



**DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS
COMPETITION COMMITTEE**

ROUNDTABLE ON COMPETITION IN BIDDING MARKETS

-- Note by Germany --

This note is submitted by the German Delegation to the Competition Committee FOR DISCUSSION at its forthcoming meeting to be held on 18-19 October 2006.

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1. Promoting competition in and through auctions

1.1 Public procurement tenders

1.1.1 The Bundeskartellamt as public procurement tribunal

1. Public contracts principally have to be awarded under competitive conditions through a public tender in a transparent and non-discriminatory way. In principle the contract is awarded to the bidder submitting the economically most advantageous offer. The Bundeskartellamt has been responsible for reviewing the awarding of public contracts in the Federal Republic of Germany since 1 January 1999. The three public procurement tribunals set up at the Bundeskartellamt review, upon request, whether public contracting entities have met their obligations in the award procedure.¹ The tribunals are entitled to take suitable measures to remedy a violation of rights and to prevent any impairment of the interests affected.

1.1.2 Principles, cases and decisions

2. In the rulings of the Bundeskartellamt's public procurement tribunals the guiding principles of procurement law, i.e. competition, transparency, non-discrimination and fair tendering procedures play a very important role.

3. This can be illustrated by a recent decision of the Bundeskartellamt²: The contracting authority, the *Bundesagentur für Arbeit*, issued an invitation to tender for the supply of network components to expand its network infrastructure and to redesign its IP-network. The network components were *inter alia* to be used in a data processing centre which was to be newly built and connected with the existing data processing centre. In its invitation to tender, the public entity explicitly asked for products of a certain component manufacturer. German public procurement law, however, in principle calls for an invitation to tender which is neutral as regards certain products or techniques. The contracting authority may only then explicitly ask for a certain product if this is justified by the nature of the goods and services which are the subject matter of the contract to be awarded. Also, trade names may only be asked for as an exception and only with the addition "or equivalent". In the case described above, the contracting authority claimed that only the products named in the invitation to tender would allow for full compatibility, interoperability and easy error analysis. The procurement tribunal found, however, that the specification of network components in the invitation to tender was not justified. The new data processing centre was to be built on a different site and connected with the existing data processing centre on the basis of standard protocols. Such a connection would not require identical components. The Bundeskartellamt found that the invitation to tender was not only contrary to the above mentioned provision demanding product neutrality but also contrary to the principles of competition and non-discrimination. As a result, it ordered the contracting authority to withdraw the invitation to tender.

4. In many cases, the Bundeskartellamt finds that the contracting authorities do not apply the criteria laid down in their invitations to tender to determine the economically most advantageous offer or,

¹ Review by the public procurement tribunals presupposes that certain thresholds are met. These thresholds, which are based on directives of the European Union, are, at present, as follows: 130.000 € as regards public service and supply contracts awarded by the highest administrative authorities of the Federal Republic of Germany, 200.000 € as regards such contracts awarded by other public entities and 5 Mio. € as regards public works contracts.

² VK 2 – 104/06 of 18 September 2006, not yet published. Decisions of the public procurement tribunals are available under <http://www.bundeskartellamt.de/wDeutsch/entscheidungen/vergaberecht/EntschVergabe.shtml>.

in a first step, a certain number of qualified competitors. In a decision in 2005³ the Bundeskartellamt ordered the contracting authority to re-evaluate the request by a bidder to participate in a competition for the design of a repository for the state library in Berlin. The jury had only evaluated the request according to the criterion “quality of design”. However, in its invitation the contracting authority had clearly distinguished between “design qualifications”, “experience in the building of libraries and archives” and “design qualifications as regards building projects of a particular magnitude which serve one particular purpose”. The Bundeskartellamt found that the contracting entity had, by not applying its own criteria, violated the principles of transparency and non-discrimination.

5. In another case⁴, the Bundeskartellamt took the opportunity to underline the importance of deadlines which a contracting entity has to grant in an award procedure. The law e.g. provides for a certain time period after the publishing of an invitation to tender to allow a potential bidder to make a request to participate in a restricted procedure. A shortening of the deadline is only possible in cases of particular urgency that must not have their cause in the internal organisation of the public entity. The contracting authority, the German Federal Ministry of Finance, had, however, shortened this deadline significantly. In the procedure before the Bundeskartellamt, the authority claimed that it had to shorten the deadline because of the ongoing legislative process in which the ministry wanted to include results to be established by the contractor. The applicant, on the other hand, argued that due to the shortened deadline he was not able to make his request. In its decision, the Bundeskartellamt found that the ministry had violated its obligation to stick to the statutory deadlines because there were no convincing reasons to shorten the deadline: The legislative process and its envisaged termination was an internal process which was - and still could be - influenced by the ministry.

1.2 Bidding consortia and anti-trust enforcement

6. Anti-trust enforcement can serve in various ways to promote competition in auctions. Collusive bidding is prohibited by the ban on cartels according to Art 81 EC Treaty and Section 1 of the Act against Restraints of Competition (ARC). In the past years the Bundeskartellamt has fined several cartels which operated in bidding markets (e.g. removal services, ready-mixed concrete, firework devices, etc.). Bid rigging is also prosecuted as a criminal offence (Section 298 Penal Code).

7. An important aspect of the ban on cartels is the case law which specifies the conditions under which bidders are allowed to submit a joint bid in an auction. Such bidding consortia can be found in virtually all auction markets but are most frequent in the construction industry. A bidding consortium between two or more significant competitors typically violates the ban on cartels if both companies would have submitted a bid absent the agreement to bid jointly. Setting up a bidding consortium is therefore a cartel agreement if bidding separately would have been a viable and rational business decision and if the agreement appreciably restricts competition. Bidding consortia can also fall under the scope of German merger control.

³ VK 3 – 224/04, decision of 19 January 2005, available under <http://www.bundeskartellamt.de/wDeutsch/archiv/EntschVergArchiv/2005/EntschVergabe.shtml>.

⁴ VK 3 – 49/05, decision of 9 June 2005, available under <http://www.bundeskartellamt.de/wDeutsch/archiv/EntschVergArchiv/2005/EntschVergabe.shtml>.

Case example: Prohibition of joint participation by Rethmann and Tönsmeier in GfA Köthen⁵

8. Rethmann, Tönsmeier and the public-owned GfA Köthen were active in various local disposal markets, especially in the market for the collection and transport of residual waste, waste paper and other types of waste. In a tender to privatise GfA Köthen, Rethmann and Tönsmeier submitted a joint bid. In November 2004, the Bundeskartellamt prohibited the joint participation of Rethmann and Tönsmeier in GfA Köthen. Both the formation of a bidding syndicate by Rethmann and Tönsmeier and the formation of a joint venture constituted illegal anti-competitive agreements within the meaning of the ban on cartels. As a result of the formation of the bidding syndicate only one joint bid was submitted in the tender to privatise GfA Köthen instead of two independent bids. Rethmann, the second-largest German waste disposal company, and Tönsmeier, a well-established medium-sized enterprise, would both have been able to submit an independent bid. According to the Bundeskartellamt's evaluation Rethmann and Tönsmeier would also have coordinated their competitive behaviour in the relevant geographic market after the merger as a consequence of the formation of the cooperative joint venture. Furthermore, the merger would have strengthened a dominant oligopoly in the markets for the collection and transport of residual waste and waste paper in a geographic area of approx. 100 km surrounding the District of Köthen.

1.3 Auctioning obligations as a remedy in antitrust enforcement and merger control

9. In some cases the obligation to conduct an auctioning process can be an effective remedy in antitrust enforcement. In the Bundeskartellamt's practice there are some relevant cases of this both in abuse control and merger control. Generally speaking, this kind of remedy can be effective if it serves to open up markets and thus promote competition on a long-term basis. Within the context of German merger control, remedies imposed in a clearance decision must not be aimed at subjecting the merging companies to a permanent control of conduct. The Bundeskartellamt is thus only able to clear a merger subject to structure-related remedies. These may be structural remedies in the narrower sense (e.g. selling parts of the company) or remedies aimed at opening up markets by reducing barriers to entry. The latter may include auctioning obligations. Two relevant cases are reported below.

Case example: DSD cost savings through auctions⁶

10. Under the German Packaging Ordinance companies are obliged to take back and dispose of the packaging which they have brought into circulation. The endconsumers do not pay directly for the waste disposal but rather the disposal costs are borne by the company circulating the packaging. The company circulating the packaging discharges its obligation to take back and dispose of the packaging by contracting DSD (or other companies) to do this. At the time when the take back obligations were introduced, the German industry - backed and facilitated by politics - set up the company DSD ("Dual System Germany") to fulfil the obligations. The result was a monopolist with a cartel-like ownership structure. Its shareholders consisted of companies from the waste management sector and large companies from the trade and industry. The waste management companies were at the same time procurers of DSD as they collected and sorted the packaging waste on DSD's behalf. From the early nineties when the company was set up, DSD enjoyed a "quasi-monopoly" in the market for taking back sales packaging. The Bundeskartellamt initially tolerated DSD's competition law infringements, but made clear that the tolerance would only be temporary. Due to its market power and interlocking interests, DSD's incentives to reduce its costs were weak.

⁵ The full text of the Bundeskartellamt decision on 16 November 2004 is available at <http://www.bundeskartellamt.de/wDeutsch/download/pdf/Fusion/Fusion04/B10-74-04.pdf>

⁶ For more details see the press release of 12 October 2004 which is available at http://www.bundeskartellamt.de/wEnglisch/News/Archiv/ArchivNews2004/2004_10_12.shtml

11. In order to partially allay the competition concerns of the Bundeskartellamt, DSD decided in early 2003 to implement for the first time a transparent and non-discriminatory system of awarding service contracts to the waste disposal companies.⁷ The first call for tenders did not bring about any real competition in bidding for many contract areas with the result that in 2004 DSD had to put out a second invitation for tender for almost half of all its contract areas. In this second invitation for tender DSD, at the Bundeskartellamt's recommendation, had considerably improved the basic conditions for competition, above all for small and medium-size disposal companies, which thus had an increased chance of success. As a result, from 2005 the costs of collecting and sorting, in comparison to the charges paid up to 2003, were reduced by approx. 200 mio. Euro, which corresponded to a reduction of more than 20 per cent.

Case example: Joint venture clearance subject to auctioning conditions⁸

12. In December 2003, the Bundeskartellamt cleared the planned project of DB Regio AG (DB Regio) and üstra Hannoversche Verkehrsbetriebe AG (üstra), to combine their local public transport activities in the greater Hanover area in a joint venture. Clearance was made, however, under the dissolving condition that contracts for local public transport services in the Hanover region be awarded through competitive procedures.

13. DB Regio provides all local passenger rail services in the relevant Hanover market area on the basis of a transport contract with the Hanover regional authorities, the duration of which is limited to the end of 2006. In addition it is also active in local public road transport in the greater Hanover area via its regional bus subsidiaries. üstra is by far the leading municipal transport company in the greater Hanover area. On account of a considerable overlap in their areas of operation their combined market shares reach a level of well above 80 per cent in the Hanover market area.

14. The auctioning conditions ensure that the market is opened up gradually. Accordingly, as soon as the current contracts have expired, at least 30 per cent of DB Regio's local passenger rail services and at least 50 per cent of üstra's bus transport services have to be awarded in a Europe-wide award procedure with effect from 1 January 2007 and 1 January 2010 respectively. By 1 January 2013 at the latest the Hanover regional authorities, as the contracting entity for local public transport, have to award all bus transport services provided by üstra and all local passenger rail services provided by DB Regio in the region in a Europe-wide competitive procedure.

2 Merger evaluation in bidding markets

15. The fact that the market under investigation is characterised by auctions plays an important role in the Bundeskartellamt's merger review practice. It is a common market feature that comes up in many cases. Most markets where the customers are businesses and virtually all markets where the customers are government entities can be described as bidding markets.

16. In its practice-, the Bundeskartellamt has not accepted a general "bidding market defence". However, it investigates thoroughly the implications that the auctions have on competition. Bidding market characteristics are most likely to make a difference in the context of market definition and in the evaluation of the evidentiary value of market shares. In several Bundeskartellamt merger review decisions it is also discussed whether auctions make a difference for the analysis of buyer power.

⁷ It should be noted that this was only one among several actions that DSD had to take. The most significant change DSD had to make was to dissolve its cartel-like ownership structure by the end of 2004.

⁸ The full text of the Bundeskartellamt decision on 2 December 2003 is available at http://www.bundeskartellamt.de/wDeutsch/download/pdf/Fusion/Fusion04/B9_91_03.pdf

2.1 *No general “bidding market defence”*

17. In its most general form the “bidding market defence” equates to the claim that because the market at hand is characterised by auctions, it is impossible for the suppliers to have market power. Klemperer and other auction theory scholars show that this argument holds only under specific conditions which are hardly ever met in reality.⁹ Very similar to these theoretic arguments, the Bundeskartellamt has in its case practice rejected the general “bidding market defence” if it is not substantiated by arguments which convincingly explain how the auctions prevent a dominant market position (i.e. make unilateral or coordinated effects unlikely).

18. Good examples to illustrate this point are the mergers Shell / DEA and BP / Veba in 2001.¹⁰ The markets affected by these mergers included inter alia the market for jet fuel A1 at Frankfurt airport. In the proceedings the parties claimed that there was no collective dominant position because jet fuel A1 delivery contracts were awarded through auctions. According to the analysis of the Bundeskartellamt, this claim was not substantiated. Potential entrants need to build up a specific infrastructure at and to the airport (e.g. pipelines, etc.) in order to become a credible bidder. The fact that auctions were conducted therefore did not improve the conditions for entry for newcomers. Entry was also unattractive for newcomers as the very same companies that produce jet fuel A1 also deliver it on site. It did not seem likely that the auctions as such would reduce the transparency between the few suppliers on the Frankfurt airport jet fuel A1 market. Both mergers were therefore only cleared subject to conditions.

2.2 *Market definition in bidding markets*

19. In principle, auctions have the potential to encourage market entry by companies active in adjacent markets. Auction processes can therefore be an argument in favor of a relatively broad market definition. This aspect is particularly relevant in geographic market definition. A common misunderstanding is that the market should be defined by the geographic target audience of the bid taker (buyer). In several merger proceedings, the merging parties argued that the buyers are obliged to conduct a “Europe-wide” auction due to regulations for government procurement processes, and that the market should therefore be defined as Europe-wide. However, such an obligation does not mean that there are credible bidders in this market from all over Europe.

20. In bidding markets the Bundeskartellamt typically reviews data from past auctions in order to assess which companies can be viewed as credible bidders and in which geographic area they are able to place a credible bid. This can be a laborious but worthwhile exercise. The relevant market is not defined with reference to the target audience of the bid takers but rather with reference to the scope of credible bidders.

21. The case Rethmann / Tönsmeier / GfA Köthen, which was already mentioned above, is also a good example to illustrate this methodology.¹¹ In order to assess the geographic scope of the markets for the collection and transport of residual waste and waste paper, the Bundeskartellamt surveyed all 112 regional authorities which are the actual and potential customers in this market. 29 bids had been conducted by these authorities in the past five years. The Bundeskartellamt was able to obtain the bidding

⁹ See e.g. the referenced literature in the “scoping paper” to this roundtable, COMP/2006.68

¹⁰ The full texts of the Bundeskartellamt decisions on 19 December 2001 are available at:
<http://www.bundeskartellamt.de/wDeutsch/download/pdf/Fusion/Fusion01/B8-120-01.pdf> and
<http://www.bundeskartellamt.de/wDeutsch/download/pdf/Fusion/Fusion01/B8-130-01.pdf>

¹¹ The full text of the Bundeskartellamt decision on 16 November 2004 is available at:
<http://www.bundeskartellamt.de/wDeutsch/download/pdf/Fusion/Fusion04/B10-74-04.pdf>

data for 26 of these bids. Through the analysis of these data it was found that only those bids are likely to be successful which are submitted by companies which already have a branch within a certain geographic vicinity to the place of tender. According to the findings the geographic market spans all administrative districts within approx. 100 km of the area covered by the tender, i.e. the District of Köthen.

22. Other cases, for example the June 2005 prohibition of the merger RUAG Deutschland GmbH / MEN Metallwerk Elisenhütte GmbH,¹² illustrate that a “Europe-wide” auction does not necessarily mean that the market is in fact Europe-wide. The merger project would have created a de facto monopolistic position for RUAG / MEN on the German market for small calibre ammunition (also called small arms ammunition) for customers in the authorities sector and military sector. In this case, the parties claimed that the market was wider than national because the customers sometimes conducted “Europe-wide” auctions. However, the Bundeskartellamt opined that the geographic market was limited to Germany because of the special technical product requirements on the domestic market and the close manufacturer-customer relations. Due to these market characteristics, RUAG and MEN were the only two credible bidders in this market.

2.3 *Market shares in bidding markets*

23. Another important aspect in the case experience of the Bundeskartellamt is the evidentiary value of market shares in bidding markets. There are two main reasons why market shares can be of less significance in bidding markets if compared to other markets.

24. The first reason is that the contracts may be infrequent and that the value of each contract may be high relative to the overall market volume or to a supplier’s total sales in a period. In economic terms, this describes a situation where the demand is lumpy. The durability of the market share levels may therefore be weaker. In tendency, market shares will be more volatile with a lumpier demand. A direct consequence for merger analysis is that market shares should always be analysed for several years preceding the merger notification and not just for one year. Also, the competition authority should investigate the value of each contract in relation to the overall market volume. Additional information may be gathered by looking at the installed base (for investment goods) and/or the orders on hand. The more volatile market shares are and the higher the relative value of each contract, the less explanatory power market shares will have. However, it should be noted that lumpiness of demand is strictly speaking a market feature which is independent of the exact price formation process. Therefore, a lumpy demand can also be present in non-bidding markets (for example, the market may be characterised by bargaining processes).

25. The second reason is that in bidding markets other credible bidders may pose a significant competitive constraint even though one company in the market holds high market shares. However, this might be the case in non-bidding markets as well. As a rule, the Bundeskartellamt does not assign equal market shares to all credible bidders only because the market is characterised by auctions. In contrast, the Bundeskartellamt calculates market shares in an analogous way as in non-bidding markets (see the paragraph above) and investigates why the market leader has won contracts more often than other competitors. The analysis may (or may not) show that even though the market leader has high market shares, it nevertheless cannot act independently of competitors due to a sufficient number of credible bidders.

26. An instructive example in this regard is the analysis in the clearance decision for Von Roll Inova GmbH to acquire the “industrial boiler and plants” (IBP) business of Alstom Power Conversion GmbH in

¹² The full text of the Bundeskartellamt decision on 30 June 2005 is available at:
<http://www.bundeskartellamt.de/wDeutsch/download/pdf/Fusion/Fusion05/B4-50-05.pdf>

May 2006.¹³ Among the several markets affected, the highest combined market shares of Von Roll and Alstom's IBP business were in a German market for Hausmüllverbrennungsanlagen, namely approx. 60% in a 5-year period.¹⁴ The Bundeskartellamt conducted an in-depth analysis of all invitations to tender for household waste incineration plants in the years 2001 – 2005. In this period nine invitations to tender for waste incineration plants were issued, all of which were awarded to general contractors. The Bundeskartellamt assumed that from the buyers' point of view all bidders that were admitted to the second bidding round were credible bidders. Therefore, on the basis of invitations to tender in the last five years, it was examined to what extent the number of bidders would have changed in the second bidding round if Von Roll and Alstom's IBP business were considered as one bidding unit. The parties to the merger participated independently as credible bidders in seven of the nine invitations to tender for general contractor services. Out of these seven invitations to tender, if Von Roll and Alstom's IBP business were considered as one unit, in two cases two bidders would have remained, in two cases three, and in three cases four. In the period indicated above, a total of nine different bidders participated in the second round. An analogue analysis was also conducted for the main components of household waste incineration plants. The analysis concluded that, although the merger led to a decrease in the number of bidders and high market shares, there still remained a large enough number of credible bidders to create sufficient competitive pressure.

2.4 Buyer power in bidding markets

27. Quite similar to the general "bidding market defence" it is sometimes argued that the presence of auctions is as such proof of countervailing buyer power. Auction theory suggests that even the opposite argument can be made because bidders may be able to influence the auction design or to deviate from the auction rules.¹⁵ In line with these theoretic arguments, the Bundeskartellamt does in its practice not presume that the presence of auctions creates countervailing buyer power.

28. An instructive example in this regard is the merger Getinge / Heraeus which was cleared subject to obligations in May 2002.¹⁶ Getinge held a dominant position in the market for operation table systems for hospitals and clinics. This dominant position was not relativised by the fact that the buyers (hospitals and clinics) purchased their operation tables through formal auctions. In contrast, the investigation showed that by assisting the hospitals and clinics in the specification of the tenders, Getinge was sometimes able to undermine the auction process as the tender included specifications which only Getinge was able to meet. Also, Getinge met with a quite fragmented demand side so that there was no sufficient countervailing buyer power.

¹³ The full text of the Bundeskartellamt decision on 15 May 2006 is available at:
<http://www.bundeskartellamt.de/wDeutsch/download/pdf/Fusion/Fusion06/B5-185-05.pdf>

¹⁴ There was no final determination made on the geographic scope of the market.

¹⁵ See e.g. the referenced literature in the "scoping paper" to this roundtable, COMP/2006.68

¹⁶ The full text of the Bundeskartellamt decision on 29 May 2002 is available at:
http://www.bundeskartellamt.de/wDeutsch/download/pdf/Fusion/Fusion02/B4_171_01.pdf