, methods, and production processes can be aligned or approximated. These standardization agreements can cover different issues such as the standardization of scales or dimensions for a specific product, or other technical specifications in those markets where products need to match and interact with other products and systems. Such interactions are essential. Terms of access for a unique quality mark or for the approval of it by a regulatory entity, can also be considered as a standard.

Respective market

Standardization agreements can affect three different types of markets:

First, the product market for which the standard applies. Standards for entirely new products can uncover similar issues with those that appear in R&D agreements, in terms of market specification.

Second, the service market for standards placement, if there are structures that put such standards – or related agreements – in place.

Third, in some specific cases, a distinguishable market reserved for testing and certification.

Standards' agreements are signed between private companies, or between parties that have some public interest and belong to any public structures that are authorized to deliver services in the interest of the public.

The nature of the deal

1. In those cases where the placement of the standard is not restricted and is transparent, than the standardization agreements as laid out above and that do not impose any duties to comply with them, or that are part of a broader agreement for product compatibility, do not restrict competition. This is normally enforced on those standards that are approved by an official standardization organization, which conduct their work on non discriminatory, open, and transparent basis.

2. There is no considerable restriction for those standard agreements that do not apply (or that have limited application) in a respective market, for as long as they preserve their current state. Also, no restriction happens when small and medium enterprises work together to standardize collective bid entering procedures, or when these companies seek to standardize unimportant parts of their products such as shapes or ratios, which do not affect the core part of competition.

3. Those agreements that use a standard that is part of a broader restrictive agreement, and that aims to exclude current or potential competitors, fall under the provision of Article 4 of the law. For example, if there is a national association that imposes a national standard on all the market, and requires that all competitors in that market comply with that new standard, or asks third parties to not engage in commercial activities with those companies that do not embrace the new standards.

4. Standardization agreements can be subject to article 4 of the law in those cases where the agreement itself assures that the parties involved gain full control of production and/or innovation, by restricting their ability to compete based on their unique product characteristics, and thus affect the competitive behavior of suppliers and buyers of standardized products. The nature of the standard and its effect in the corresponding market on the one hand, and the

possible restrictions that are unnecessarily imposed on the other, should be taken into consideration when evaluating an agreement.

5. The existence of competition restrictions in standardization agreements depends on the extent to which parties remain free to develop alternative standards or products that do not necessarily comply with the agreed standard. Standardization agreements can restrict competition in those cases when they bar parties to develop alternative standards or trade products that do not comply with the standards agreed. Those agreements that give to specific structures exclusive rights to test and evaluate standard compatibility are overdoing their job, and can be considered as a case of competition restriction. Also, the latter can be also restricted by agreements that limit the use of labels to show conformity with standards, except in those cases where such compliance is required by legal and regulatory dispositions.

Market power and market structure

Big market shares being held by parties in the affected market do not cause any problems in regards to standardization agreements. Their effectiveness is often in direct proportion with the part of the market that relates to the industry that imposes and enforces a certain standard. On one hand, those standards that are not available to third parties might exclude them (or other participants in different market or geographical segments) from structurally participating in the market. Therefore, the evaluation of whether the agreement restricts competition will be conducted on an individual basis and will be extended up to the point where restrictions for new entrants are removed completely.

Economic benefits

In general, the Authority must maintain a positive stance in front of agreements that promote entrance in a shared market or that promote the development of new markets and improve supply conditions.

Standards should not limit innovation when the goal is to reap economic and technical gains. This will firstly depend from the lifespan of complementary products, as well as from the cyclical stage of the market. The effects on innovation should be analyzed on a case by case basis. Parties can show (based on certain data) that collective standardization improves consumer efficiency, but that the new standard causes the obsolescence of an existing product without any additional benefits.

Necessity

Given their nature, standards can not be included in every technology or specification that exists in the market. In some cases, it might be beneficial for consumers and the economy in general to have only one technological solution.

However, this standard should be imposed on non discriminatory basis. Ideally, standards should be detached from technology. In every case, one should give plausible arguments as to why one standard is preferred over another one.

Participation in the placement of a new standard should be opened for all interested parties, except in those cases where parties show lack of efficiency in such participation or if there are official guidelines as to how one participant can proxy its own opinions collectively, as is the case with normal standardization procedures.

It should be made clear that the placement of a standard, the R&D process for developing that standard, and the commercial use of it are three different things. Standardization agreements should cover not more than what they initially intend for accomplishing their objectives, be it for technical compatibility issues or for achieving a certain level of quality. For example, it should be clearly shown why it is necessary that to gain the given economic benefits it is required to impose an industry standard when only one competitor offers an alternative. If this is the case than the agreement must make the parties involved to boycott the deal.

Respective examples on standardization agreements are found in Appendix 5.

7. ENVIRONMENTAL AGREEMENTS

Definition

Environmental agreements include those agreements that are undertaken by different parties to decrease pollution, as laid out in the respective environment laws or in the environmental objectives. Therefore, the goals and measures accepted and approved are needed to be directly linked with lower pollution levels or in accordance with waste disposal guidelines. This excludes those agreements that affect lower pollution as a byproduct of other, unrelated, measures.

Respective market

When the polluting element is not a product within itself, the respective market will be the one of the product in which the pollutant is incorporated. Regarding waste accumulation and recycling agreements, excluding their effects in markets where parties are active producers and distributors, one should evaluate the effects in the market of waste management services that apply to the product at hand.

The nature of the deal

1. The evaluation will be focused on the discretion that will be given to parties in regards to the technical and economic tools available for use to achieve the

desired environmental objective. The greater the number of such tools available, the lower the restrictive effects on competition.

2. Similarly, those agreements that establish the environmental performance of products, or those processes that do not alter the product, or considerably affect the diversity of production in a respective market and that do not have any marginal importance to influence purchasing decisions, are excluded from the provisions of Article 4 of the law. In those cases where there are some product categories that are prohibited or expulsed from the market, restrictions can not be judged as heavy since they play a minor role in the respective geographic market.

3. Lastly, those agreements that create a new market, for example the recycling agreements, do not, generally speaking, limit competition as long as parties are able to undertake their normal activities independent of one another, and other alternatives/competitors are lacking.

4. Environmental agreements, by their very nature, are included in the provisions of article 4 of the law if the agreement in itself is not genuinely linked to the improvement of the environment, but is instead used as a mask for a prohibited agreement between parties, such as price fixing, production restriction, market division, or exclusion of current and potential competitors from the market.

5. Those environmental agreements that apply to a big part of the industry at the national level might fall under the provisions of article 4 of the law if they limit the ability of parties to project the characteristics of their products and production processes, and thus gaining some kind of reassurance on the production and sales of each others' products. In addition to the restrictions applied to the parties entering the agreement, an environmental agreement might affect third parties as well, which can be both suppliers and retailers.

6. Environmental agreements, which can make third parties exit the market or considerably affect their sales and production processes, can become subject of Article 4 of the law if these parties have significant influence in the market. This is equally applied to those cases when parties cap their individual pollution quotas.

7. Similarly, the agreements in which parties that have a considerably big market share in an essential part of that joint market place a specific and exclusive supplier of waste gathering and recycling for their products, than such a case can fall under the provisions of article 4 of the law in terms of restricting competition, unless there is only one current or potential supplier.

Economic benefits

1. The Authority holds a positive stance on those environmental agreements in its plans of environmental actions, as long as such agreements conform to all rules for the protection of competition.

2. The environmental agreements that fall under the provisions of article 4 of the law can bring several economic benefits, both at the individual level or at the general consumer welfare level. This is so if the net benefits of the agreement are greater than the net costs and harms to competition. To fulfill this condition there should be clear net benefits in terms of decreased pressure on the environment due to the agreement, compared to a previous environmental status when the agreement was not in place. In other words, expected economic benefits should be greater than the costs.

3. Such costs include the diminishing of competition, as well as costs associated with the adaptation of different economic operators and other third parties to the new conditions. The benefits can be evaluated in two phases. If consumers experience a positive rate of return from the agreement in a relatively reasonable period of time, it is not necessary that the general environmental benefits be imposed objectively. Otherwise, a cost benefit analysis might be necessary to see if the net benefits from the agreement to the consumer are possible under some reasonable assumptions.

Necessity

1. When an environmental agreement shows objectively that there is economic efficiency to be expected from it, then every measure taken can be clearly labeled as necessary for the achievement of a specific environmental goal within the economic context used herein.

2. An objective evaluation of the data, that *prima facie* might seem unnecessary, should be done by keeping in mind the ratio between cost and efficiency, and showing that based on reasonable assumptions, other alternative measures could have been more costly economically and financially. For example, one should clearly show that the enforcement of a uniform tariff, independent of the individual costs of waste gathering, is necessary for the well functioning of an industrial gathering system.

Respective examples on environmental agreements can be found in Appendix 6.

APPENDIX Nr. 1

RESEARCH AND DEVELOPMENT AGREEMENTS

Example 1

Scenario: There are two primary companies currently in the market for electronic components' production: Company A (30%) and Company B (30%). Each of these companies has invested in R&D agreements meant to develop small electronic parts, and they have already produced a few initial prototypes. Next, they agree to join their efforts in an R&D agreement, and create a joint production venture to fulfill the requirements of the agreement. The R&D products will than be sold to the parties that created the joint production venture, which will later sell them on their own account. What is left in the market are small companies that do not posses the necessary capital to make the necessary investment.

Analysis: Small electronic parts, even though they can partially compete in current markets, are generally considered a new technology. In this case, the analysis should initiate from both research poles towards this future market. If the joint venture develops further, then the technological production will only exist in one direction, while both A and B should show that they can reach the market individually with these products. Although the agreement might have the advantage of bringing a new technology in the market relatively faster, it also diminishes product diversity and promotes cost alignment and approximation between parties. Some consideration should be given to parties being able to exploit their own position in current markets. Since both companies will not feel the usual competition pressures regarding the new technology, they will have fewer incentives to confront competition with the same intensity. However, some of these effects can be corrected by asking parties to take out licenses on the basic know-how associated with the production of the small components. But, again, it will be impossible to make all the necessary adjustments to grant exclusion under the provisions of the law.

Example 2

Scenario: A small research company A, which does not have its own marketing structure, has discovered and certified a pharmaceutical substance based on a new technology that will revolutionize the treatment of a specific disease. The company enters into an R&D agreement with a big pharmaceutical firm, firm B, which produces alternative medicine for the treatment of the same disease. Company B lacks any similar R&D programs. For current products, company B has a market share of 75%, but the production patents expire in a period of 5

years. There are two other research poles that are in almost the same stage and that use the same technological basis as the new one. Company B will find the money and the necessary know-how to market the newly developed product in a future market. Company B has a license to produce and distribute the new product exclusively for as long as the patent remains valid. It is expected that both parties will bring the product to market in a period of 5-7 years.

Analysis: The product might belong to a new respective market. Parties share complementary resources and capacities by cooperating and thus increase the likelihood of the new product entering the market. Even though company B seems to have considerable market power in the current market, this power will soon diminish and the existence of other research poles is possible for eliminating every incentive that reduces R&D efforts. The right to exploit the new technology during the time left in the patent might be necessary for company B to make considerable investments required by company A, which does not hold any marketing resources. In this context, the agreement does not seem to restrict or limit competition.

Example 3

Scenario: Two engineering companies that produce spare parts for cars agree to enter in an agreement to combine their R&D efforts for improving the production and performance of an existing spare part. They also share their technologies by licensing a business in this area, but they will still keep producing separately. Companies have market shares of 15 and 20% respectively in the OEM product market. There are two other big competitors and internal R&D programs offered by big auto manufacturers. They have market shares of 20 and 25% respectively in the international market for licensing the technologies for these products, as measured by the volume of income generated. Also, there are two additional technologies in the market. The usual lifecycle for spare parts is 2-3 years. Every 5 years, both companies have introduced new products or have improved old products with new versions.

Analysis: Since any of the R&D efforts from both companies do not aim at bringing an entirely new product in the market, the markets that will be taken in consideration are: the market for existing car spare parts, and the market for the licensing of respective technologies. However, (their R&D programs overlap extensively) smaller R&D overlap through the cooperation will allow parties to spend more on R&D than they would have done if they tackled this issue separately. There are other technologies out there, and the combined market power in the OEM market does not create a dominant position for them. Even though their share in the technological market is high, 45%, there are other competing technologies. In addition, car manufactures, which have not licensed their respective technologies for these products so far, might be potential entrants in this market and therefore can limit the parties' ability to impose price increases. As is described in this guide, the new venture and agreement might

be able to benefit from exclusion.

APPENDIX Nr. 2

PRODUCTION AND SPECIALIZATION AGREEMENTS

Shared Production

Example 1

Scenario: Two suppliers A and B decide to create a new production facility for a chemical product X that is jointly controlled by both parties. This facility will produce almost half (50%) of their total production volume. X is a homogeneous product and can not be substituted by other products, i.e. it creates a market of its own. The market is quite stable. Parties will not increase general production considerably, but will temporarily shut down two of the old facilities and will adjust the capacity of the new one. A and B have a 20% market share. There are three other suppliers in this market where each of them has 10-15% market share. Some other smaller competitors exist as well.

Analysis: there is a possibility that this agreement might have an effect on the general level of competition of parties because the deal will give them considerable market power, even if **there is no dominant position present.** Heavy restrictive effects in the market are possible. The high increase in efficiencies that might be the scope of these effects are impossible to expect if there is no considerable increase in the level of production.

Example 2

Scenario: Two suppliers A and B create a shared production agreement in the same respective market as in example 1. Also, parties produce 50% of the total production volume from this joint production agreement. Both A and B have a 15% market share. There are three other players: C with a market share of 30%, D with 25%, and E with 15%. B has a joint facility with E.

Analysis: There are several players in the market and there is a quite symmetrical structure. The shared production agreement creates an additional link between players. The cooperation between A and B will de facto increase market concentration as well as E's effect on A and B. This cooperation is expected to bring serious and severe limitations to competition, as in example 1, and it is not possible to expect high efficiency gains.

Example 3

Scenario: A and B portray a joint production agreement for an intermediate good X through the restructuring of the facility. This joint production sells product X to A and B exclusively. It produces 40% of the total production volume for A, and 50% of the total production volume for B. A and B are the exclusive users of product X but are not the exclusive suppliers in the market. The part of A over the total supply of industrial product X is 10%, of B is 20%, and the part from the joint production is 14%. However, in the non-exclusive market, A and B have 25 and 35% percent of the market, respectively.

Analysis: Regardless of the strong and non-exclusive position of parties in the market, the cooperation can not eliminate the competitive effect for product X if the difference in costs between exclusive and non exclusive use is small. However, a rapid change in costs should counteract in a greater part of the market up to 60%. Otherwise, this cooperation might bring serious consequences for competition, which can not be offset by substantial economic gains.

Example 4 relates to the cooperation in the market for an intermediary important good, <u>with excessive effects in the lower flow market.</u>

Example 4

Scenario: A and B propose to share production for an intermediary product X. They will shut down their old factories of product X and will substitute the production volume by a new joint factory for X. The intermediary product X is calculated by taking 50% of the total cost of the final product Y.

Both A and B each have 20% of the market for product Y. There are two other considerable suppliers of Y and each of them has 15% market share. There are a few small players as well.

Analysis: In this case, cost alignment and approximation is large; in addition, parties want to gain market power by coordinating their behavior in the market for product Y. The case where competition problems arise and evaluation is rendered necessary is almost similar to example 1, even though here the cooperation applies to the upper flow market.

<u>Reciprocal specialization</u>

Example 5

Scenario: Company **A** and Company **B** both produce and supply homogeneous products X and Y, which belong to different markets. A's market share of product

X is 28% and of product Y is 10%. B's market share of product X is 10% and of product Y is 30%. Because of economies of scale they enter into a reciprocal specialization agreement, which states that, in the future, A will only produce product X, and B will only produce product Y. Both firms accept cross offers so they will remain in the market as suppliers. Regarding the homogeneous nature of the products, distribution costs are negligible. There are two other producers of X and Y with market shares around 15% each and what is left of the market is owned by other competitors at 5-10%.

Analysis: The intensity of cost approximation and alignment is very high, and only a small part of total costs remains different. Therefore, there is little room for competition to exist normally. Parties want to gain market share and power by coordinating their commercial behavior in the markets for X and Y. In addition, it is quite possible that the supply of Y by A and of X by B will shrink through time, and this case presents large competition restriction issues, which can not be offset by the benefits derived from scale economies.

This scenario might change if X and Y were heterogeneous products with a large cost share in marketing and distribution expenses (i.e. 65-70% of total cost). Also, if the supply of these differentiated products is a condition for successful competition, than the withdrawal of one or more parties as supplier of X and/or Y is impossible. In such a scenario, the exclusion criteria might have been fulfilled regardless of the high market share ratio. (One makes sure that the economies are sensitive.)

Subcontracting between competitors

Example 6

Scenario: Company **A** and Company **B** are market competitors for end product X. Company A has 15% market share and Company B has 20% market share. Both produce Y, an intermediary good, which serves as raw material in the production of X, but is also used for the production of other products. The cost for it is 10% of the cost of X. Company A produces good Y only for internal consumption, while B is also a seller of Y to third party consumers. Their market share for Y is 10%.

A and B agree to enter in a subcontracting agreement, where A will buy 60% of its required volume of Y from B. It will still produce 40% of its total production need internally, without loosing any know-how in the production of Y.

Analysis: First, since A is the sole producer of Y for internal consumption purposes, it should be evaluated whether A is a potential entrant in the sale market for Y to third parties. If this is not the case, than the agreement does not restrict competition related to Y. Excessive market effects for X are also impossible if we take into consideration the low cost approximation and

alignment created from the agreement.

If A is seen as a potential real entrant in the resale market for Y to third parties, than one should take into account the position of B in the market for Y. Since B's market share is relatively low, than the conclusion from this analysis doesn't change.

APPENDIX Nr. 3

PURCHASING AGREEMENTS

Example: One group of auto makers agree to share the purchase cost for product X. Their combined purchase of X is equal to 15 units. Total sales for all auto makers are 50 units. **However, X has been sold to the producers of other products, with sales equal to auto sales.** All sales of X are calculated over 100 units. Therefore, the group market share (of the purchasing market) is 15%.

Example 1

Scenario: Two producers, A and B, decide to jointly purchase component X. They are competitors in their sale market. Their joint sales represent 35% of total sales of X in the market, which is assumed to be the respective geographical market. There are 6 other competitors (competitors of A and B in their sale markets) that hold 65% of the buying market; one of them has 25%, while the rest have considerably less market share. On the supply side, the market is very concentrated, with 6 suppliers of component X, two of them holding 30% each and the rest holding 10-15% (HHI ranges from 2300-2500). In their sale market, A and B reach a combined market share of 35%.

Analysis: Regarding the parties' market power in their selling markets, gains from cost savings can not be channeled to the end consumer. In addition, shared purchases could increase costs for the other smaller competing parties because the two most powerful competitors offset their price decrease for some consumers by rising prices for their smaller consumers. By increasing concentration in the lower flow market, the cooperation might bring a further consolidation of behavior coordination between suppliers. Even a small concentration (which can always work close or below the optimal minimum of scale) can kick some players out of the market if they can not reduce their prices further. It is possible that in such a case, competition be seriously harmed.

Example 2

Scenario: 150 small retailers enter into an agreement to form a shared-purchase organization. They have to buy a minimum amount of a good through this

organization, which is calculated for about 50% of the total cost for each retailer. These retailers can buy through the organization more than the required minimum, and they can also purchase from outside the agreement. They have a combined market share of 20% each both in the sell and buy markets. A and B are the two major competitors of this organization, where A has 25% market share in each market of interest, and B has 35%. The rest of the smaller competitors have also formed a shared purchase group. The 150 retailers can reach a considerable purchasing volume if they combine their economies.

Analysis: Retailers can reach a considerably high cost scale if they ultimately buy more together more than the minimum volume agreed. However, combined, they only have a medium market position both in the sell and buy markets. In addition, the cooperation brings some economies of scale, and as such, it might be excluded from the provisions of the law.

Example 3

Scenario: Two supermarket chains enter into an agreement to buy together 50% of their products, which are calculated as accounting for 50% of their total costs. In the respective purchase markets and for different product categories, parties have the following market shares: 25 and 40%. In the respective sale market they have 40% (assuming there is only one geographical market in the respective market). There are 5 other retailers which have 10-15 % market share each. Market entrance at this point is impossible.

Analysis: it is possible for this joint purchase agreement to have some effect on the competitive behavior of parties, because the cooperation must give them considerable market power. This is especially the case when market entry is weak. There is greater incentive to coordinate market behavior if costs are approximately similar. Similar margins should account for uniform prices. Even though there are some efficiency gains from the cooperation, it is not possible to exclude it given the very strong market power.

Example 4

Scenario: Small cooperative farms enter into an agreement to share some of their purchases together, and thus form an organization to serve this purpose. They have to buy a required minimum volume from the organization, and they can even buy more than this minimum from the same organization. But they can also purchase from outside the organization. Each party has a total market share of 5% in each selling and buying market, thus giving a combined market share of 25%. There are two other retailers that have 20-25% market share each, and a few other small retailers have a market share of less than 5%.

Analysis: the creation of this organization might serve the union to create such scale economies in both the selling and purchasing market so that they can

successfully compete with the two other larger retailers. In addition, the presence of these two other players with similar market positions might make it possible for an efficiency agreement to be passed down to the end consumers. In such a case, the agreement is likely to be excluded.

APPENDIX Nr. 4

<u>TRADING AGREEMENTS</u>

Example 1

Scenario: 5 small food retailers, each with 2% market share in the general food market, agree to the following: share their distribution structures, trade under a joint name, and sell their products under a uniform price. This initiative includes a substantial investment in warehouses, transportation, advertising, marketing, and a selling requirement. This effort reduces their cost base significantly, which typically reaches 50% of the selling price, and allows them to operate through a more efficient and faster distribution system. The clients of food producers are the big retail chains.

Three food multinational groups dominate the market, where each has 20% market share. The rest of the market is left to small independent producers. The product line of the parties in this agreement overlap in some considerable areas, but their combined market share does not go beyond 15%.

Analysis: The agreement includes price fixing so it falls directly under the provisions of Article 4 of the law, even though the parties in this agreement do not hold market power. However, the integration of marketing and distribution efforts is used to gain substantial efficiencies, which means that the ultimate gains can be channeled to the end consumer in terms of lower costs and improved services. The issue here is whether the agreement is excludable, or not. To answer this, one has to judge whether price fixing is necessary to achieve the successful integration of marketing functions and to ultimately get the economic benefits that will come as a result. In this case, price fixing might be seen as a necessity, so much in fact that the clients of the big retail chains do not want to deal with a broader price structure. Also, this is as necessary as selling under one name (which can mean goodwill) or having uniform marketing practices including price standardization.

Example 2

Scenario: Two bearings producers, each holding 5% market share, create a shared selling organization, which will trade products, will set prices, and will distribute orders to headquarter companies. They reserve the right to sell outside this structure. Distribution for clients continues to be fulfilled by neighboring plants directly. Their argument is that this agreement will create efficiencies

because the joint selling power can make products available to the same clients in the same time, thus eliminating any overlap in selling efforts. In addition, the joint enterprise would distribute orders to factories close by whenever possible, thereby reducing transportation costs.

Analysis: The agreement includes price fixing and so it falls under the provisions of article 4 of the law, even though the parties can not be seen as holding any market power. This agreement can not be excluded as long as the efficiencies in terms of cost savings are due to the restriction of competition between parties.

Example 3

Scenario: two producers of soft drinks are active in two neighboring markets. Between them, they hold 20% of the market share in the internal market. They agree to distribute each other's products reciprocally in the corresponding geographical market. The market is dominated by a large number of soft drink producers that have a 50% market share each.

Analysis: The agreement falls under the scope of article 4 of the law if the parties were potential competitors. Therefore, to evaluate this scenario one should analyze the barriers to entry in the players' corresponding markets. If the parties can enter freely in each other's markets, than this agreement eliminates competition between them. However, even though market share data show that they can posses some degree of market power, a market structure analysis shows this not to be the case. In addition, in a reciprocal distribution agreement, users benefit for as long as there is an optimal choice in every geographical market. The agreement must be excluded even though it is considered as one that restricts competition.

APPENDIX Nr. 5

STANDARDIZATION AGREEMENTS

Example 1

Scenario: EN 60603-7:1993 specifies requirements for attaching television decoders to video generating appliances such as play stations and video registering devices. Even though the standard is not a legal obligation for parties, in practice, the producers for such devices use the standard all together, since this is seen as a feature demanded by the market.

Analysis: Article 4 of the law is not violated. The standard has been approved by the standardization structures, through transparent and open procedures at the national, European, and international level. The approval is based on a national consensus that reflects both producers and consumers' preferences. All

producers are allowed to use the standard.

Example 2

Scenario: Several VHS tape producers agree to develop a quality mark or standard to label the VHS tapes as a product that fulfills a certain minimum technical requirement. Producers are free not to use the standard and can produce tapes that do not conform to the standard. Also, the new standard is available to other developers as well.

Analysis: Given that the standard does not restrict competition in any other way, Article 4 of the law is not infringed since participation in usage is not restricted to others and the agreement is transparent and does not impose any obligation on other parties to comply with the standard. However, if the parties agree to produce only the new VHS tapes that comply with the standard, than this practice restricts technical development and would impede parties to sell their differentiated products, which violates Article 4 of the law.

Example 3

Scenario: A group of active competitors in different markets, which are interdependent with the products that ought to be comparable with more than 80% of respective markets, agree to develop together a new standard that will enter competition against other standards available in the market and that are extensively used by their competitors. The different products that will comply with the new standard will no longer comply with the current standards. Since there is a substantial need to invest in moving from an old standard to a new one, and to start producing using that old standard, the parties agree to produce a certain volume of their products under the new standard to create a critical mass in the market. Also, they agree to limit the production of their other products that do not comply with the new standard up to last year's volume.

Analysis: Given the market power of parties in this case and the agreement provisions for production restriction, this case violates article 4 of the law. An omission is made in those cases where access to technical information has been appropriated on non discriminatory grounds and on reasonable terms for other suppliers that would like to compete.

APPENDIX Nr. 6

<u>ENVIRONMENTAL AGREEMENTS</u>

Example 1

Scenario: Almost all producers and importers of a certain home appliance (e.g. washing machine), agree, in the presence of an incentive given by a public

structure, to not produce or import products that are not in compliance with a certain environmental standard (e.g. energy efficiency). Together, the parties have 90% of the market share. The products that will be bought outside the market are an important part of the total sales volume. They will be substituted with other products that favor the environment, but that at the same time are more expensive. The agreement indirectly limits the production of third parties (e.g. electronic devices, suppliers of components incorporated in the products that have been pushed out of the market).

Analysis: The agreement gives parties the right to control individual production and importing and it applies to an extensive share of their total output, while at the same time diminishing third party production volume. Consumer choice, which has been partially focused on the environmental characteristics of the product, will decrease, and prices will increase. The agreement falls under the provisions of Article 4 of the law.

However, the new products are more advanced technically and by reducing environmental problems, which is an indirect goal after all (emissions from energy consumption), they will not create or inevitably exacerbate another environmental problem (e.g. water consumption, detergent usage, etc.). Net contributions for improving the environmental situation goes beyond cost increases. In addition, individual buyers of the most expensive products will quickly recoup the cost increase since the most eco friendly products have lower operational costs.

The other alternatives against the agreement are seen as less secure and come at a higher cost – lower efficacy in achieving the same net benefits. Different technical tools are economically available for those parties that aim at producing goods that comply with the accepted environmental characteristics, and competition will continue to exist for the other product characteristics. For these reasons, the agreement fulfills the requirements of being excluded from the enforcement of article 4 of the law.