

**ANNUAL REPORT OF THE CROATIAN COMPETITION AGENCY  
FOR 2005**

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*\*This is the abridged version of the 2005 Annual Report of the Croatian Competition Agency providing an overview of the activities of the Agency in 2005.*

## INTRODUCTION

The Annual Report of the Croatian Competition Agency for 2005 for the first time covers both the activities of the Agency in the area of anti-trust and mergers and the area of state aid. This approach enables a clear insight into the most important activities of the Agency relating to the implementation of competition law and policy in the territory of the Republic of Croatia during the preceding year. The drafting of this report, which took place in the time of the start of the negotiations for the accession of the Republic of Croatia to the EU and the formal *screening* process (the analytical overview and evaluation of the degree of harmonisation of national legislation with the EC *acquis* in the area of competition), also gave us the opportunity for reconsidering the role of the state and jurisdiction, which apart from the Agency and other specific regulators, play an important role in the creation of competition law and policy both in the EU and in the Republic of Croatia.

The practices performed by the Agency in the past year partly reflect the economy of the country which is undergoing transition and takes the final steps in the privatisation process, particularly considering the restructuring and consolidation processes in the food manufacturing sector. Privatisation processes contribute to a redefinition of the role of the state in the economy, enable undertakings to adjust to market economy and take advantage of new possibilities for growth in the regional and international markets. Nonetheless, some areas like iron and steel industry and the shipbuilding sector still have to undergo the necessary restructuring and rationalization processes with the aim of keeping the undertakings in question in business under market conditions. It is therefore necessary first of all to adopt viable restructuring plans in these two sensitive sectors and particular undertakings, which is also a prerequisite in the ongoing negotiations between Croatia and the EU in the chapter covering competition policy.

Competition authorities of the EU Member States usually address serious competition issues and anticompetitive practices which may significantly affect, structurally or economically, the relevant markets. Therefore, they have adjusted their procedural rules so as to remove the workload from dealing with cases which do not appreciably restrict competition and provide for private enforcement. This Agency also focuses on cases with appreciable anticompetitive effects, given that the procedure and investigation involve considerable resources and complex legal and economic analyses. In the forthcoming period the Agency will in cooperation with other competent authorities devote its efforts to finding a more efficient and effective model of enforcement within its competences, but also in respect of raising the efficiency of the courts. This on the account of the fact that the existing system of the administrative court review concerning the legality of the decisions taken by the Agency as well as the imposition of sanctions which falls under the competence of misdemeanour courts, repeatedly proved inconvenient and inefficient. The

Agency finds the solution to this problem in joining the powers of courts in that of one court which would then decide in commercial matters. This system would undoubtedly contribute to fewer violations and provide for effective sanctioning. Its views to the problems concerned and other issues relating to the promotion of more efficient and effective competition policy mechanisms, the Agency has laid down in detail in its Strategy Statement for 2006 which is available on the web site of the Agency<sup>1</sup>.

The work of the Agency largely depends on its human resources. On the account of its powers of jurisdiction which cover all sectors besides banking and a part of telecommunications, and in line with the Pre-Accession Economic Programme (PEP) 2006-2008, it is necessary to improve the administrative capacity, which means additional and trained expert staff that will competently and efficiently deal with the implementation of competition rules.

The year of 2005 was marked by the start of the negotiations between the Republic of Croatia and the EU. The formal *screening* process which took place at the end of the year, gave us an additional insight into the degree of harmonization of the national legislation in the area concerned with the EC *acquis*. In its report which followed the *screening*, the European Commission stressed the need for further strengthening of administrative capacities of the Agency, which is the only way to ensure the investigation of certain markets and anticompetitive practices. In other words, the conditions for market entry, the requirements for the performance of certain professions and the enforcement mechanisms relating to imposition of fines for violations of competition law must reach the necessary degree of compatibility which will enable Croatia to be incorporated into the Community's internal market. It means that the establishment of a modern and effective competition system can ensure free movement of goods, persons, services and capital which is nowadays realized in the Community.

The pre-accession period must therefore be used for the preparation of the competition framework as a whole, with the view to achieving the standards and in line with the recommendations received from the negotiations, comparable to those applicable in the EU.

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<sup>1</sup> [www.aztn.hr](http://www.aztn.hr)

## **ACTIVITIES OF THE COMPETITION AGENCY IN 2005**

Competences of the Competition Agency in the areas of competition and state aid are regulated by the Competition Act (Official Gazette, No 122/2003) and State Aid Act (Official Gazette, No 140/2005).

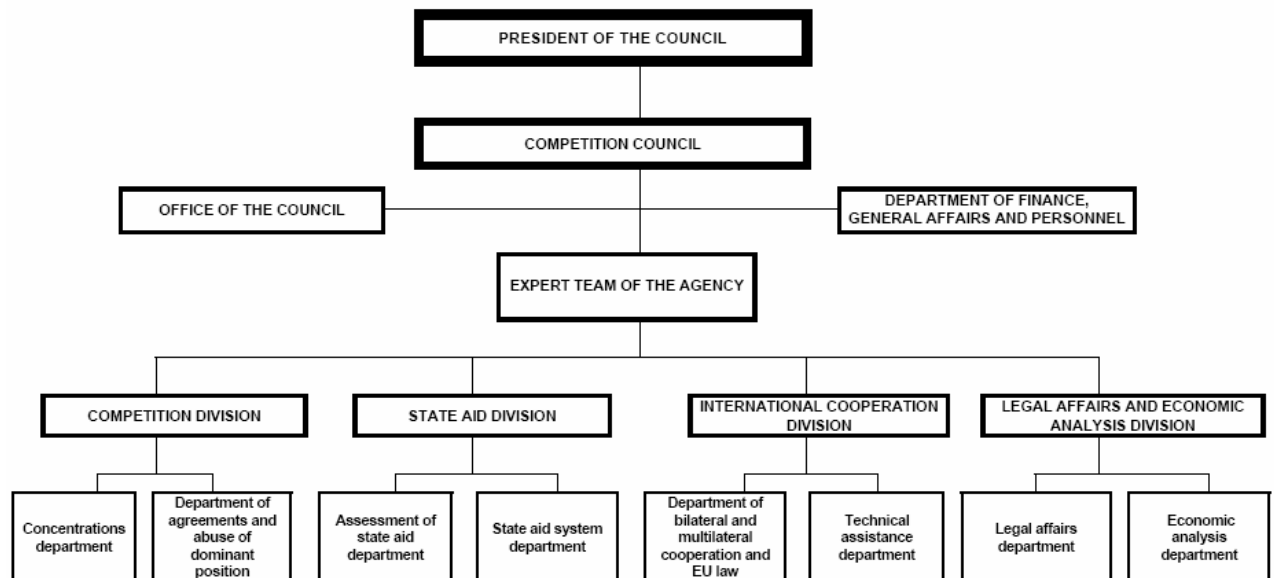
Within its scope of jurisdiction, in 2005 the Agency focused its activities on the completion of the legislative framework within the meaning of the fulfilment of the obligations undertaken under the Stabilization and Association Agreement (SAA) as well as strengthening of the implementation of the legislative framework concerned, through its substantive decisions and raising awareness of competition and state aid issues through cooperation with the authorities of similar jurisdiction and international organizations.

The enforcement record for 2005 consists of a total of 328 resolved cases, 237 of this total covered anti-trust and mergers whereas 91 were in the area of state aid. Apart from the intensified work on the cases (summaries of selected cases may be found below), the Agency also focused on competition advocacy, especially in the area of state aid, where it issued opinions on proposed draft laws and other legal acts and encouraged further education and training of related public administration authorities and promoted knowledge and perception of competition law and policy among the general public. The support provided by foreign consultants within EU projects was here of great importance.

The Competition Act also stipulates the organization of the Agency, work and scope of the Competition Council, terms of appointment, terms of office and relief from office of the president and members of the Council, regulates the decision making procedure and administrative and professional activities of the expert team. Other relevant issues, such as a detailed internal structure of the Agency, its management and performance are provided by the Statute of the Agency. The Competition Council is the managing body of the Agency; it consists of five members, one of which is the president of the Council, and takes its decisions at regular sessions. Its work is regulated by the Council's Standing Orders.

The expert team of the Agency performs administrative and professional activities and reports to the Council. The part of the expert team which is directly involved in carrying out the procedures in respect of particular cases, so called case handlers who work in two separate divisions of the Agency, Competition Division and State Aid Division (see below) and deal with competition issues (anti-trust and mergers) and authorisation, monitoring of the implementation and recovery of state aid respectively, in 2005 amounted to 25 highly qualified economists and lawyers holding a university degree. Three of the stated number hold a masters degree, most lawyers have passed their bar exam. The staff is young – the average age of the expert team is 32.

## Internal organization of the Croatian Competition Agency



On 31 December 2005 the Agency had 37 employees (plus five members of the Council), which is 28 % more than in 2004. Nonetheless, this growth of staff does not by far mean that the expert team of the Agency will in future be able to stand the work load relating to the implementation of competition and state aid rules. The optimum number of employees necessary for the implementation of the legislation in question is 64. This number has been estimated by way of comparison with similar bodies of EU Member States, such as Slovakia, Lithuania, Latvia and Estonia, which given the scope of activity, market size and population, proved to be adequate examples.

### *The budget of the Agency in 2005*

The funds for the activities pursued within the scope of the Agency are provided from the budget of the Republic of Croatia<sup>2</sup>. The budget of the Agency for 2005 after the budget revision amounted to 9,325,000 HRK which is 41.64 % more as compared to 2004.

*The following table shows the funds approved (after the budget revision) and total expenditure of the Agency from 2003 – 2005*

Item	2003	2004	2005	Index 2005/2004
<b>A. FUNDS APPROVED FROM THE CENTRAL BUDGET</b>	<b>6.317.499</b>	<b>6.583.685</b>	<b>9.325.000</b>	<b>141,64</b>
<b>1. Current expenditure</b>	<b>5.047.263</b>	6.407.507	8.233.188	128,49
1.1. salaries	3.099.483	4.578.383	5.764.377	125,90
1.2. material expenditure	1.947.780	1.829.124	2.463.316	134,67
1.3. financial expenditure	-	-	5.495	-
<b>2. Capital expenditure</b>	<b>682.615</b>	192.073	240.476	125,20
<b>B. TOTAL EXPENDITURE (1+2.)</b>	<b>5.729.878</b>	<b>6.599.580</b>	<b>8.473.664</b>	<b>128,40</b>
<b>C. BALANCE (A.-B.)</b>	<b>587.621</b>	<b>-15.895</b>	<b>851.336</b>	<b>-</b>

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<sup>2</sup> Article 30, paragraph (7) of the Competition Act.

## **1. ANTI-TRUST AND MERGERS**

Since its establishment in 1997, the Agency has been continuously involved in the activities relating to enhancement of the legislative framework concerning competition. Based on its experience and everyday practice it has proposed new solutions to the problems which would ensure advancement to a higher level of competition in the Republic of Croatia. At the same time, in its everyday work the Agency always takes account of the best practices of other countries, especially EU Member States and those with a longer tradition in the application of market economy standards, and endeavours to promote competition law and policy, within its own national legal system, which would adequately correspond to the EU standards of legal protection in this area.

The existence of a legal framework based on market economy and competition rules which is in line with EU *acquis* is one of the basic criteria for the assessment of readiness and ability of the Republic of Croatia for EU membership. This is also a set prerequisite for successful negotiations for the accession of Croatia to the EU under Chapter 8: Competition Policy. Nevertheless, the established national legal framework must also be measurable by its application in the everyday work of competition authorities. In this sense, the objective of the Agency is to participate actively in the establishment of and co-operation with other similar authorities in the Republic of Croatia, such as specific regulators, the Croatian National Bank and others, which within their scope of work, perform similar activities in respect of competition in particular sectors. This interaction with other relevant competition authorities and sector-specific regulators, particularly by putting formal arrangements in place for liaising with the regulators concerned, facilitates the enforcement of competition rules, promotes competition law and policy and contributes to the fulfilment of the criteria for EU membership.

### **1.1. Legal framework**

The adoption of the last two regulations provided by the Croatian Competition Act – the Regulation on block exemption granted to certain categories of technology transfer agreements and Regulation on block exemption granted to insurance agreements – concluded the process of bringing into compliance of the national legislation with the EU competition rules. The adopted rules ensure legal certainty for all stakeholders, particularly domestic and foreign undertakings. The Croatian Competition Act and relevant secondary legislation have been translated into English and published on the web site of the Agency, whereas the relevant EU legal acts – regulations, guidelines and communications of the European Commission – have been translated into Croatian and are also available on the web site of the Agency.

Under the adopted regulations, the undertakings may enjoy the benefits of the "safe harbour" where the market share of the undertakings – parties to the

agreement, does not exceed the prescribed highest shares, and where the agreements concerned do not contain hard core restrictions and, as a rule, have positive effects on competition, thereby contributing to improving the production or distribution of goods and/or services, while allowing consumers a fair share of the resulting benefit, as long as the exempted agreements do not afford the undertakings – parties to the agreement the possibility of eliminating competition in respect of a substantial part of the products in question.

The Regulation on block exemption granted to certain categories of technology transfer agreements is taken here as an example to illustrate hard core restrictions which these agreements may not contain, and consequently, may as such not benefit from the block exemption provided by this Regulation, regardless of the market share held by the parties to the agreement. Such agreements are within the meaning of Article 9 of the Competition Act null and void.

*Hard core restrictions contained in technology transfer agreements*

<b>HARD CORE RESTRICTIONS WITHIN AGREEMENTS BETWEEN COMPETING UNDERTAKINGS</b>	
<b>1. the restriction of a party's ability to determine its prices when selling products to third parties</b>	
<b>2. the limitation of output</b>	<b>NOT PROHIBITED</b> <i>limitations on the output of contract products imposed on the licensee in a non-reciprocal agreement or imposed on only one of the licensees in a reciprocal agreement</i>
<b>3. the allocation of markets or customers</b>	<i>the allocation in the case of:</i> <ul style="list-style-type: none"> <li><i>a. the obligation on the licensee(s) to produce with the licensed technology only within one or more technical fields of use or one or more product markets;</i></li> <li><i>b. the obligation on the licensor and/or the licensee, in a non-reciprocal agreement, not to produce with the licensed technology within one or more technical fields of use or one or more product markets or one or more exclusive territories reserved for the other party;</i></li> <li><i>c. the obligation on the licensor not to license the technology to another licensee in a particular territory;</i></li> <li><i>d. the restriction, in a non-reciprocal agreement, of active and/or passive sales by the licensee and/or the licensor into the exclusive territory or to the exclusive customer group reserved for the other party;</i></li> <li><i>e. the restriction, in a non-reciprocal agreement, of active sales by the licensee into the exclusive territory or to the exclusive customer group allocated by the licensor to another licensee provided the latter was not a competing undertaking of the licensor in the relevant market at the time of the conclusion of its own licence;</i></li> <li><i>f. the obligation on the licensee to produce the contract products only for its own use provided that the licensee is not restricted in selling the contract products actively and passively as spare parts for its own products,</i></li> <li><i>g. the obligation on the licensee, in a non-reciprocal agreement, to produce the contract products only for a particular customer, where the licence was granted in order to create an alternative source of supply for that customer.</i></li> </ul>
<b>4. the restriction of the licensee's ability to exploit</b>	<i>restriction of the ability of any of the parties to the agreement to carry out research and development, unless such restriction is</i>

<b>its own technology or the restriction of the ability of any of the parties to the agreement to carry out research and development</b>	<i>indispensable to prevent the disclosure of the licensed know-how to third parties</i>
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<b>HARD CORE RESTRICTIONS WITHIN AGREEMENTS BETWEEN NON-COMPETING UNDERTAKINGS</b>	
<b>1. the restriction of a party's ability to determine its prices when selling products to third parties, without prejudice to the possibility of imposing a maximum sale price or recommending a sale price, provided that it does not amount to a fixed or minimum sale price as a result of pressure from, or incentives offered by, any of the parties</b>	
<b>2. the restriction of the territory into which or of the customers to whom, the licensee may passively sell the contract products</b>	<p style="text-align: center;"><b>NOT PROHIBITED</b></p> <ul style="list-style-type: none"> <li><i>a. the restriction of passive sales into an exclusive territory or to an exclusive customer group reserved for the licensor;</i></li> <li><i>b. the restriction of passive sales into an exclusive territory or to an exclusive customer group allocated by the licensor to another licensee during the first two (2) years that this other licensee is selling the contract products in that territory or to that customer group;</i></li> <li><i>c. the obligation to produce the contract products only for its own use provided that the licensee is not restricted in selling the contract products actively and passively as spare parts for its own products;</i></li> <li><i>d. the obligation to produce the contract products only for a particular customer, where the licence was granted in order to create an alternative source of supply for that customer;</i></li> <li><i>e. the restriction of sales to end-users by a licensee operating at the wholesale level of trade;</i></li> <li><i>f. the restriction of active or passive sales to unauthorised distributors by the members of a selective distribution system.</i></li> </ul>
<b>3. the restriction of active or passive sales to end-users by a licensee which is a member of a selective distribution system and which operates at the retail level, without prejudice to the possibility of prohibiting a member of the system from operating out of an unauthorised place of establishment</b>	

In spite of the fact that all secondary legislation provided by the Competition Act has eventually been adopted, the alignment process has though not been completed. It has been also stated in the opinion given by the European Commission that further adjustment to EU legislation is needed in some other sectors, transport for example. In addition, the past years of the implementation of competition rules provided by the existing Competition Act, proved the necessity of an urgent revision and modification of the act concerned. The proposed changes include the removal of the deficiencies particularly in respect of the judicial review of the decisions taken by the Agency, introduction of the ability of the Agency to impose sanctions and introduce immunity programme (leniency) for cartels, i.e. the total or partial reduction of fines applied to undertakings, "whistle blowers" who inform the Agency and demonstrate evidence of the existence of a hardcore cartel. The expert team of the Agency in collaboration with the European consultants has been working on the proposal for amendments to the 2003 Competition Act which will be communicated to the Ministry of Justice by the end of the year 2006.

## **1.2. Activities of the Agency in respect of anti-trust and mergers**

The scope of the activities of the Agency in this segment of its jurisdiction consists particularly of the administrative work relating to:

- assessment of restrictive agreements between undertakings;
- establishment of abuse of a dominant position of undertakings, and
- assessment of compatibility of concentrations between undertakings.

Nevertheless, the Agency also performs the following important activities:

- it issues opinions on compatibility of the proposed draft laws and other legal acts with the provisions of the Competition Act and opinions on other issues which may appreciably affect competition;
- its also gives expert opinions upon request of the parties involved, other natural and legal persons, attorneys etc. in respect of the interpretation of competition rules, and
- compiles statistical reports for the purposes of international cooperation.

Total number of cases/files received and closed (anti-trust, mergers, advocacy - legal opinions) in 2005

Category of case/file	No of cases/files opened in 2005	No of decisions/ opinions/others in 2005*
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<b>I ADMINISTRATIVE CASES:</b>		
1 ABUSES	21	3
2 AGREEMENTS	4	5
3 CONCENTRATIONS	30	26
<b>Total:</b>	<b>55</b>	<b>34</b>

<b>II ADVOCACY (OPINIONS):</b>		
1. OPINIONS ON DRAFT LEGISLATION	15	9
2. OTHER EXPERT OPINIONS UPON REQUEST OF THE PARTIES	42	50
<b>Total:</b>	<b>57</b>	<b>59</b>

<b>Subtotal ADMINISTRATIVE CASES + ADVOCACY (I+II)</b>	<b>112</b>	<b>93</b>
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<b>III. OTHER NON-ADMINISTRATIVE FILES</b>	67	58
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<b>IV. STATISTICAL REPORTS, INTERNATIONAL PROJECTS AND COOPERATION</b> (international cooperation; cooperation with Croatian institutions and other bodies)	53	53
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<b>TOTAL (I-IV):</b>	<b>232</b>	<b>204</b>
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\*including cases/files opened in preceding years (2003 and 2004) which were resolved/closed in 2005

### **1.2.1. Assessment of agreements between undertakings**

The assessment of agreements between undertakings, particularly of hard-core cartels, is one of the most challenging tasks of all competition authorities in the EU and worldwide. The part of the activities in respect of uncovering of hard-core cartels is even more difficult for this Agency, due to the fact that, although the Croatian Competition Act provides for high fines in case of the conclusion of prohibited agreements (the fine amounts to up to 10 % of the total annual turnover of the undertaking/s concerned in the year preceding the year when the agreement was entered into), this is far from being enough in the combat against cartels.

Why is that so? Neither the Croatian Competition Act, nor the minor offence courts provide for immunity (leniency) programme for cartels, i.e. the total or partial reduction of fines applied to undertakings which inform the Agency and demonstrate evidence of the existence of a hardcore cartel. This instance has proved to be vital in the investigation and combat of cartels in the USA and EU Member States. The practice of the European Commission proves that no cartel case would have been successfully solved without the cooperation of the undertakings concerned with the antitrust authorities.

The detection of cartels also requires fulfilment of some additional standards. A separate section for investigation of cartels with an adequate number of staff should be established within the Agency. The staff would require expert lawyers and economists, but also some IT experts, specialists in computer forensics. Such separate cartel sections exist in a number of EU Member States, but one example, that of Hungary, is particularly interesting, on account of the fact that this section consisting of 10 employees already yields results in uncovering cartels and imposing high fines for infringements. For the sake of comparison, 9 employees of the Competition Division of the Croatian Competition Agency must deal with assessment of agreements, abuse of a dominant position and compatibility of concentrations.

Not only are cartel agreements restrictive agreements. Restrictive of competition may also be agreements between undertakings which are not competing undertakings, such as agreements between the manufacturers of motor vehicles and their distributors or repairers, those between suppliers of raw materials and manufacturers, or franchise holders and franchise acquirers etc. We are talking here so called vertical agreements. Nonetheless, restrictive of competition may very often also be other categories of agreements such as technology transfer agreements, insurance agreements, R&D and specialisation agreements etc.

During 2005 the Agency closed the proceedings in five cases of allegedly restrictive agreements. The assessment proceedings proved four of this total number of cases to be prohibited agreements (two cartel agreements and two vertical agreements containing hard-core restrictions), while in one case it was

established that the agreement in question may not be considered prohibited and the request of the party was subsequently rejected.<sup>3</sup>

#### 1.2.1.1. Restrictive agreements – Selected case 1

##### ***P.Z. Auto d.o.o - Kolnoa – prohibited agreement***<sup>4</sup>

On the basis of the decision of the Competition Council, the Agency decided that the agreement concerning the sales of gear shift mechanical blocks in the territory of the Republic of Croatia entered into between the undertaking *P.Z. Auto* and the undertaking *Kolnoa* on 1 December 2003, is prohibited and consequently void.

The undertaking *P.Z. Auto*, authorised car dealer, undertook the obligation to purchase the *Construct/Mul-t-lock Cylinder Inside and Mul-t-lock* as well as other products of the same manufacturer from *Kolnoa*. *Kolnoa*, authorised importer of the gear shift mechanical blocks in question, on its part undertook the obligation to finance professional staff training of the *P.Z. Auto* as well as to provide training for its buyers' professional staff, which is concerned to bring additional financial benefit to the buyers of the *P.Z. Auto*, and which is one of the features of exclusive purchase agreements. The agreements in question are not prohibited as long as they are concluded by the undertakings which do not hold a dominant position in the market and provided that they do not contain restraints laid down by separate rules. Nevertheless, in the case concerned, given that the undertaking *Kolnoa* holds a high degree of dominance in the market, between 80% and 90% of the market share, whereas *P.Z. Auto* by its distribution network consisting of authorised distributors and repairers significantly contributes to its turnover, such an agreement may not be covered by the exemption of certain categories of vertical agreements provided for in the Competition Act.

Other than the above mentioned, the agreement in question has also represented a basis for a direct obligation causing the authorised distributors and service providers within the *P.Z. Auto* distribution system, not to sell the substitute products, in this particular case mechanical locks, of particular competing suppliers, in this particular case of the undertaking *Magnat*, authorised importer for Croatia of *Defend-lock* mechanical blocks, the sole competitor in the market, if they wish to achieve financial benefits. *Magnat*, which applied for the assessment of agreements concerned, was by these exclusive purchase

<sup>3</sup> Besides the above mentioned five cases of allegedly restrictive agreements, in 2005 the Agency carried out the assessment in four more cases relating to the assessment of agreements upon the request of the parties. In three cases thereof it was decided that there were no legal grounds for the initiation of the proceedings within the meaning of the Competition Act, whereas in one case the Agency terminated the proceedings on the basis of lack of legal grounds for further actions.

<sup>4</sup> The decision of the Agency, Class: UP/I-030-02/2004-01/38, Reg. no: 580-02-05-10-73, of 4 October 2005, was published in Official Gazette, No 138/05 and on the web site of the Agency.

agreements and the business plan agreements excluded from the market in question. The economic analysis carried out by the Agency also proved the anti-competitive effects due to restrictions contained in the agreement concerned relating to financial benefits offered by imposing non-compete obligations.

In its decision, the Competition Council noted that the ability of the authorised distributors and service providers of the undertaking *P.Z. Auto* to purchase the gear shift mechanical blocks from the undertaking *Kolnoa*, and other relevant products from the suppliers they may freely choose, remains undisputable. However, provided that such agreements do not contain hard core restrictions as laid down in the Regulation on block exemption granted to certain categories of vertical agreements. Such a decision must exclusively be the result of the authorised distributors' and service providers' free choice, and under no circumstances it may be a directly or indirectly imposed obligation on the part of the undertaking *P.Z. Auto*.

#### 1.2.1.2. Restrictive agreements – Selected case 2

##### **Protocol to fix the price and predetermine contractors concluded between 17 undertakings engaged in humanitarian demining – cartel agreement<sup>5</sup>**

On the basis of the decision of the Competition Council, after having carried out the assessment of the agreement entered into between seventeen undertakings engaged in humanitarian demining, upon the request of the Croatian Mine Action Centre from Osijek, the Agency declared the agreement concerned null and void. Reference is made to a series of legal acts (Protocol to fix the price and predetermine contractors, Statement on compliance with determined prices, non-provision of capacities and payment of bills of exchange, Agreement on deposit and safeguarding of bills of exchange), subsequently establishing that the seventeen signers of the contact concerned directly determined demining prices and shared the market by predetermining individual bidders.

In this particular case, the undertakings in question concluded a cartel agreement by directly fixing the price for demining per m<sup>2</sup> in a particular territory of the Republic of Croatia, thereby sharing the market and predetermining which of the signers will provide demining services and under which price they will compete for public tenders. The agreements in question also provided for sanctions for non-compliance with the obligations concerned.

Taking into account the importance of humanitarian demining for the Republic of Croatia, this service, its providers and the market may only be regulated by law, which would ensure access to the market concerned to undertakings which are

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<sup>5</sup> The decision of the Agency, Class: UP/I-030-02/2004-01/95, Reg. no: 580-02-05-07-75, of 4 October 2005, was published in Official Gazette, no 119/05 and on the web site of the Agency.

registered for the provision of the services in question and have obtained all statutory certificates and licenses.

### **1.2.2. Establishment of abuse of a dominant position**

Although the mere fact that an undertaking holds a dominant position in the relevant market does not automatically mean that there are anti-competitive effects in the market concerned, the behaviour on the market of the undertaking concerned is nevertheless a spot of special concern of this Agency.

Despite the existing general public opinion, the task of this Agency is neither to prevent the growth of undertakings where this growth is a result of their effective business activities, high quality products or competitive prices which they may offer to the consumers, nor to encourage the undertakings which make losses on account of their own failures to remain on the market. Nevertheless, the task of the Agency is to detect and prevent all forms of abuse of dominance on the part of the undertakings who hold a dominant position in the market with the aim of denying entry to the market to new competitors or foreclosing the market for incumbent firms, unduly preventing, restricting or distorting competition in the market concerned. It is therefore of key importance for the Agency to act as a deterrent to such behaviour and to raise awareness of such abusive practices among undertakings. Such deterrent policy is essential in the Republic of Croatia and subsequently in the work of this Agency, taking into account the constant lack of administrative capacity, inability of the Agency to impose sanctions for infringement of competition law together with the existing system for imposition of sanctions through the minor offence court which repeatedly proved inadequate.

The Croatian Competition Act provides particularly for the following forms of abuse of a dominant position by undertakings:

1. directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions;
2. limiting production, markets or technical development to the prejudice of consumers;
3. applying dissimilar conditions to equivalent transactions with other undertakings, thereby placing them at a competitive disadvantage;
4. making the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.

During 2005 the Agency received 21 requests for initiation of the proceedings relating to the establishment of abuse of a dominant position, whereby the above listed forms of abuse were equally represented. 27 cases dealing with alleged abuse of dominance were resolved<sup>6</sup>, the proceedings in 3 cases were closed (in

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<sup>6</sup> The number of resolved cases relating to the establishment of abuse of a dominant position also includes the cases received in the preceding years of 2003 and 2004, given that the proceedings in the latter cases have been closed in this report period.

one case it was decided on abuse of dominance) and in 21 cases there were no grounds for the initiation of the proceedings, whereas in 3 cases the Agency terminated the proceedings.

#### 1.2.2.1. Abuse of a dominant position – Selected case 3

##### ***Ponikve d.o.o., Krk – abuse of a dominant position***<sup>7</sup>

In the case of the undertaking *Ponikve d.o.o. Krk* the Agency decided that the undertaking in question, followed by the initiative of the Croatian Consumers' Association, abuses a dominant position by imposing unfair prices in the relevant market of households' water supply, sewage and waste water purification on the island of Krk.

Here are the key quotes of the Agency's decision: "On the basis of a thorough economic analysis, it has been established that *Ponikve d.o.o.* discriminates the consumers by directly imposing unfair water prices, encouraging the consumers who annually spend greater amounts of water to pay lower prices. Such water supply tariffs created on the basis of consumers' categories (32 categories have been established according to the annual water use) discourage the users to spend water rationally or proportionally to their actual needs. The consumers actually benefit from the uncontrolled or excessive water consumption, by paying lower water charges. Not only does this categorisation place particular consumers at a disadvantage towards other consumers, but also applies dissimilar conditions to consumers within the same group."

*Ponikve d.o.o.* has been ordered by the Agency, to establish, within a set period of three months, a new price list which would set the price for its services by a free choice of a tariff model by consumers. The new tariffs must not impose unfair prices, but should ensure the effective households' water supply, sewage and waste water purification and at the same time aim at the protection of the water resources of the Republic of Croatia. The comparative analyses carried out by the expert team of the Competition Agency relating to the water markets in Croatia and in the EU, unquestionably showed that in spite of the scarceness of water and its special significance as a renewable resource, it is possible to establish a water price system which would not impose unfair prices to the consumers.

#### **1.2.3. Assessment of compatibility of concentrations between undertakings**

Concentrations between undertakings are legitimate forms of creation of an economic entity where a change of control on a lasting basis results from the

<sup>7</sup> The decision of the Agency Class: UP 030-02/2004-01/66, Reg.no:580-02-05-41-42 of 20 October 2005 was published in Official Gazette No 132/05 and on the web site of the Agency.

merger of two or more previously independent undertakings or the acquisition, by one or more persons already controlling at least one undertaking.

So, when we talk concentrations, we cover all different legal forms such as mergers and acquisitions, acquisition of control or decisive influence, or the creation of a joint venture constituting a concentration. In the context of globalisation processes, concentrations of undertakings have become most usual way in which undertakings try to increase their economic, financial and, consequently, their market power.

In the Republic of Croatia, the creation of concentrations between undertakings is being controlled by separate independent authorities, one of them which is also this Agency. It is beyond doubt that creation of concentration, as a rule, affects competition. These effects may be positive or negative. It is the task of the Agency to carry out the appraisal and decide on the actual or potential positive or negative effects of the concentration in question.

A concentration shall be prohibited only if its implementation produces effects which significantly impede effective competition. In other words, a concentration with certain negative effects on competition, but which are not significant, shall not be automatically prohibited.

The wide spread opinion that concentrations between undertakings are *per se* detrimental to competition and as such must generally be prohibited does not reflect the actual state of affairs. The number of prohibited and conditionally compatible concentrations in Europe and world wide, as well as in Croatia, is negligible compared with the total number of implemented concentrations and does not exceed 1 % thereof.

Appraisal of concentrations in the Republic of Croatia in 2005 indicates several common features of concentrations.

First, all parties to concentrations in the Croatian markets are very often successful, profit making undertakings (e.g. *Billa Nekretnine/Minaco*, *ERA-Tornado/RM-Trgohit* and *Mercator-H/ERA Tornado*). Nevertheless, it should be taken into account that the Agency does not perform the appraisal of all concentrations, but only of those undertakings parties to concentrations which meet the requirements relating to their aggregate thresholds as defined by the Competition Act. Given that aggregate turnover worldwide and in the territory of Croatia is taken as a relevant criteria in the assessment of compatibility of concentrations, data on possible concentrations between relatively small and presumably unsuccessful undertakings are not available to the Agency.

Second, the appraisal of concentrations related mostly to horizontal mergers, i.e. concentrations between competing undertakings (e.g. *Europapress*

*holding/Slobodna Dalmacija, Billa Nekretnine/Minaco, ERA-Tornado/RM-Trgohit, Mercator-H/ERA Tornado and Styria Media International (Austrija)/X-Press).*

Third, some of the concentrations which were implemented in 2005 were by their nature vertically integrated concentrations. On one hand, there were horizontal mergers with appreciable vertical effects (e.g. *Europapress holding/Slobodna Dalmacija* and *Distri-press/Europapress holding/Ivan Granić/Veltrade/Adris grupa*), whereas, on the other hand, some vertical concentrations produced significant horizontal or conglomerate effects (e.g. *Agrokor/PIK Vrbovec* and *Agrokor/Belje*).

The fourth feature indicates that the undertakings with their seat outside Croatia have chosen concentrations they entered into with the Croatian incumbent firms rather than opting for Greenfield investment. These have usually been Croatian undertakings holding a relatively low market share and using a rather obsolete technology but, at the same time, with valuable brands and/or important human resources. An example of such a concentration is the one between *CME Media Enterprises (Netherlands)/NOVA TV* and *Styria Media International (Austria)/X-Press*.

The fifth common feature is the trend which indicates certain growth in the number of concentrations in which successful undertakings holding appreciable market power acquire and rescue the ones which are less successful, or are almost certainly facing bankruptcy or wind-up. Such concentrations ensure brand survival and know-how preservation of undertakings that would predictably soon disappear from the market, thereby retaining wider choice for consumers (e.g. *Agrokor/Belje*, and *Europapress holding/Slobodna Dalmacija*).

Sixth, a considerable number of concentrations have been implemented in the media sector. Here are particularly meant the concentrations in the publishing sector including press distribution at both the level of retail and wholesale (e.g. *Styria Media International (Austrija)/X-Press*, *Europapress holding/Slobodna Dalmacija* and *Distri-press/Europapress holding/Ivan Granić/Veltrade/Adris grupa*). On the account of the fact that any change in ownership structure in this sector is considered a concentration and as such is subject to obligatory notification, the number of concentrations in the media industry is particularly high. Nevertheless, possible significant effects on competition could have been caused only by one concentration, the one between the undertakings *CME Media Enterprises (Netherlands)/NOVA TV*.

In 2005 the Agency received a total of 30 notifications of concentrations between undertakings (prior to their implementation), and it closed the proceedings in 31 cases relating to the assessment of compatibility of concentrations<sup>8</sup>. 18

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<sup>8</sup> 21 cases were registered in 2005, while 5 cases relating to the assessment of compatibility of concentrations were handled on the basis of notifications received in 2004. In 3 cases the Agency dismissed the notification on the basis of lack of grounds for initiation of the proceedings whereas

notifications of the above mentioned total were in respect of concentrations between undertakings in the media sector and have been handled pursuant to the Electronic Media Act (Official Gazette, No 122/03)<sup>9</sup>.

Two planned concentrations have been declared conditionally compatible in the second Phase. These concentrations raised competition concerns and as such underwent special investigation proceedings which must be concluded by the decision of the Competition Council within three months following the day on which the proceedings were initiated. Pursuant to Article 26 paragraph (4) of the Competition Act, the Agency decided that anticompetitive effects of the concentrations concerned may be remedied by imposing conditions and obligations as well as time limits for the fulfilment thereof. The concentrations in question have been selected and described below.

#### 1.2.3.1. Assessment of concentrations – Selected case 4

##### **Agrokor d.d. Zagreb / PIK Vrbovec d.d. Vrbovec – Conditionally compatible concentration<sup>10</sup>**

The specificity of the concentration in question is the fact that both the business activity (food sector) of the undertakings parties to the concentration and the ownership ties within the Agrokor group indicated possible negative effects of the concentration in question on competition. Moreover, it had to be taken into account that *PIK Vrbovec d.d.* was a firm in difficulty, the acquisition of which, on the part of one of the biggest Croatian undertakings in this sector, would mean the restoration of long term viability and maintenance of infrastructure.

The Agency rendered the concentration between the undertakings *Agrokor d.d.* and *PIK Vrbovec d.d.* conditionally compatible. The Council proposed the remedies to restore conditions for effective competition which would be distorted as a result of the proposed concentration in the relevant food and non-food retail market and the relevant meat wholesale market covering fresh baby beef and pork and processed baby beef and pork products. In this particular case, the imposed remedies especially took into account the fact that *Agrokor* acquired *PIK Vrbovec* in the privatisation process.

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in 3 cases the relevant proceedings have been terminated on the account of lack of legal basis for further actions.

<sup>9</sup> The Electronic Media Act, as *lex specialis*, provides for the obligation of notification of a concentration in the media sector regardless of the aggregate turnover of the parties to the concentration. It means that any change in ownership structure of the undertaking involved in electronic media publishing must be notified both to the Council for Electronic Media and this Agency.

<sup>10</sup> The decision of the Agency, Class: UP 030-02/2004-02/90, Reg.no: 580-02-05-41-109 of 28 December 2005 was published in Official Gazette No 9/06 and on the web site of the Agency.

Consequently, the imposed structural measures involved the divestiture of several retail outlets (termination of lease agreements, transfer of assets to other undertakings or reallocation of the retail outlets in the territory of two counties (Zagreb and Varaždin), where *Agrokor's* market shares exceeded 40 %.

In addition, *Agrokor* has been imposed an obligation, to ensure within the period of the following three years, that its wholesale and retail includes the meat products in question provided by other competing undertakings to the undertaking *PIK Vrbovec* and the undertakings members within the *Agrokor* group. The supply in question must amount to not less than 25 % of the sales volume of the processed products in question, and not less than 20 % of the sales volume of the fresh meat in question.

Finally, the Competition Council ordered the undertakings *Kozum* and *PIK Vrbovec* (members within the *Agrokor* group) that the agreements which had been concluded with the buyers of the products in question before the concentration has been implemented, should remain in effect within the period of one year, in order to enable the undertakings involved to adjust to the new market conditions.

#### 1.2.3.2. Assessment of concentrations – Selected case 5.

**Concentration between the undertakings *Ivan Granić* from Zagreb, *Europapress holding d.o.o.*, *Veletrade* and *Adris grupa d.d.* – acquisition of joint control over the undertaking *Distri-press d.o.o.*<sup>11</sup>**

The concentration in question indicates a number of specificities. First, this particular form of acquisition of control over the undertaking *Distri-press* required first of all the establishment of the compliance with the concept of a concentration. Second, this concentration was a horizontal merger in the press wholesale market with possible spill over effects on the neighbouring markets – the press retail market and cigarettes sales market. Taking the above mentioned into account and possible effects this concentration may have had on competition, the Agency declared it conditionally compatible.

In respect of the concept of a concentration and in accordance with the definition stipulating the existence of a lasting change in the structure of the undertaking concerned and focusing on the notion of control, it has been established that one undertaking is conferred decisive influence or has the possibility of exercising decisive influence. The decisive influence may be exercised relating to the strategic decisions on the business policy of the target company, such as the power to appoint the members of the board, decisions on use of technology, products differentiation etc.

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<sup>11</sup> The decision of the Agency was published in Official Gazette, No 11/05 and on the web site of the Agency.

Prior to the implementation of the concentration in question the company *Distri-press* consisted of two members: *Europapress holding (EPH)* and *Ivan Granić*. Although each of the members had 50 % of the share capital, in fact *Distri-press* exercised the decisive influence. The implementation of the concentration would have brought about a structural change, by two new members entering the group, *Veltrade* and *Adris grupa*. This would mean that the undertakings *Ivan Granić*, *Veltrade* and *Adris grupa* would each have had 25 % of *Distri-press* share capital. Although none of the members would have had the majority shareholding or voting rights, where a company has more than two minority shareholding members it shall be considered that they acquire joint control if, in law or in fact, minority shareholders have additional rights which allow them to veto decisions which are essential for the strategic commercial behaviour of the joint venture or when that strategic decisions are subject to approval of a specific quorum.

In this particular case, the Agency established that the sole control by *EPH* over *Distri-press* prior to the implementation of the concentration concerned, changed into joint control by *EPH*, *Ivan Granić*, *Veltrade* and *Adris grupa*. The structural change in *Distri-press* brought about a lasting change in the control over the undertaking in question, whereby the operations in question comply with the concept of a concentration as defined by the competition rules.

In addition, the Agency established that the implementation of the concentration in question would have had significant spill over effects on the press wholesale market and neighbouring markets – the press retail market and cigarettes sales market. These possible effects are considerably related to cross ownership and personal links between *Distri-press* and the competing undertakings – *Tisak d.o.o.* and *Slobodna Dalmacija Trgovina d.o.o.* Such structural and personal links threaten to make way to the conclusion of cartel agreements between the undertakings concerned. Nevertheless, the Agency took the view that the possibility of concerted practices may be eliminated by imposing certain remedies to restore effective competition. The imposed conditions and obligations may ensure competition between the undertakings *Distri-press* and *Tisak* after the implementation of the concentration in question.

The most part of remedies imposed include the changes of the provision under *Distri-press* Articles of Association and entail particularly the following:

- 1) Modification of the provisions under the Articles of Association on factual veto rights on key decisions to be replaced by the provision stipulating the strategic decisions on the business policy to be taken by a  $\frac{3}{4}$  majority. This should prevent the members of the group to veto decisions of *Distri-press* acting as an independent economic unit;
- 2) Elimination of interlocking directorates by changing the relevant provisions of the Articles of Association preventing the same persons to be concurrently

appointed in *Distri-press* management boards and those of its members and eliminating the role of the members in the daily management of *Distri-press*;

3) Prohibition imposed by the Agency on the undertaking *Distri-press* concerning the unilateral termination of the existing distribution agreements with retailers and publishers who are not members of *Distri-press*, whereby the mentioned remedies are fixed for a two- year period;

4) Prohibition imposed by the Agency on *Distri-press* in respect of the conclusion of any distribution or resale agreements with the non-member undertakings covering the resale to the members of the Association under the more favourable conditions than those used in the distribution and resale to competing undertakings, in accordance with the General Conditions applied to press distribution.

The Competition Agency established that the commitments and obligations imposed on the participating undertakings in the view to eliminating the effects of prevention, restriction and distortion of competition had been entirely fulfilled, thus making the implementation of the concentration in question acceptable.

### **1.3. Competition advocacy**

Not only may the behaviour of undertakings and their business activities on the market lead to distortion of competition. Under certain circumstances, the rules in effect and their application by public authorities and other institutions may also impede competition. Thus, one of the important tasks of the Agency is to carry out critical examinations and propose revision of certain laws and other legislation which directly or indirectly produce anti-competitive effects.

Thus, the competences of the Agency, apart from the control of anti-competitive behaviour, also entail the ability to draw attention of law makers and public administration authorities to certain provisions which could potentially affect competition where such provisions are not duly justified, such as in cases of general economic interest.

The Agency may also assess the legislation in effect and in case of established anti-competitive effects of the provisions concerned, has the power to issue opinions thereon and communicate them to the Croatian Government and competent ministries, indicating the negative aspects and possible consequences of the implementation of the legislation concerned.

Finally, if certain operations on the market or within certain sectors give rise to competition concerns, the Agency *ex officio* performs investigation of the market or sector concerned, carries out analyses and initiates proceedings in view to determining and subsequently, eliminating the market failure in question.

Competition advocacy cases in 2005 amounted to 59 opinions, where 9 of this total were opinions on laws and other legislation, while 50 opinions were issued upon request of the parties.

### 1.3.1. Competition advocacy – Selected case 6

#### **Opinion on tying sales of books to sales of daily papers**

Upon request of the Ministry of the Economy, Labour and Entrepreneurship, the Agency issued its opinion on tying sales of books to sales of daily papers, in which it has been established that the sales of books together with daily papers by the newspapers publishing companies has inappreciable effect on competition, negligible for the development and maintenance of effective competition, while it undoubtedly benefits the consumers.

The main business activity pursued by the undertakings *Večernji list* d.d. and *EPH* d.o.o. is newspapers publishing, whereas book publishing is not primarily their business. In the newspapers publishing market, which is defined as the relevant market in this particular case, they do not hold a dominant position.

Even if a dominant position of the undertakings in question in the book publishers market would have been established, in order to establish that the tying of the products concerned contravenes competition rules, it has also been necessary to prove that the publishers sell the books together with the daily papers under so called predatory prices, which is a deliberate strategy by a dominant firm, of driving competitors out of the market by setting prices below production costs. If the predator succeeds in driving existing competitors out of the market and deterring future entry of new firms, he can subsequently raise prices and earn higher profits.

In the assessment of potential consequences that the practice by the press publishers concerned may have on competition in the relevant market, the Agency has especially taken into account the structure of the market concerned and the relatively easy access, which makes it inappropriate for predatory pricing and abuse of dominance. In addition, the Agency pointed out in its decision that compared with the EU and American comparative legal practice predatory pricing has been successfully proved only in very few cases.

Consequently, any other form of price reduction complies with competition rules and it is considered to benefit competition on account of effective allocation of resources and overall price reduction to the advantage of the consumers).

In its assessment, the Agency also took into account the fact that the practice of the sales of books tied with the sales of newspapers is a common practice in EU Member States, such as Italy, Poland and Germany, where, according to the knowledge of the Agency, it has not been prohibited, in spite of the fact that the

prices of books sold through tying have been appreciably lower than the prices of books sold in book shops.

Taking all above mentioned into account, the Agency concluded that at the moment of the decision the practice concerned produced no anti-competitive effects on the part of the newspapers publishers and undeniably benefits the consumers, by making the books more accessible to the consumers not only due to their price but also through their availability on newspaper stands and other outlets in the territory of Croatia where book shops are scarce.

Finally, it was pointed out in the decision of the Agency that in this particular case the sales of books together with the sales of newspapers cannot be considered tying within the meaning of competition rules. In this case, there are two different products where the use and the quality of use of one product - tying product (newspapers), is not dependable on the other product – tied product (books), whereby newspapers are obtainable as a single product, independently of the purchase of books. The lower price of books in this particular case reflects lower variable costs which were the result of tied selling of books and newspapers, with the objective of the daily press promotion.

### 1.3.2. Competition advocacy – Selected case 7

#### **Opinion on the criteria and method for the provision of taxi services in the Republic of Croatia<sup>12</sup>**

In its opinion of 28 December 2005, the Agency holds the view that the existing rules regulating the taxi license grants on the local level and other legislation regulating the issue in question, do not provide for free entry to the taxi market and as such prevent its development under competitive conditions, which results in high tariffs and makes the provision of taxi services uncompetitive and inefficient.

The existing rules concerning the provision of taxi services are inherited from the former economic system and the absence of competition in this area particularly affects the consumers – individual citizens, but also the undertakings whose access to the market is hindered or who, under the existing circumstances, have not been offered a possibility for growth and development.

In its opinion the Agency proposed the revision of the existing rules in this area, which would ensure free access, development and growth in the market concerned, and at the same time the compliance with the prescribed standards relating to the provision of the services in question, with the view to quality enhancement and safety of its users.

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<sup>12</sup> The Report on the criteria and method for the provision of taxi services in the Republic of Croatia has been published on the web site of the Agency.

The recommendations in question are particularly related to fixing of the fares for the provision of taxi services, which under no circumstances may fall under the competence of a taxi drivers association or other associations which represent the interests of the service providers. With the objective of consumer protection, the maximum fares should be fixed by the local authorities, whereby the service providers would be given the opportunity to determine the prices within the set ceiling. The position of the Council is that free entry to the taxi market will bring benefits for the consumers, lower prices, high availability and diversity of services, and at the same time provide incentives for the provision of taxi services among undertakings and lessen the taxi industry "black market" in the Republic of Croatia.

### 1.3.3. Competition advocacy – Selected case 8

#### **Opinion in respect of parallel imports and exclusive distribution agreements<sup>13</sup>**

After having received a number of requests from different undertakings, the Agency also issued the opinion on parallel imports in the case of existence of exclusive distribution agreements. Pursuant to competition rules applicable in the Republic of Croatia and the relevant EC competition rules, there is no impediment to parallel imports of the products for resale in the geographic market allocated to an exclusive distributor for the same type of products through passive sales, provided that the importer protects the manufacturer's rights and does not infringe the Croatian rules.

Under the Croatian Regulation on block exemption granted to certain categories of vertical agreements, exclusive distribution means a vertical agreement where the manufacturer or supplier limits his sales of contract products to only one buyer (distributor) for a certain territory which has been exclusively allocated to this buyer.

The Regulation in question stipulates so called hard core restrictions, such as the restriction of the territory into which, or of the customer to whom, the buyer (authorised distributor) may sell the contract products and the restriction of active or passive sales to end users, which are prohibited. Nevertheless, the prohibition shall not apply to the vertical restraints having as their object the restriction of the buyer's (authorised distributor's) active sales into the exclusive territory or to an exclusive customer group reserved to the supplier or allocated by the supplier to another buyer, where such a restriction does not limit sales by the customers of the buyer (authorised distributor).

The restriction or prohibition of the buyer's active sales protects its position as an exclusive importer and authorised distributor. Nevertheless, the restriction of the

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<sup>13</sup> This opinion has been published on the web page of the Agency.

buyer's passive sales would be considered a hard core restriction, given that this may create absolute territorial protection leading to a separation of markets or territories and enabling abuse of so created monopolistic position in the market. Passive sales means sales in response to unsolicited requests from individual customers in other distributor's exclusive territories, including delivery of products to such customers, to the extent that such responding is not the result of active sales operations. Sales generated by general advertising or promotion in the media or on the Internet that reaches customers in other distributors' exclusive territories or customer groups, as a result of the development in the technology and since being easily accessible, are considered to be a reasonable method of approaching the customers or groups of customers.

Exclusively from the point of view of competition rules, parallel imports of products through passive sales is generally permitted, although business operations have been appointed to an exclusive distributor in a particular territory. Thus, exclusive distribution agreement concluded with an undertaking and covering the territory of the Republic of Croatia does not prevent other undertakings to purchase the same type of products from the producers or other undertakings abroad, for resale in the territory of Croatia, alongside with the exclusive distributor. This provision has been transposed into the Croatian competition rules from the relevant EC rules and the opinion of the Agency has been issued exclusively from the point of view of competition rules, whereby no account has been taken of intellectual property rights or customs regulations.

## **2. STATE AID**

In the Republic of Croatia the state aid control system has been regulated by the 2005 State Aid Act. The State Aid Act has been brought into compliance with the EC *acquis* and it sets out the general criteria and relevant rules in respect of authorisation, monitoring of the implementation and recovery of state aid within the framework of the international commitments undertaken by the Republic of Croatia.

The Act in question provides for state aid control system in compliance with the commitments undertaken by the Republic of Croatia under the Stabilization and Association Agreement (SAA). As referred to in Articles 69 and 70 of the SAA, Croatia committed itself to approximation of laws with the relevant EU rules in the area of competition also involving the rules for authorisation and monitoring of state aid by the time of its accession to the EU. It is necessary to point out here that the provisions and time limits in respect of competition rules as laid down under Article 70 of the SAA began to run on 1 March 2002, the day of the entry into force of the Interim Agreement on trade and trade-related matters between the European Community and the Republic of Croatia, which remained in force until the entry into force of the SAA on 1 February 2005.

### **2.1. Legislative framework**

The system of state aid control (authorisation, monitoring of implementation and recovery of state aid) was first established in the Republic of Croatia under the State Aid Act (Official Gazette No 47/2003, 60/2004) and Regulation on state aid (Official Gazette No 121/2003). In accordance with the 2003 State Aid Act, the Agency was empowered to issue opinions on the proposals of legal acts containing so called general state aid, whereas it issued decisions on the proposed individual aid.

The implementation of the former system in practice as well as the comments received from the European Commission indicated that it is necessary for the system to be improved and made more efficient and effective. Consequently, the new State Aid Act was drafted and put into effect in December 2005. This 2005 State Aid Act necessitated the adequate modifications of the Regulation on state aid which subsequently entered into force in May 2006 (Official Gazette No 50/2006).

The 2005 State Aid Act brought as a novel that the Agency has the power to issue a preliminary binding opinion on draft proposals for laws which contain state aid. This preliminary binding opinion is then submitted to the Government of the Republic of Croatia or to the Croatian Parliament. On the other hand, the Agency gives its authorisation (prior decision) concerning legislative proposals for aid schemes submitted by the ministries, local and regional self-government units and any legal entity granting or administering state aid.

Unlike the 2003 Regulation on state aid which provided for a detailed set of rules concerning the granting of state aid, the 2005 Regulation on state aid stipulates that upon the proposal of the minister of finance, the Government of the Republic of Croatia shall issue decisions on the publication of the lists of relevant EC state aid rules containing the texts of the legislation covering the particular rules translated into Croatian and the provisions concerning the method of implementation of the rules in question. This will ensure full harmonization of the Croatian state aid rules with the EC *acquis* in the area concerned. The old 2003 Regulation, or certain parts thereof, will be applicable for the time being simultaneously with the new 2005 Regulation, whereby it will be gradually replaced by the latter. This is to ensure continuity and consistency in the enforcement of state aid rules in Croatia.

The Ordinance on the form and content of the notification and the method of data collection and keeping the state aid register (Official Gazette No 11/05) has also been adopted and sets the rules relating to data collection which are necessary in the assessment procedure relating to state aid proposals and establishes the method in which annual reports are drafted. This system which relies on obligatory notification and drawing up of annual reports ensures necessary transparency in the process of granting state aid.

### ***Definition of state aid***

State aid is prohibited and this general prohibition of state aid derives from the fact that the uncontrolled advantage given to particular undertakings or sectors would jeopardize the functioning of the common market, diminish economic prosperity and have negative impact on the effectiveness of the economy.

Uncontrolled granting of state aid serves the ineffective undertakings and enables them to survive on the market on the expense of the effective ones, postpones structural reforms, negatively affects productivity and competitiveness of the national economy as a whole, but also that of the individual undertakings.

In compliance with the EC *acquis* and Croatian legislation, state aid shall be considered any measure:

- which involves a transfer of state resources, irrespective of the fact whether the resources come from the state budget, the budget of regional or local authorities, public banks or private or public companies, which directly or indirectly manage state resources;
- which constitutes an economic advantage that the product, undertaking, sector or region would not have received in the normal course of business;
- which is selective and thus affect the balance between aid recipients and their competitors. Selectivity is what differentiates state aid from so-called

"general measures" which apply to all undertakings in all economic sectors without exception;

- which has a potential effect on competition and trade between Member States, in other words between Croatia and the Community. Within the meaning of the EC *acquis* and particularly the practice of the European Court of Justice, it is sufficient if it can be shown that the aid beneficiary is involved in an economic activity and that he operates in a market in which there is trade between Member States.

The measure may be considered state aid if all the above mentioned criteria are cumulatively met.

State aid can take many forms: that of state guarantees, soft loans, grants, debt write-offs, capital injections etc. Examples of economic advantage are buys/rents of publicly owned land at less than the market price, sales of land or shares of a company to the state at higher than market price, privileged access to infrastructure without paying a fee etc.

As a rule, measures which are not considered state aid are as follows:

- general economic policy measures, ensuring equal position of all sectors, regions and undertakings (e.g. profit tax reduction relating to all undertakings in Croatia);
- support for households (social support);
- investments in infrastructure (in principle);
- EU funds (e.g. CARDS programme).

In addition, the EC state aid rules, as well as the corresponding Croatian legislation, regulate that small amounts of aid (*de minimis* aid) do not have a potential effect on competition and trade between Member States, and between Croatia and EU. Such aid is granted within the Community in the amount of not exceeding 100,000 EUR over any period of three years, whereas the amount granted in Croatia is 750,000 HRK, and as such is exempted from the application of the state aid rules and may be granted in all sectors with the exception of aid to promote exports, steel production and transport sector.

## **2.2. Activities of the Agency in the area of state aid**

Pursuant to the State Aid Act the competences and powers of the Croatian Competition Agency also entail authorisation, monitoring of the implementation and recovery of unlawfully granted or misused state aid.

The Agency also performs other activities within its scope of jurisdiction in the area of state aid: assesses state aid proposals and aid schemes within annual and multi-annual state aid approval plans, monitors the implementation of state aid granted and orders the recovery of unlawfully granted state aid or aid used in contravention of the rules, keeps the state aid register, cooperates in the budget preparation with the authorities responsible for the preparation of the state

budget in compliance with the separate law, submits the annual report on state aid to the Croatian Parliament, cooperates with international authorities in compliance with the international commitments undertaken by the Republic of Croatia, participates in the preparation of draft proposals for laws and other regulations concerning state aid, promotes and encourages improvements in the state aid system and performs other activities relating to the implementation of the State Aid Act.

*State aid cases received and closed during 2004 and 2005*

Type of case	Received cases		Cases received in 2004 and closed in 2005		Cases received and closed in 2005	Total of closed cases
	2004	2005	2004	2005		
<b>1. ADMINISTRATIVE CASES</b>						
Individual state aid	41	26	9	13	11	<b>33</b>
- aid to shipbuilding (guarantees)	15	8				
<b>2. OPINIONS</b>						
Opinions on aid schemes	43	29	11	21	23	<b>55</b>
Opinions on laws	1	3		1	2	<b>3</b>
<b>TOTAL</b>	<b>85</b>	<b>58</b>	<b>20</b>	<b>35</b>	<b>36</b>	<b>91</b>

In 2005 a state aid inventory comprising the existing aid schemes which need to be brought into compliance with state aid rules has also been compiled and submitted for adoption to the Croatian Government. The establishment of this comprehensive inventory of aid schemes means that the obligation under Article 70 of the SAA has been satisfactorily fulfilled. The priority of the Agency and different aid providers is now to adjust the aid schemes in question as soon as possible with the state aid rules in effect given the significance of this harmonization for the opening of the negotiations in the chapter dealing with competition policy.

One of the key activities of the Agency in this area is also further cooperation with and training of aid providers. This is based on the fact that aid providers insist that representatives of the Agency take part in the activities relating to redefinition of state aid policy in certain sectors of the economy in the form of working groups which are responsible for revision and modifications of particular parts of legislation and aid schemes. To that view, in 2005 the representatives of the Agency participated on the temporary or permanent basis in the work of several working groups for the conclusion of the National restructuring programme for the Croatian steel industry, drafting of the Act on Liner Shipping and Seasonal Coastal Maritime Transport, Free Zones Act and Investment

Promotion Act, as well as in the working group for the drafting of the strategy and capacity building for regional development in Croatia.

With the support of the CARDS project for 2002, the establishment of a comprehensive state aid data base worth 400,000 EUR in equipment and program support is under way. Within the meaning of the contract, in autumn 2005 the selected IT company began the installation of the electronic data base which is to be finished during 2006. The new IT system has already passed the testing period and data received from aid providers are currently being entered into the new data system.

### **2.2.1. Authorisation of state aid**

Authorisation of state aid is one of the most important tasks of the Agency within the implementation of the State Aid Act. The complexity of aid proposals requires effective cooperation between the Agency and aid providers, particularly at the stage when necessary data are collected and documents prepared. The contribution of aid beneficiaries cannot be neglected, especially in respect of the cases dealing with restructuring of undertakings and involving conclusion of viable business plans based on the realistic assumptions as to future operating conditions. In this sense, the 2005 State Aid Act enables efficient case handling and taking a proper share of responsibility in the preparation of the above mentioned restructuring business plans.

#### 2.2.2.1. State aid – Selected case 1

##### **Draft Decision on giving state guarantees for the loan taken by Hrvatske ceste d.o.o with Zagrebačka banka d.d. for the financing of the project for construction and maintenance of public roads in 2005 – non-aid decision**

The Agency dismissed the request made by the Ministry of the Sea, Tourism, Transport and Development, relating to the Draft Decision on giving state guarantees for the loan taken by Hrvatske ceste d.o.o. with Zagrebačka banka d.d. for the financing of the project for construction and maintenance of public roads in 2005.

The loan is exclusively used for the settlements upon completion of contract works under the programme for construction and maintenance of public roads in compliance with the Plan for the construction and maintenance of public roads in 2005. Hrvatske ceste d.o.o. has under this Plan been entrusted with management and maintenance of public roads as public goods.

The Competition Council dismissed the request on the account of the fact that the construction in question is considered to be a general purpose infrastructure not fulfilling the selectivity criteria and as such does not constitute state aid pursuant to the State Aid Act, where the state guarantee for the loan in question

is aimed at the construction of infrastructure which is of general interest and publicly used by all potential and actual users on the toll-free basis.

#### 2.2.1.2. State aid – Selected case 2

##### **Decision on equity participation of the Republic of Croatia in the undertaking Slavonija modna konfekcija d.d. Osijek – authorisation of individual aid<sup>14</sup>**

The Ministry of the Economy, Labour and Entrepreneurship submitted to the Agency the request for authorisation of the Proposed Decision on equity participation of the Republic of Croatia in the undertaking Slavonija modna konfekcija d.d. Osijek (textile industry).

According to the Proposed Decision, the Ministry of Finance is to convert the outstanding debt of the undertaking Slavonija d.d. due on 31 March 2005 into equity participation of the Republic of Croatia in the undertaking Slavonija d.d.

The outstanding debt to the Ministry of Finance consists of taxes, social contributions and VAT. Namely, the losses of the undertaking Slavonija d.d. resulted primarily from underutilization of manufacturing capacity due to the fact that the undertaking in question lost some of its markets abroad and thus has not been able to meet its liabilities and contributions to the state. This makes Slavonija d.d. a firm in difficulty pursuant to the Regulation on state aid (Official Gazette No 121/03).

The Restructuring plan of the undertaking Slavonija d.d. from 2005 – 2009 has been concluded pursuant to the Regulation on state aid. It is based on a feasible plan to restore a firm's long-term viability; it involves the reorganisation and rationalisation of the firm's activities on to a more efficient basis, including the rise of the production volume for the purposes of the national market and at the same time the decrease in so called loan businesses which generate losses. The restructuring plan in question also provides for the reduction of the number of employees, particularly from the non-production units, and redundancy benefits from its own resources. Accordingly, the current number of employees is to be reduced by some 34 % in the period from 2005 – 2009 (from 332 to 220 employees).

The restructuring plan in question should also ensure optimal utilization of the capacities which is to be implemented by the relocation of the existing plants into the buildings formerly used for fur processing. These facilities, with some 3.200 m<sup>2</sup> of size would match the planned labour force of some 200 to 250 workers. The first effects of the restructuring plan will be achieved in 2006, whereas some

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<sup>14</sup> The consolidated text of the decision has been published in Official Gazette No 133/05.

activities in the restructuring process will be carried out during 2007, when the whole process is planned to be completed.

The Agency has approved the decision also taking into account the social circumstances and living conditions in the town of Osijek and in the County, which are characterised by serious underemployment and appreciable and constant decrease in the number of undertakings in the textile industry, and consequently, increase in the number of unemployed textile workers. In the past, in the area of Osijek there were ten undertakings operating in the textile market, whereas this number currently amounts only to two undertakings, one of them being Slavonija d.d. Out of 34.449 unemployed workers in the area of Osijek (unemployment rate of 34.7 %), 2.530 come from the textile industry. The restructuring plan provides for payments to workers made redundant and stops serious underemployment in the region concerned.

Taking everything into account, the Agency concluded that the equity participation of the Republic of Croatia in the undertaking Slavonija modna konfekcija d.d. Osijek constitutes state aid for restructuring of firms in difficulty under Article 4, par (3), item d) of the State Aid Act. Moreover, the restructuring plan concerned guarantees a long-term viability of the undertaking in the market without receiving any new aid. The outstanding loan converted into the equity of the Republic of Croatia is to ensure the debt settlement in the upcoming privatisation process.

#### 2.2.1.3. State aid – Selected case 3

##### **Financing Model for the Renewal of the Ship Operators' Passenger Fleet, where ship operators are small undertakings – *de minimis* aid**

Upon the request of the Ministry of the Sea, Tourism, Transport and Development, the Competition Council authorised the aid scheme Financing Model for the Renewal of the Ship Operators' Passenger Fleet, where ship operators are small undertakings. Taking into account that the aid amounts earmarked for ship operators do not exceed 750.000 HRK, they have been assessed as *de minimis* aid.

The Financing Model for the Renewal of the Ship Operators' Passenger Fleet, where ship operators are small undertakings, covers the construction of passenger and excursion fleet in exclusively Croatian shipyards and is aimed at Croatian private ship operators - small enterprises, entails co-financing (30 % from the undertaking's own resources and 70 % from the loans given by commercial banks) of the construction of passenger liner ships of less than 100 gross tonnage and 30 meters length, and excursion ships of less than 300 gross tonnage, from the subsidies allocated by the Ministry.

The aid scheme in question will improve transport linkages and accessibility to islands, maritime safety, range of tourist services and increase employment in shipyards.

In accordance with the decision of the Council, pursuant to Article 6 par (1) item l) of the 2003 State Aid Act (Official Gazette No 47/03 and 60/04), the planned aid scheme constitutes *de minimis* aid within the meaning of the Regulation on state aid. *De minimis* aid amounts earmarked for ship operators may not exceed 750.000 HRK per operator within the period of three years.

#### 2.2.1.4. State aid – Selected case 4

##### **Proposal for incentives aimed at development and improvement of the conditions in the textile and leather-footwear industry in Croatia – authorisation of horizontal aid**

The Agency received from the Ministry of the Economy, Labour and Entrepreneurship the Proposal for incentives aimed at development and improvement of the conditions in the textile and leather-footwear industry in Croatia.

The Proposal for incentives aimed at development and improvement of the conditions in the textile and leather-footwear industry in Croatia provides for state aid for research and development, state aid for environmental protection, as well as state aid for training, which are, in the opinion of the Agency, in compliance with the provisions of the State Aid Act and Regulation on state aid, hence provided that the Ministry fulfils all the criteria stated in the opinion of the Agency in compliance with the provisions of the Regulation on state aid relating to aid categories concerned.

The Ministry has been requested to submit the proposed modifications of the Proposal in question which was subsequently received by the Agency and assessed as fully adjusted to state aid rules in effect.

### 3. INTERNATIONAL CO-OPERATION AND TRAINING

This part of the report deals with the activities of the Agency relating to international co-operation in the report period of 2005, particularly the activities in the process of the accession of the Republic of Croatia to the EU, technical support projects of which one of the beneficiaries is also the Agency, bilateral and multilateral co-operation and participation of the employees of the Agency in international seminars and conferences on competition and state aid.

#### 3.1. European Union

The intensified activities of the Agency in this area started with the formal opening of the negotiating process in October 2005 which was followed by the analytical overview and evaluation of the degree of harmonisation of national legislation with the *acquis communautaire*, known as *screening*. A number of representatives of the Agency have been involved in the preparation of negotiations within the working group relating to Chapter 8: Competition policy and participated in explanatory and bilateral meetings that were held in Brussels in November and December of the same year. These were followed by the forth meeting of the Subcommittee for Internal Market and Competition where the representatives of the European Commission were informed on the progress made by the competent authorities in the Republic of Croatia concerning the implementation of the commitments undertaken under the Stabilization and Association Agreement.

Strengthening of the administrative capacities of the Agency, particularly of its competition expert team, but also involving other stakeholders in the implementation of the relevant legislative framework, such as judiciary, has been encouraged through the CARDS project 2001 "Support to the development of competition policy in Croatia in line with EU standards and best practice". This was the first project involving EU technical support the beneficiary of which was the Agency. The project closed in December 2005 and was followed by the new CARDS project 2003 "Further strengthening of the Croatian Competition Agency and implementation of competition law and policy".

In June 2005 the implementation of the *twining* project in the area of state aid "Support to the Croatian State Aid System" was also commenced in the co-operation with partner countries Germany and Slovenia. The objective of this project which is to be carried out until the early 2007 is to provide support to the Agency in the implementation of the commitments undertaken under the Stabilization and Association Agreement. The project concerned also includes the purchase and establishment of a comprehensive electronic data base on state aid in the Republic of Croatia (CROSADS – Croatian State Aid Database System).

### 3.2. Multilateral and bilateral co-operation

Intensified activities relating to the accession of the Republic of Croatia to the EU involve interaction and sharing experience with the old and new Member States and other candidate countries. These linkages with the competent national authorities and a number of international networks and initiatives become even more important.

Under the chairmanship of Croatia and OECD, the Regional Centre for Competition in Budapest was the host of the second annual meeting of the *South East Europe Competition Authorities Network* (SEECAN). In July 2004, the SEECAN initiative sponsored by the OECD brought together competition authorities from south-east Europe with the view to enhancing their efficiency and implementation of competition rules in practice. The first annual chairmanship on rotating basis, selected among the SEE competition authorities was held by the representative of the Croatian Competition Agency.

In the conclusions of the meeting in December 2005 it was pointed out that all SEE countries made some progress in the area of competition law and policy. However, further strengthening of the competition authorities, efficient enforcement, focusing on cases involving hard core restrictions of competition and permanent competition advocacy must remain the priorities in future.

In June 2005 a similar initiative was also presented in Rome. The co-operation project *Competition Policy in the Balkan Countries* started under the initiative of the Italian competition authority, with the purpose to provide a forum where national authorities would present their antitrust laws and discuss enforcement practices, with a particular emphasis on the specificities associated with the development of the market economy in the countries concerned.

Regular activities relating to international co-operation also included participation in *International Competition Network* (ICN) competition projects, different projects of the European Bank for Reconstruction and Development, UNCTAD and WTO.

The Croatian Competition Agency was invited to Romania where it signed the Cooperation Agreement with the Romanian Competition Council. This was the first co-operation agreement concluded between the Agency and a similar competition authority abroad. The agreement in question provides for the cooperation in the field of competition, including state aid, by means of experts' exchange, seminars, as well as exchange of information on the concrete cases from the practice of both bodies.

The Agency continued co-operation with the Slovenian and Hungarian competition authorities and first steps have been taken towards co-operation with the Competition Council of Bosnia and Herzegovina and the Bulgarian Competition Office.

### **3.3. Professional training and international seminars**

With the view to efficient and effective enforcement of competition and state aid rules in the context of harmonization with the relevant EC rules in effect, strengthening of administrative capacities of the Agency remains one of its essential tasks. Education and training of its staff and raising awareness of competition and state aid matters between other regulators, public administration authorities, undertakings and the general public has been and will continue to be fundamental in the activities falling under the scope of this Agency. In spite of its limited financial resources, the Agency endeavours to take advantage of every opportunity to participate in training courses, seminars and conferences, home and abroad. Here it appreciates the support which has been ensured through different support projects, availability of foreign experts and encouraged by international organizations.

## CONCLUSION

In the report period concerned, the Croatian Competition Agency has completed its extensive activities in the area of anti-trust and mergers concerning the drafting of secondary legislation which started in 2004. The last two bylaws, Regulation on block exemption granted to certain categories of technology transfer agreements and Regulation on block exemption granted to insurance agreements, which had to be adopted pursuant to the provisions of the Competition Act, were consequently adopted by the Croatian Government in early 2005. Further improvements of the legislative framework in the area of anti-trust and mergers are to be continued, in the context of the fulfilment of the criteria for the EU membership. In the near future, it is necessary to find new and more satisfactory solutions concerning the court review of the legality of the decisions of the Agency and an adequate system for the imposition of fines in respect of the infringements of competition rules within the meaning of the Competition Act. This complex matter, taking into account both its legal and economic aspects, also involves permanent training of judges which, once started, must also be continued in future.

In its Progress Report for Croatia for 2005 the European Commission has reported on progress made by the candidate states in preparing for EU membership. The first such report on Croatia highlights the necessity for further development of the Agency's administrative capacity but also further development and training of the judiciary in competition matters. The EC also mentions the need of considerable strengthening of the enforcement record which is the only possible way to creating the competition environment and legal certainty of undertakings known in the EU. The *screening* results in respect of competition matters also indicate the necessity of these criteria to be satisfied in order to continue the accession negotiations successfully.

It has been indicated more than once in this annual report that the Agency, apart from its usual activities essentially covering case handling procedures, continuously carried out competition advocacy and awareness raising activities as one of its most important tasks at this stage. So called competition advocacy cases amounted to a total of 59 expert opinions which have been given upon the request of public authorities and other parties in respect of interpretation of the provisions of the Competition Act or assessment of compatibility of proposals for laws and other legal acts with the Competition Act. In 2005 the Agency carried out assessment of some concentrations in the privatisation process with significant effects on competition. It worked on the establishment of abuse of a dominant position, whereby the so called *Ponikve case*, in which discriminating water supply tariffs on the island of Krk had been applied (see selected case 3), was one of the particularly worth mentioning, taking into account the comprehensiveness of the analyses that have to be carried out throughout the proceedings against the undertakings engaged in such infringements which particularly raise competition concern. The scope of necessary legal and

economic analyses in such cases of serious violation of competition rules speak again for the urgent need of additional human resources which could respond to the requirements of the wide scope of jurisdiction which has been assigned to this Agency, so as to enable efficient and effective enforcement in the area of potential abuse of dominance and other forms of distortion of competition in different markets.

In the area of state aid, the work of the Agency in this report period, beside the every day activities in respect of case handling, concentrated on the establishment of the state aid inventory, i.e. list of aid schemes in effect and other legal acts on the basis of which state aid had been authorised or granted before the 2003 State Aid Act entered into force. The establishment of the state aid list, in the context of the adjustment of the aid schemes in question with the relevant state aid rules, was particularly important for the continuation of the Croatian accession negotiations. Also to that end, the EU *twinning* project in co-operation with Germany and Slovenia as partner countries has been commenced.

Some sectors, such as the steel and iron industry and shipbuilding, remain subject to restructuring and other reforms. Individual restructuring plans of the firms in question are being drawn up. These restructuring plans are to ensure a long-term viability of the firms under market conditions.

The adoption of the 2005 State Aid Act provided the prerequisites for further promotion and development of the state aid system in Croatia and the fulfilment of the international commitments undertaken by Croatia under the Stabilization and Association Agreement and the criteria set in the negotiation process. Further activities of the Agency and its co-operation with aid providers is to ensure the establishment of effective competition and enable Croatian undertakings to face competition in the global market, by granting state aid which is directed to strengthening and achieving competitiveness of Croatian economy as a whole. In other words, the objective of state aid rules is to ensure interventions and support of the state where it positively affects efficiency of a greater number of economic entities (aid to horizontal objectives such as science, research and development, environmental protection, training), or in cases where there is a need to compensate for market failures, but only exceptionally with the purpose of benefiting certain undertakings or sectors.

Finally, it has to be pointed out that the powers of the Agency have been precisely defined by the Competition Act and State Aid Act and the relevant subsidiary legislation which was adopted pursuant to these acts. The task of the Agency is more efficient and effective enforcement of the acts concerned which may be achieved only through necessary and permanent professional training and improvement of work, which, on the other hand, require interaction with other competent authorities, particularly the judiciary and public

administration, who participate in the implementation of competition rules and state aid control in the Republic of Croatia.