

# The theoretical Economic, Institutional and Regulatory Framework of Protection of an economic Competition in the Czech Republic

**Ihona Bařantová**

Associate Professor,  
Department of Economics,  
Faculty of Law,  
Charles University,  
Prague, Czech Republic

## **Abstract**

*This article describes the theoretical economic, institutional and regulatory framework of protection competition in the Czech Republic as a Member State of the European Union. The article is divided into four parts. The first part deals with the substance of economic competition. There are mentioned economists who had a theoretical impact on the interpretation of the concept of economic competition. The second part describes the institutional and legal regulation of the Czech Office for the Protection of Competition and its relation to the EU law. In the Czech Republic, the basis of protection competition is Act No. 143/2001 Coll. Legal regulation of the protection of competition stems from competition law of the EU. The Treaty on the functioning of the European Union regulates cartel-related matters in Articles 101 and 102. The third part describes the Leniency Programme and the fourth part of the article refers to the judgment of the European Court of Justice (C 557/12), which described the effect of an umbrella pricing.*

**Keywords:** competition, cartel, anti-trust law, leniency, umbrella pricing

## **Introduction**

This article describes the theoretical economic, institutional and regulatory framework of protection of an economic competition in the Czech Republic as a Member State of the European Union. A competition is an economic concept. Some economists and policy-makers have opinion that only free market is effective. Effective market competition is the main driving force behind overall competitiveness and economic growth. Therefore for this reason, a protection of a policy competition and competition laws have been born. The European Common Market and the globalized economy also require international cooperation in the protection of competition. Laws and regulations of protection of competition may be also formed by judgements of Court. The judgements and court decision may be feedback to the economic theory of competition. The article stresses the connection of the law and economics.

### The theoretical economic framework

For the functioning of a market economy are essential private property and the existence of a competitive surroundings. The aim of market with the competition is to allocate resources according to the preferences of consumers and the coordination of a large number of individual negotiations between market participants. The result is an efficient use of scarce resources. The ideal competitive environment in economics textbooks refers to perfect competition. But it is an economic model. The economic reality is imperfectly competitive (Blair, Sokol 2015). English economist Joan Robinson (1903–1983) and her book “*Economics of Imperfect Competition*“ and American economist Edward Chamberlin (1899–1967) and his book “*The Theory of Monopolistic Competition: A Re-orientation of the Theory of Value*“ are considered to be the foundations of a market structure analysis and analysis of an imperfectly competitive market structure.

The significant inter-war Czechoslovak economist and politician Karel Engliš (1880–1961) supported the conclusions of the Austrian School regarding irreplaceability of economic individualism as the basis for a modern economic market system (Engliš 1938). In the Czechoslovak Republic during the years 1918–1938, the others authors focused on the topic of cartel regulative legislation (anti-trust law), for instance Ervin Hexner (1893–1968) and Imrich Karvaš (1903–1981). In 1932, Karvaš’s book “*Vliv kartelov na konjunktúru*” [“The influence of cartels to economic prosperity”] defined cartel agreements and the definition affected the lawmaker of Act No. 141/1933 Coll. L. O. (Collection of Laws and Ordinances), on cartels and private monopolies (Bažantová 2013).

Fundamentals of the theory of competition in the European Union are based on the working of the Freiburg School and its representatives Walter Eucken (1891–1950) and his book “*Grundsätze der Wirtschaftspolitik*“, Wilhelm Röpke (1899–1966), Franz Böhm (1895–1977) and Alfred Müller-Armack (1901–1978) and a politician Ludwig Erhard (1897–1977), (Bažantová 2012, p. 42-44).

Protection of economic competition aims to increase the competitiveness for the market surroundings or the removal of barriers that weaken competition. Competition in product relevant markets (goods and services) may be compromised by agreements between undertakings, abuse of a dominant position of competitors or business concentration. “Relevant market” means the market of goods which are identical, comparable or mutually interchangeable from the point of view of their characteristics, price and their intended use in an area, where the conditions of competition are sufficiently homogenous and which can be clearly distinguished from neighbouring areas. The best-known manifestation of prohibited agreements are cartels, i.e. horizontal agreements among direct competitors operating in the relevant market. These particular agreements are prohibited, as their object or effect has been the distortion of competition:

- direct or indirect fixing of prices or other business terms and conditions,
- limitation or control of production, sales, research and development or investments,
- division of markets or sources of supply,
- agreements making the conclusion of a contract subject to acceptance of further performance, which by its nature or according to commercial usage and fair business practices has no connection with the object of such contracts,
- application of dissimilar conditions to identical or equivalent transactions with other undertakings, thereby placing them at a competitive disadvantage,
- restricting competition among members of professional associations by decision of the management of such associations,
- obligation of the parties to the agreement to refrain from trading or other economic cooperation with undertakings not being party to the agreement, or to otherwise harm such undertakings (“group boycott”).

Prohibited agreements also include vertical agreements between a supplier and its customers. These are mainly agreements on resale price maintenance, where the supplier determines the prices at which its distributors should sell the suppliers' products to final consumers or other dealers, and enforces compliance with these prices.

A specific type of a cartel agreement in recent years is a prohibited agreement among bidders in public procurement, so-called "bid rigging". Tenderers often illegally cooperate to increase the contract price, to pre-determine the winner of the tender or to divide contracts by region. It is estimated that this causes an increase of price of public contracts averangely by 20 percent (UOHS 2013, p. 11).

### **Institutional and regulatory framework**

In the Czech Republic, the protection of competition is institutionally ensured by the Office for the Protection of Competition ("UOHS") which has its seat in Brno. The Government of the Czech Republic cannot interfere with the decisions of the Office for the Protection of Competition.

The Office for the Protection of Competition of the Czech Republic is the central authority of state administration responsible for creating conditions that favour and protect competition, supervision over public procurement and consultation and monitoring in relation to the provision of state aid (UOHS 2014, p. 6).

The basic principles of an economic competitive are set in the Act No. 143/2001 Coll. (Collection of Laws), on the Protection of Competition. The scope of competencies of the Office is governed by a special legal regulation Act No. 273/1996 Coll., on the scope of competence of the Office for the Protection of Competition, as subsequently amended by Act No. 187/1999 Coll. The Office for the Protection of Competition is headed by a Chairman, nominated by the Czech Government and appointed by the President of the Czech Republic. The term of office for the Chairman is six years, and nobody may serve more than two terms. The Chairman may not be a member of any political party or political movement.

The Office for the Protection of Competition of the Czech Republic supervises whether and how the undertakings fulfil the obligations arising for them from Act No. 143/2001 Coll. or the decisions of the Office adopted on the basis of this Act, publishes concentration notifications and its decisions which have come into force. In cases where the situation in the individual markets indicates distortion of competition, the Office shall conduct investigation into conditions of competition in such markets ("sector inquiry") and shall propose measures for their improvement. In particular, the Office shall issue reports which contain recommendations for improvement of competition conditions. If someone violate obligations (pursuant Act No. 143/2001 Coll.), the Office may impose remedial measures, the aim of which is to restore effective competition in the market and to stipulate reasonable deadline for their fulfilment. Imposition of remedial measures shall not exclude parallel imposition of a fine.

The EU law is applied in cases where anti-competitive conduct may affect trade among Member States. Legal regulation of the protection of competition stems from competition law of the European Union. The Treaty on the functioning of the European Union ("TFEU") regulates cartel-related matters in Articles 101 (ex Article 81 TEC) and 102 (ex Article 82 TEC). Since 2004, when the Czech Republic has become the Member State of the European Union, the Office for the Protection of Competition shall be empowered to apply (ex) Articles 81 and 82 of the Treaty to individual cases, if the behaviour of undertakings may affect trade between Member States within the meaning of Articles 102 and 103 of TFEU (Tomášek et al. 2013). For this purpose, the Office shall be entitled to:

- require that an infringement of Articles 102 and 103 of TFEU be brought to an end,
- impose order interim measures,

- accept commitments,
- impose fines.

The Office for the Protection of Competition has the most of international activities focused on the meetings with the European Commission, particularly with the Directorate General for Competition that is responsible for coordination of convergence process of competition rules in member states, as well as in third countries (UOHS 2011, p. 15). The cooperation is also organised at the level of international organisations and networks focused on the questions related to the functioning competition, for example: ECA (the European Competition Authorities), ECN (the European Competition Network), ICN (the International Competition Network), OECD (the Organization for Economic Cooperation and Development), UNCTAD (the United Nations Conference on Trade and Development).

### **The Leniency Programme**

According to the Office for the Protection of Competition, the detection of cartels is an undeniable priority of competition authorities around the world. Cartels have a devastating impact on competition in the market and therefore on the economy of a country. In the Czech Republic, participants of cartel agreements may face high fines for such agreement – up to 10 percent of the net turnover is achieved by the undertaking in the relevant market in the last accounting period. Given that prohibited agreements are inherently secret and that their participants often use sophisticated means to prevent their conduct from being revealed, competition authorities rely on an investigative tool (UOHS 2013, p. 11).

The Leniency Program is based on the concept of the Prisoner's dilemma and the Game Theory. John von Neumann (1903–1957) and Oskar Morgenstern (1902–1977) in their book “*Theory of Games and Economic Behavior*” (1944) described using models to study interactions with formalized incentive structures. The Game Theory is the study of strategic decision making. It is a general term for all mathematical models where the subjects are subjected to solving situations of conflict and cooperation. It is applicable in economic and political sciences. The term has been generalized for all situations where the person has to opt a certain strategy which helps him to maximize his personal benefit.

In the United States laws, the term “whistleblowing” is used. The term was firstly interpreted in False Claims Act 12 in the United States in 1863. The term describes an activity where one of the cartel participants decided to reveal the whole cartel with the usage of persuasive evidence and as a reward receives no or limited penalty for this illegal market conduct or behaviour. In Europe laws, including the Czech laws, the term “leniency” is used. The European Commission has opted for incorporation of leniency legislation since 2006. The legal framework for granting immunity were the Commission Notice on Immunity from fines and reduction of fines in cartel cases C-2006/298 of 8 December 2006 (Official Journal EU).

According to the European Competition Network, it refers to an immunity as well as to a reduction of any fine which would otherwise have been imposed on a participant in a cartel, in exchange for the voluntary disclosure of information regarding the cartel which satisfies specified criteria prior to or during the investigative stage of the case (ECN 2012).

The Office for the Protection of Competition sets out the framework for granting immunity from a fine imposition or reduction of the fine imposed upon undertakings which are or have been party to secret cartel agreements and which decide to cooperate with the Office during the investigation of the cartel agreement. The Office for the Protection of Competition introduced the Leniency Programme in 2001 and it has been used intensively since 2006, since the Office has annually received several applications for leniency (UOHS 2013, p. 11).

The Czech Leniency Programme was amended in 2013 to make it more attractive for cartel members and to offer greater incentives to disclose a cartel (the Section 22ba of Act No. 143/2001 Coll.), (Notice 2013a, 2013b). The Programme functions by promising impunity to members of a cartel that notify the competition authority of the existence of a prohibited agreement and provide sufficient evidence to break the cartel and punish its members of that cartel agreement. The Office for the Protection of Competition of the Czech Republic should not impose a fine, which it would otherwise impose, if the undertaking as the first provides the Office with such information and proofs, which enables the Office to conduct an investigation in place, or if the undertaking as the first provides the Office with such information and proofs, which enables the Office to prove the existence of a cartel agreement. On the basis of the Leniency Programme the Office may decrease a fine, for instance where an undertaking does not provide the Office with information and proof as the first; however, it provides it with such information and proofs, proving the existence of a cartel agreement. A reduction of fines can also be achieved by other members of a cartel if they apply for leniency during the investigation and present evidence with added informative value that helps to prove the existence of the cartel, i.e. secret horizontal agreements between two or more undertakings aimed at coordinating their competitive behavior in the market and/or influencing the competition through practices such as the fixing of purchase or selling prices or other trading conditions, the allocation of production or sales quotas, the sharing of markets including bid rigging and restrictions of imports or exports (Notice 2013a). Others fundamental changes have been as follows: strengthening the protection of leniency documents in the administrative file; successful applicants for leniency are not banned from participation in public procurement; if conditions are met, the criminal liability of a successful applicant for leniency expires under Section 248 (2) of the Criminal Code (UOHS 2013, p. 6).

In my opinion, in spite of the fundamental changes, the functionality of Leniency Programme is threatened by factors such as the risk of private actions for damages, especially at the level of the European Union, as shown by a judgment C-536/11 and by judgment C-557/12 of the European Court of Justice in Luxembourg (Official Journal EU).

### **The Judgment of the European Court of Justice and “Umbrella Pricing”**

In the context of the European Union it is the idea of Common Market that is threatened by conclusion of agreements distorting economic competition. In a judgment of the case “Kone and Others” of 5 June 2014 of the European Court of Justice in Luxembourg recalled the direct effect of the competition rules in the Common Market (C-557/12, Official Journal EU). The judgment has provoked the economic debate on the protection of competition and debate about accountability cartels. A market price is one of the main factors taken into consideration by an undertaking when it determines the price at which it will offer its goods or services. Where a cartel manages to maintain artificially high prices for particular goods and certain conditions are met, relating, in particular, to the nature of the goods or to the size of the market covered by that cartel, it cannot be ruled out that a competing undertaking, outside the cartel in question, might choose to set the price of its offer at an amount higher than it would have chosen under normal conditions of competition, that is, in the absence of that cartel. In such situation, even if the determination of an offer price is regarded as a purely autonomous decision, taken by the undertaking not party to a cartel, it must none the less be stated that such decision has been able to be taken by reference to a market price distorted by that cartel and, as a result, contrary to the competition rules, said the European Court of Justice.

The “umbrella pricing” is when undertakings that are not themselves party to a cartel, are benefiting from the protection of the cartel’s practices, knowingly or unknowingly set their own prices higher than they would otherwise have been able to under competitive conditions. Consequently, the victim of the umbrella pricing may obtain compensation for the loss caused by the members of a cartel, even if it did not have

contractual links with them, where it is established that the cartel at issue was, in the circumstances of the case and, in particular, the specific aspects of the relevant market, liable to have the effect of umbrella pricing being applied by third parties acting independently, and that those circumstances and specific aspects could not be ignored by the members of that cartel. It is for the referring court to determine whether those conditions are satisfied.

According to this judgment of the European Court of Justice, any person has entitled to claim compensation for the harm suffered where there is a causal relationship between that harm and an agreement or practice prohibited under Article 101 TFEU. The right of any individual to claim compensation for such a loss actually strengthens the working of the European Union competition rules, since it discourages agreements or practices, frequently covert, which are liable to restrict or distort competition, thereby making a significant contribution to the maintenance of effective competition in the European Union. In the absence of Community rules governing the matter, it is for the domestic legal system of each Member State to designate the courts and tribunals having jurisdiction and to lay down the detailed procedural rules governing actions for safeguarding rights which individuals derive directly from Community law, provided that such rules are not less favourable than those governing similar domestic actions (“principle of equivalence”) and that they do not render practically impossible or excessively difficult the exercise of rights conferred by Community law (“principle of effectiveness”).

At present, effective enforcement protection of competition and enforcement antitrust law is a complex issue. This poses challenges ahead for economists, lawyers and politicians.

## References:

- Bažantová, I. (2012), Velké korporace z pohledu dějin ekonomických teorií. In Bažantová, I. (ed.) *Ekonomie regulace: Velké korporace*. Praha, Nakladatelství V. Lelek 2012.
- Bažantová, I. (2013), Dílo Imricha Karvaše „Vliv kartelov na konjunktúru“ a jeho odkaz pro současnost. In Čičkánová, D. a kol. (eds.) *Bratislava Legal Forum 2013*. Univerzita Komenského v Bratislavě, Právnická fakulta 2013, p. 33-36.
- Blair, R. D., Sokol, D. D. (eds.), (2015), *The Oxford Handbook of International Antitrust Economics*. Vol. 2. Oxford University Press 2015.
- Chamberlin, E. (1933), *The Theory of Monopolistic Competition: A Re-orientation of the Theory of Value*. Harvard University Press 1933.
- ECN (2012), *Model Leniency Programme* (As revised in November 2012), available [http://ec.europa.eu/competition/ecn/mlp\\_revised\\_2012\\_en.pdf](http://ec.europa.eu/competition/ecn/mlp_revised_2012_en.pdf)
- Engliš, K., *Soustava národního hospodářství I., II*. Praha, Melantrich 1938.
- Neumann, J., Morgenstern, O. (1944), *Theory of Games and Economic Behavior*. Princeton, University Press 1944.

UOHS (2013a), Notice of the Office for the Protection of Competition of 4 November 2013 on Application of Article 22ba (1) of the Act on the Protection of Competition (Leniency Programme). Brno, 2013.

UOHS (2013b), Notice of the Office for the Protection of Competition of 8 November 2013 on the Procedure focused on speeding up the a Administrative Procedure using the Institute of Application of fine under Article 22ba(2) of the Act on the Protection of Competition (Settlement Procedure). Brno, 2013. Official Journal of the European Union, available [www.eur-lex.europa.eu](http://www.eur-lex.europa.eu)

Robinson, J. (1933), *Economics of Imperfect Competition*. London, Mcmillan 1933.

Tomášek, M., Týč, V. a kol. (2013), *Právo Evropské unie*. Praha, Leges 2013.

UOHS (2011) [The Office for the Protection of Competition], *Information Bulletin*, Brno, 2011, no. 2-3.

UOHS (2013) [The Office for the Protection of Competition], *Annual Report*, Brno, 2013.

UOHS (2014) [The Office for the Protection of Competition], *Office in a Nutshell*. Brno, 2014.