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

ROUNDTABLE ON COMPETITION IN THE CONSTRUCTION INDUSTRY

-- Note by Germany --

This note is submitted by the Delegation of Germany to the Competition Committee FOR DISCUSSION at its forthcoming meeting to be held on 11-12 June 2008.

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1. Introduction

1. The construction trade's¹ situation depends heavily – arguably more than that of other sectors - on business cycle variations and structural developments. In Germany the economic situation of the enterprises and the employment situation in the construction sector have deteriorated since the mid-1990s. The decade between 1995 and 2005 was characterised by a significant reduction in the number of construction enterprises and drastically decreasing employment in the trade. Compared to the situation ten years earlier, in 2005 the number of enterprises with 20 and more employees was down by about 50% and employment was reduced by much more than 50%. Furthermore, in the period 1995-2005 the construction industry was confronted with declining turnover and reduced investment activity. The turnover of the sector in 2005 was slightly over half that of 1995 and investments were just about one third of the level of 1995.

2. Against this background in the following some competitive issues of the construction sector shall be examined. In particular, the market definition applied by the Bundeskartellamt (II.), supplier structure (III.) and anticompetitive activities in the sector (IV.) shall be outlined. Moreover, the arguments often raised by the construction industry against competition – "cost overruns" and "ruinous competition" – shall be discussed.

2. Market definition

3. In its decision-making practice regarding the main construction trade, the Bundeskartellamt differentiates between the product markets for building construction and for underground engineering construction.

4. As regards *underground engineering construction*, a further differentiation is made between road construction and other underground engineering markets (e.g. tunnel construction, underground cable construction, special underground construction). However, an alternative approach would be to combine road and underground construction as these services are offered comprehensively by many (larger) companies. A conclusive market definition, however, has not been made so far as the issue of the creation or strengthening of a dominant position has not presented itself in any of the markets.

5. In the case of the *building construction* industry the Bundeskartellamt differentiates between building and special building construction markets (e.g. hydraulic engineering, railway track construction). Furthermore, in the Hochtief/Philipp Holzmann proceedings a market for major projects with a contract volume of more than 25 million Euros was defined. Such a volume criterion was considered to be necessary for the definition of technologically and logistically complex construction services involving a high financial risk.² Furthermore, the definition of a separate market for projects and concessions (privately financed infrastructure projects such as e.g. airports or roads) has also been considered. However, here as well, a conclusive market definition has not been made so far as the issue of the creation or strengthening of a dominant position has not presented itself in any of the markets.

¹ According to the common definition in Germany the term "construction trade" comprises on the one hand "main construction trade" (Site preparation, building construction and underground engineering construction) and on the other hand "finishing construction trade (building installation, other construction work as well as the lease of building machinery with operating personnel). This contribution, however, is focused solely on building construction and underground engineering construction.

² WuW BkartA 2729. The Berlin Court of Appeals did not follow this first product market definition and revoked the Bundeskartellamt's prohibition decision (WuW/E DE-R 94). As Hochtief AG did not pursue the planned concentration, the issue could not be decided upon by the Federal Court of Justice.

3. Supplier structure

6. Generally it can be stated that new market entries are rare in those areas of the construction industry which require high investments or specific expertise. For example, in narrow technologically specialized markets with small market volumes (e.g. special underground engineering, railway track construction or hydraulic engineering) the number of suppliers tends to be relatively low as expensive machinery is required in these sectors. Due to the technological and economic requirements to be fulfilled by the companies, only a few suppliers are involved in major projects. Where, however, construction projects do not exceed certain dimensions (e.g. in housing and road construction), a large number of suppliers are active in the market.

7. All in all, according to public statistics, the supplier structure in the main construction industry in Germany presents itself as follows: There are about 74,800 undertakings. About 72,600 of these undertakings employ less than 50 staff members. Only 184 of these undertakings employ more than 200 staff members.³ Although the term “undertaking” (*Betrieb*) used in the public statistics is not identical with the concept of undertakings within the meaning of the German Act against Restraints of Competition (*Gesetz gegen Wettbewerbsbeschränkungen*, GWB), these figures tend to indicate a traditionally medium-sized structure of the German construction industry. In this respect it has to be considered that most of the large construction companies are active globally and thus achieve most of their turnover abroad. For example, the 2007 volume of orders of Hochtief AG for its business activities in Germany amounted to 3.9 billion Euros. Its international business, on the other hand, accounted for 29.89 billion Euros.⁴ It should also be noted that companies often set up syndicates for the realization of major construction projects. The share of external services provided in the main construction sector is thus generally high. Particularly the cost share for external services of companies with more than 1000 employees should be noted. It amounts to 46.6 per cent, i.e. a very substantial part of the services are provided by subcontractors.⁵

4. Competition policy issues in the construction industry

8. In the construction sector, the activities of the Bundeskartellamt during the last few years have largely been focused on merger control. This applies particularly to the road construction sector in which the market leader STRABAG (market share below 20 per cent) has acquired a large number of companies. However, most mergers of large construction companies tend to fall within the jurisdiction of the European Commission.

9. The picture is different in the sector for building materials, which is upstream of the construction sector. In the last few years most of the cartels uncovered by the Bundeskartellamt involved the building materials sector. In particular the 2003 cartel proceedings against companies in the cement sector should be mentioned. These resulted in fines amounting to a total of 702 million Euros being imposed on 12 undertakings and their managers.⁶ The companies had operated anti-competitive market allocation and

³ Source: Statistisches Bundesamt (Federal Statistical Office), *Produzierendes Gewerbe – Beschäftigte und Umsatz der Betriebe im Baugewerbe 2007*, Fachserie 4 / Reihe 5.1, available at: <https://www-ec.destatis.de/csp/shop/sfg/bpm.html.cms.cBroker.cls?cmspath=struktur,sfgsuchergebnis.csp>

⁴ Cf. information provided at <http://berichte.hochtief.de/gb07/42.jhtml>

⁵ Source: Statistisches Bundesamt (Federal Statistical Office), *Produzierendes Gewerbe – Kostenstruktur der Unternehmen im Baugewerbe 2005*, Fachserie 4 / Reihe 5.3, available at: <https://www-ec.destatis.de/csp/shop/sfg/bpm.html.cms.cBroker.cls?cmspath=struktur,sfgsuchergebnis.csp>

⁶ See Bundeskartellamt, Activity Report 2003/2004, Abbreviated Version, p. 33, available at http://www.bundeskartellamt.de/wEnglisch/download/pdf/05_TB_Kurz_e.pdf These decisions were appealed against. The appeal proceedings are still pending

quota agreements, some of them since the 1970s, and had continued to do so until 2002.⁷ Further important cartel proceedings were those against ready-mixed concrete manufacturers in which on account of quota agreements in several regional markets fines totalling 12.75 million euros were imposed against 62 companies and 3 individuals responsible.⁸ In the construction sector itself, however, there have been no recent indications of any cartel activities.

10. It should be noted, however, that following the entry into force of the Law on Combating Corruption on 20 August 1997, anticompetitive agreements in bidding procedures, which is probably the most common type of anticompetitive behaviour in the construction industry, were upgraded from an administrative offence to a criminal offence and are thus punishable under Section 298 of the German Criminal Code (StGB). As the prosecution of criminal offences committed by natural persons in Germany lies solely within the responsibility of the public prosecutor, since the introduction of the new criminal offence element, cases of bid-rigging have been prosecuted primarily by the respective public prosecutors. The Bundeskartellamt last imposed sanctions totalling 1.1 million DM against seven companies and persons responsible for collusive tendering in 1999 in fines proceedings which had been pending since the end of 1996. After evaluation of the extensive evidence the suspicion of collusion was confirmed in twelve invitations to tender for the construction of gas, water and district heating pipes, especially in south and south-west Germany between 1993 to 1996, with a contract volume of approx. 13 million DM.

5. "Cost overruns" and "Ruinous Competition"

11. Representatives of the construction industry tend to invoke "cost overruns" and "ruinous competition" to champion for more cooperation and less competition in their sector. These same arguments are used to defend a so-called "quality control strategy" initiated late last year by the "German Federation of the Construction Industry" (hereafter "Federation"). In the federation's assessment construction companies have had to take on several uncontrollable risks as a result of the poor economic situation in recent years in order to win any orders whatsoever. In particular the risk of obtaining approval from local authorities for the building project or of the construction site being contamination-free has often been passed on to the construction companies by the contracting entities.⁹ In order to stop this, in the federation's view, "ruinous" market behaviour, the formation of a condition cartel is aimed at. On the basis of these industry plans, it would no longer be possible to transfer certain risks in construction procedures by contract to the contractor. By precluding these risks to business the construction industry hopes to concentrate on "quality competition".¹⁰ The federation has submitted a draft proposal for the condition cartel to the Bundeskartellamt for its competitive assessment. The assessment is still ongoing.

12. Under Section 2 (2) ARC (old version) agreements and decisions, whose subject matter was the uniform application of general terms of business, were exempted from the prohibition of cartels, insofar as they did not relate to prices or price elements. This provision was eliminated with the 7th Amendment to the ARC in 2005. Condition cartels and recommendations still remain admissible, however, insofar as they fall under European law, under Art. 81 (3) EC, subject to an examination of the clauses in each individual

⁷ See Bundeskartellamt, Activity Report 2003/2004, Abbreviated Version, p. 33, available at http://www.bundeskartellamt.de/wEnglisch/download/pdf/05_TB_Kurz_e.pdf.

⁸ See Bundeskartellamt, Our Activities in 2005 and 2006, p. 45, available at: http://www.bundeskartellamt.de/wEnglisch/download/pdf/05_TB_Kurz_e.pdf Due to ongoing appeal proceedings the fines totalling 2.83 million euros (12 companies, 1 person responsible) are not yet final.

^{9c} Baubranche plant Kartell gegen Risiken", Frankfurter Allgemeine Zeitung of 28.12.2007, available at http://www.faz.net/s/Rub0E9EEF84AC1E4A389A8DC6C23161FE44/Doc~E0FDD52B963544309EFD53C770F5F~ATpl~Ecommon~Scontent.html?rss_aktuell

¹⁰ Loc.cit.

case. The draft submitted by the federation exceeds the threshold for a recommendation because it obliges the economic operators to apply the basic conditions as far as possible and thus constitutes a restraint of competition. The Bundeskartellamt is currently examining whether the draft fulfils the conditions for eligibility for exemption (achieving efficiency gains, indispensability of achieving these efficiency gains, allowing consumers a fair share of the resulting benefit, no elimination of competition).