



Located in Central Europe<sup>1</sup>, Southeast of Germany, the Czech Republic is also bordered by Austria, Poland, and Slovakia. The country's capital is Prague, and the Czech Republic is now a parliamentary democracy.

Following the First World War, the closely related Czechs and Slovaks, of the former Austro-Hungarian Empire, united to form Czechoslovakia. After the Second World War, the country fell into the ambit of Soviet influence.

With the collapse of the Soviet Union in 1989, the country regained its independence through a 'Velvet Revolution'. Five years later, by means of a 'Velvet Divorce', the country re-emerged as its two national components, the Czech Republic and Slovakia. The Czech Republic joined NATO in 1999 and the EU in 2004.

### Economy

The Czech Republic is a small open economy that has since 1990s undergone a major economic transformation from a former centrally planned economic model to a functioning market economy based on principles of free and undistorted competition. The private sector accounted for a mere four percent of GDP at the start of transition. The state's withdrawal from the real economy has been rapid, boosting the private sector's share of GDP to more than 80 percent in 2002<sup>2</sup>.

Rapid economic growth in 1995-96 lifted GDP per head (at purchasing power parity exchange rates) to just over 50 percent of the EU average by 1996. Since then it has increased by a further 10 percent, to an estimated US\$12,149 in 2001, despite the intervening recession. This places the Czech Republic's level of economic development behind only Slovenia among the former communist countries<sup>3</sup>.

PROFILE	
Population:	10.2 million***
GDP (Current US\$):	85.4 billion***
Per Capita Income: (Current US\$)	6,740 (Atlas method)*** 15,870 (at PPP.)**
Surface Area:	78.87 thousand sq. km
Life Expectancy:	75.3 years
Literacy (%):	-- (of ages 15 and above)
HDI Rank:	32 ***
Sources: - World Development Indicators Database, World Bank, 2004 - Human Development Report Statistics, UNDP, 2004 (**) For the year 2002 (***) For the year 2003	

Industrial production accounted for 32.8 percent of GDP (at current prices in 2002), compared with almost 48 percent in 1990. The relative contribution of agriculture, which was already small in 1990, at eight percent of GDP, has fallen as well, to 3.4 percent in 2002. By contrast, there has been a rapid expansion of wholesale and retail trade, catering, repair and financial services<sup>4</sup>.

Competition law and its enforcement has constituted, since the beginning of the economic transformation, one of the essential tools contributing to its success. And it keeps playing a vital role in safeguarding benefits of the market economy for consumers and other market participants not only in the Czech Republic itself, but also within the broader common market of the EU, to which the Czech Republic acceded in May 2004.

\* Original paper submitted in January 2005. Revised in December 2005

<sup>1</sup> <http://www.cia.gov/cia/publications/factbook/geos/ez.html>

<sup>2</sup> Economist Intelligence Unit (<http://www.economist.com/countries/CzechRepublic/>)

<sup>3</sup> Economist Intelligence Unit (<http://www.economist.com/countries/CzechRepublic/>)

<sup>4</sup> Economist Intelligence Unit (<http://www.economist.com/countries/CzechRepublic/>)

## Competition Evolution and Environment

The first mention of the cartel law in the Czech territories is found in the Austrian Coalition Act No. 43 of 1870, under which agreements between traders, made for the purpose of increasing prices to the disadvantage of customers, had no legal force.

After the establishment of Czechoslovakia in 1918, the first consistent law aimed at preventing the reduction of competition was enacted in 1933. It was the *Act No. 141/1933 Coll.*, on Cartels and Private Monopolies, which was, in accordance with the then widely accepted European conception, based on the permissibility of cartel agreements, and only rejected their abuse. Although the Act was not explicitly revoked in the post-war period, it was deprived of any real force, in the context of a centrally planned economy established in Czechoslovakia, after the Communist coup in February 1948.

The concepts of market and competition were contemplated again during the short period of political, as well as economic, reforms in the 1960s, which also led to certain legislative measures aimed at improving the functioning of the national economy planning (*Government decree No. 100/1966 Coll. and as amended by No. 169/1969 Coll.*). The main aim of these measures was to reduce the influence of the arbitrary decisions of central planning bodies, by prohibiting them to limit competitive behaviour of organisations due to administrative measures or agreements.

Furthermore, a provision was introduced into the Economic Code prohibiting organisations to abuse their economic position *vis-à-vis* other organisations, but it was actually used only in one case. The era of ‘normalisation’ of the 1970s again returned to the concept of rigid central planning, with no space for competition and market forces.

It was only after the ‘velvet revolution’, overthrowing the Communist regime in 1989 that Czechoslovakia returned to the principles of the market economy, based on competition amongst market players. More than forty years of central planning resulted in a highly monopolised Czechoslovak economy, even as compared with other communist countries of Central Europe, such as Hungary or Poland.

The main objective of the economic transformation in the 1990s was, therefore, to restructure the Czechoslovak economy, in order to create conditions for effective functioning of the market forces. An integral part of such a transformation was already in its initial phase, taking into account the creation of modern competition rules, ensuring that inefficient state monopolies are not replaced by equally inefficient private monopolies and cartels.

## Competition Legislation and Institutions

In March 1991, the *Act No. 63/1991 Coll.*, on the *Protection of Competition* came into force. Its purpose was

to protect competition in the markets for goods and services, against restriction, distortion or elimination. In the course of preparation for this first modern competition legislation, it was necessary to find the basic principles, on which the Act should be constructed.

As already been mentioned, the previous competition legislation did not correspond with the approach towards the protection of competition at the beginning of 1990s. Finally, the new Act was modelled on the well-established competition law of the European Communities, based on the three main areas of application:

- Agreements distorting competition;
- Abuse of dominant position; and
- Control of concentrations.

This approach was also chosen with respect to the anticipated establishment of more intensive relations with the European Communities. Thus, the competition rules were, from the very beginning, largely compatible with the EC Law, which also enabled the use of the case law of the European Commission and the European Court of Justice, as guidance for the practical application of the new rules.

Apart from the usual legislative instruments modelled on the EU competition rules, the Act on the Protection of Competition, from 1991, also contained certain specific provisions reflecting the process of economic transformation and privatisation. These provisions concerned the privatisation of state property, by state and municipal bodies, and obliged them to ensure that structural conditions for the creation of competition are determined, and that state monopolies are not simply transformed into private monopolies.

Along with the adoption of the competition rules, the Office for the Protection of Competition was established as a central body for the state administration responsible for the support and protection of competition, independent in its decision-making and equipped with enforcement and investigation powers pursuant to the Act on the Protection of Competition. The Office was not situated in Prague, the capital of Czechoslovakia, but in Brno, which underlined the independence of the new competition authority’s decision-making.

In 1992, the Office was transformed into the Ministry of Economic Competition. This change of status reflected the undergoing economic transformation and, in particular, the role played by the competition authority in the privatisation process. Having a Ministerial status and a seat in the Government, thus, allowed the Ministry of Economic Competition to influence, more effectively, the privatisation process, and promote the principles of competition in the restructuring measures taken by the Government.

The last institutional change in the competition policy area came in November 1996, when the current Office for the Protection of Competition ('the Office') began its activities as an independent body for central state administration, whilst preserving the competencies of the Ministry. This transformation of the Ministry, back into the Office, was one part of the change that took place in the structure of central bodies of state administration, and was decided on after the Parliamentary elections in June 1996.

The establishment of the Office reflected the fact that major privatisation and restructuring steps had already been taken, and it was considered that the effective enforcement of the competition rules was to be better secured by an independent administrative body. The independence of the Office was further strengthened by a special legislation regulating its status – the *Act No. 273/1996 Coll., on the Scope of Activities of the Office for the Protection of Competition*, amended by *Act No. 187/1999 Coll.* This act stipulates, *inter alia*, that the Chairman of the Office is appointed by the President of the Czech Republic, on the proposal by the Government, for a period of six years.

The *Act No. 63/1991, Coll., on the Protection of Competition*, subject to only minor amendments in 1992 and 1993 (reflecting also the split of Czechoslovakia into two independent countries: the Czech Republic and the Slovak Republic), proved to be an effective instrument for protection of competition throughout the 1990s. Nevertheless, planned accession to the European Union required full compliance with the EU competition rules.

Therefore, preparations for a new Competition Act began at the end of 1990s, aiming in particular at further harmonisation with the European legislation, and also reflecting the gained enforcement experience and up-to-date trends in developed competition regimes. These legislative activities led to the adoption of the *Act No. 143/2001 Coll., on the Protection of Competition*, which came into force on July 01, 2001. The main changes to the competition rules introduced by this act can be summarised as follows:

- The Act explicitly stipulates that it is fully applicable to undertakings, which provide the services of general economic interest, only with the exception of cases when the application of the Act would obstruct the performance of the special tasks assigned to these undertakings;
- The Act explicitly distinguishes horizontal and vertical agreements, and newly defines conditions for *de minimis* exemption for agreements of minor importance;
- The Act sets conditions for an exemption from the prohibition of agreements, exclusively on competition principles, reflecting Article 81(3) of the EC Treaty;
- The Act defines the dominant position on the basis of the concept of market power, taking into account more criteria than just the market share of the undertaking;

### Box 68.1: Action Against Anticompetitive Practices of Fuel Distributors

Cartel agreements between competitors, concerning prices, represent one of the most serious infringements of competition rules. One such cartel was recently discovered in the sector of distribution of fuels, at petrol stations, in the Czech Republic.

In 2001, six fuel distributors were engaged in concerted practices aimed at fixing fuel prices at petrol stations. At the end of May 2001, these distributors, within their networks covering the whole territory of the Czech Republic, practically simultaneously increased prices by almost the same amount. Moreover, there was no objective justification for such a rise in fuel prices, as purchase costs of this product had been decreasing since the middle of May 2001.

The parties to the proceedings kept such high levels of fuel prices until the end of November 2001, despite the continuing decreasing trend of their purchase prices. This behaviour was thoroughly investigated by the Office for the Protection of Competition, which found that these distributors had numerous mutual contacts in their association, exchanged e-mails and also informed each other of their pricing strategy via press statements.

The Office concluded that the six fuel distributors concerted their pricing behaviour and, thus, seriously distorted competition in the fuel market, to the detriment of final customers purchasing fuel at their petrol stations. This behaviour led to a huge impact on prices in many sectors of the national economy, where fuel constitute a significant part of the costs.

The decision of the Office was that such concerted practices were prohibited, and fines amounting to 313 million CZK (more than US\$13mn) were imposed on the six fuel distributors.

*Source: Annual Report 2004, Office for the Protection of Competition*

- The Act defines the concept of concentration of undertakings, and introduces the turnover thresholds as the relevant criterion, where concentration is subject to approval by the Office; and
- The Act introduces a two-phase proceeding for the approval of concentrations with strict deadlines (one month in Phase I + four months in Phase II), ensuring swift review of mergers.

In connection with the new Act on the Protection of Competition, the Office also elaborated and issued eight decrees granting general (block) exemptions from the prohibition of agreements distorting competition, which came into force also on July 1, 2001.

On the same day, a so-called leniency programme was adopted in the Czech Republic providing for a lenient treatment of cartel participants who voluntarily provide convincing proof about the existence of an illegal cartel agreement, of which the Office was not aware until the date of submission of the application. By adopting this modern competition law instrument, the Office demonstrated its intention to fight hard-core cartels, representing the most serious anticompetitive practices significantly harming competitors and economy as a whole.

Adoption of the new Competition Act not only introduced a modern and more efficient legal framework for the enforcement of competition rules, but also led to strengthened legal certainty of undertakings, which would be subject to competition rules comparable to the European Community law standards. Therefore, Czech market functioning would not be subject to several different competition regimes, an important benefit from the view of accession of the Czech Republic to the EU.

Following major changes to the EU competition rules in 2004, and in connection with accession of the Czech Republic to the EU in May 2004, the *Act No. 143/2001 Coll., on the Protection of Competition* was amended as of June 02, 2004. The main purpose of the changes, brought about by this amendment (for their summary see box 68.2), was to ensure the effective implementation of the modernised EU competition rules in the Czech Republic, and to empower the Office to apply Articles 81 and 82 of the EC Treaty and cooperate with the EC, and other national competition authorities, within the framework of the newly established European Competition Network.

This amendment, so far, has represented the last major change to the competition regime in the Czech Republic, which has developed during the thirteen years of its modern history into an effective instrument for protection and promotion of competition comparable to competition regimes in other developed countries.

Closely related to the competition law, the control of state aid aims at preventing the state authorities from providing subsidies, to undertakings, in a way that distorts competition in the market. In order to fulfil its obligations *vis-à-vis* the EU, the Czech Republic adopted the *Act No. 59/2000 Coll. on State Aid*, ensuring control of state aid in line with the EU rules.

The rules on state aid were enforced by the Office for the Protection of Competition, before accession to the EU. Following accession to the EU, the EU state aid rules are currently directly applicable and enforced in the Czech Republic by the European Commission. In order to ensure the effective application of these rules, the *Act No. 215/2004 Coll., Regulating Certain Relationships in the State Aid Area*, came into force on May 1, 2004, repealing the

*Act No. 29/2000 on State Aid*, and empowering the Office to perform co-ordination, advisory, consultative and monitoring functions.

The rules prohibiting unfair competition between market participants are a part of the *Act No. 513/1991 Coll., Commercial Code*, which in a general clause prohibits any unfair competition and provides examples of such practices, including, in particular, deceptive advertising; deceptive marking of goods; damaging the reputation of another undertaking; bribery or violation of trade secrets. Any entity affected by these practices may enforce compliance with these rules by a civil court action.

#### **Box 68.2: Major Changes to the Competition Legislation in 2004**

- Empowerment of the Office to directly apply Articles 81 and 82 of the EC Treaty, and the introduction of procedural rules governing their application;
- Abolishment of the notification system, that allowed undertakings to apply for individual exemption from prohibition of agreements; and the introduction of direct applicability of the relevant provisions, for exemptions from the prohibition of agreements, provided for by Article 3(4) of the Act;
- Increase of the market share thresholds for the so called *de minimis* rule to 10 percent for horizontal agreements, and 15 percent for vertical agreements (with the exception of agreements dividing markets, consumers and resources, and setting prices for the final consumers);
- Abolishment of a so-called negative clearance procedure, for agreements and abuses of dominance;
- Introduction of the possibility for the Office to issue a decision that would make binding any commitments offered by the parties, in order to remedy any alleged anti-competitive agreement or abuse of dominance, without the need to decide on the existence of the infringement itself;
- More precise definition of the abuse of dominant position in relation to the essential amenities;
- New merger notification thresholds ensuring an adequate local nexus of notified mergers to the Czech jurisdiction;
- Introduction of a new substantive test for the assessment of concentrations of undertakings, under which the concentration may not be approved if it significantly impedes effective competition (called the ‘SLC test’), especially as a result of the creation or strengthening of a dominant position in the market; and
- Introduction of time limits for the submission of proposed remedies by merging parties and provisions on the extension of deadlines, for issuing a decision by the Office, in case remedies are offered.

## Sectoral Regulation

In several, mainly network industries, the Czech Republic initiated the process of gradual liberalisation aimed at introducing competition in these previously monopoly sectors. Activities of undertakings in these sectors are governed by special regulatory rules enforced by independent sectoral regulators, which include particularly:

- **The Czech Telecommunications Office** in the telecommunication sector administers, *the Act No. 151/2000 Coll., on Telecommunications*. Currently, a new act on electronic communications is being prepared, transposing the relevant EU directives and aiming at ensuring that sectoral regulation is applied only in areas where sufficient competition has not yet been developed, and where sole application of the general competition legislation is not sufficient for ensuring effective functioning of the market;
- **The Energy Regulatory Office** in the energy sectors (in particular electricity and gas sectors) administers the *Act No. 458/2000 Coll., Energy Act*; also in this sector, new legislation is being prepared in order to transpose the relevant EU rules and to ensure their further liberalisation;
- **The Czech National Bank** regulates the banking and financial services sectors; and
- **The Czech Securities Commission** regulates the securities market.

Nevertheless, the existence of such sectoral legislation and regulators does not prevent the Office for the Protection of Competition from enforcing the general competition rules in these sectors, and from promoting competition principles.

## Interface with Regulatory Agencies

The Act on the Protection of Competition relates to all the entities that may be subsumed under the concept of 'undertaking' and to all the sectors of economy without any exception, as well as to all public and private undertakings.

Regulation authorities, as the Czech Telecommunications Office or the Energy Regulation Office implement *ex ante* measures leading to substitution of competition environment in the area, where effective competition does not exist, while the Office for the Protection of Competition prosecute *ex post* the behaviour of undertakings that distort competition or exceeds the framework of a special regulation act.

The combination of *ex ante* regulation along with the *ex post* protection of competition is considered as a useful tool for achieving effective protection of competition in the regulated industries, with the final aim of replacing regulation with competition.

The Office has established close relationship based on a memorandum of cooperation with the regulatory bodies. For instance, the memorandum with the telecom regulator was signed in January 2001. The Office cooperated with energy regulator on the creation of several decrees, in the course of which it enforced the competition principles. On the basis of a request by the energy regulator, the Office initiated one administrative proceeding in 2004 to assess whether a heat supplier abused its dominant position. The proceeding was anyhow stopped, as the Office did not find any indication suggesting abuse of dominant position.<sup>5</sup>

### Box 68.3: Restructuring of the Electricity Sector

Since the process of restructuring of the Czech electricity sector began in the mid-1990s, the Office for the Protection of Competition has promoted vertical separation of distribution, transmission and production of electricity by the incumbent electricity company ÈEZ.

In 2002, the Government decided to restructure the state-owned electricity sector undertakings. This restructuring, as approved by the Government, included the reduction of the ownership share of ÈEZ in the transmission system operation from 100 percent to 34 percent; acquisition by ÈEZ of majority shares, owned by the State, in five regional electricity distribution companies; and of minority shares in the remaining three regional distributors.

As this transaction constituted a concentration of undertakings pursuant to the Act on the Protection of Competition, it was subsequently assessed, by the Office, as to its effects on competition. In administrative proceedings in this case, the Office issued a decision approving the concentration, subject to conditions, ensuring the maintenance of effective competition in the electricity sector.

Under these conditions, the dominant producer ÈEZ has been obliged to divest one of the five acquired distributors, all minority shares in the three remaining distributors and all remaining ownership shares in the transmission system operator. The transaction, in its modified form ensured more appropriate conditions for effective competition, which is being introduced within the framework of liberalisation of this key sector of the economy.

5 Annual Report 2004, Office of the Protection of Competition

### Box 68.3: Cesky Telecom Fined for Abusing its Dominant Position

The Czech incumbent, Cesky Telecom, the dominant player in the market place, has been fined the highest ever penalty in a competition case involving a single company, in the country.

The Office for the Protection of Competition (UOHS) has fined the Cesky Telecom an amount of •270,000, after deciding that the tariff programmes the company offered, in 2001 and 2002, undermined competition in the then recently privatised market.

The Company offered significant discounts and bonuses to customers who signed long period agreements with Cesky. Customers who did not sign were being forced to pay premium rates for the same services.

The competition watchdog also found certain practices to be illegal. These practices included: the requirement of customers to use only its fixed-line services; allowing customers to make a limited number of calls per month but charging for all the calls, even if the client made fewer calls.

Source: *Digital Media Europe*, 16.02.04 (<http://www.dmeurope.com/default.asp?ArticleID=58>)

#### Consumer Protection

The protection of consumers is ensured by the *Act No. 634/1992 Coll., on Consumer Protection*, which obliges undertakings to trade fairly with consumers, and prohibits unfair practices, such as discrimination or deception of consumers. These rules are primarily enforced by the Czech Trade Inspection, Czech Agriculture, and Food Inspection Authorities.

There is a Consumer Protection Department in the Ministry of Trade and Industry, which coordinates matters concerning consumer policy, including in those spheres of consumer protection that fall fully or partially under the competence of other state administration bodies.

The Commercial Code prohibits conduct *contra bonos mores* ("against good morals") that could damage other firms or consumers. Examples listed in the statute include

deceptive advertising and marketing, misleading consumers about identity, using another firm's reputation, and endangering consumer health or the environment. These rules overlap both competition policy and consumer protection.

#### Concluding Observations and Future Scenario

The major challenge in the competition policy area, in the near future, is ensuring the effective application of both national and the EC competition rules in the territory of the Czech Republic and effective cooperation with other authorities within the European Competition Network. This is expected to result in more efficient protection of conditions for competition in the Czech Republic and contribute to better protection of competition in the framework of EU, in particular against the most serious anticompetitive practices identified by the Office, such as hard-core cartels or abuses of dominant position by incumbent undertakings in newly liberalised sectors.

#### Suggested Reading

*Annual Report 2004*, Office of the Protection of Competition

<sup>†</sup> **Josef Bednář** graduated from the Faculty of Engineering, University of Technology at Brno, in 1980. From 1981-1992, he was employed as an expert in Geofyzika Brno. Bednář has been involved in the protection of competition since 1992. In 1993, he completed a study visit at the Federal Trade Commission in the USA. From 1994 to 1999, Bednář held the position of First Deputy Minister for Competition and after the establishment of the Office for the Protection of Competition, he became Vice-Chairman. Bednář has been the Chairman of the Office for the Protection of Competition since 1999 (who has been replaced by Martin Pecina in 2005 end). He completed his postgraduate studies at the Law Faculty of the Charles University in Prague, and has been lecturing on competition at the Law Faculty of Palacky University in Olomouc since 2003. Bednář is the author and contributor to various publications.