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

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ROUNDTABLE ON COMPETITION IN THE CONSTRUCTION INDUSTRY

-- Note by Poland --

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

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1. Introduction

1. The construction sector encompasses a broad range of activities: designing, constructing, maintaining and demolishing of various building structures. It ranges from the activity of the sole worker on a small project to engineering and construction companies that undertake giant investments.

2. Construction industry is, to a large extent, susceptible to many external factors, sometimes trivial like the weather or more important ones like business cycles, changes in the interest rates and tax law. The latter affect the individual and the business decisions related to the construction activity. State and local budgets affect road construction and maintenance. Changes in the regulations can result in new constructions or, on the other hand, stop the planned projects.

3. A revival in the construction industry in Poland has been observed since 2005. In the year 2006 and the first half of 2007 the construction of infrastructure, roads, building installations and preparation of grounds for building works were the fields, which have undergone the most dynamic development. According to the General Office of Building Control 230 thousands building permissions were granted in 2005 (against 162 thousands in 2004).

4. This process is the result of various factors, like a general boom in the Polish economy, vast foreign investments, lower unemployment rate, transfers from the European Union's funds and a constantly growing demand. As a consequence, in 2007 the construction companies recorded a dynamic development and significant growth in profits.

2. Barriers to entry

5. The characteristic feature of the construction industry is the fact that in many of its branches the majority of the production is concentrated in few firms, which may possess market power vis-à-vis their clients. For example, in Poland there are only six large producers of mineral wool, four of cell concrete and plaster-cardboards, as well as three producers of reinforcement steel. A similar situation concerns the cement and paint industries.

6. Significant concentration in those industries goes back to the crisis in the early 00's. Stagnation on the market and low demand for building materials caused bankruptcy of a number of small and medium producers (e.g. of brickyards). Others did not raise the prices and sold the products with minimal profit margins. No new investments were undertaken. The production lines were limited. The strongest market players (most often foreign-owned) took advantage of the crisis and of the poor financial situation of the smaller competitors and started to take them over at relatively low cost, which resulted in a consolidation of the market.

7. As a consequence, currently the new market entrants face a very strong competition from bigger firms, which hold significant shares in the market.

8. Furthermore, various administrative constraints (such as: building permissions, special qualifications) or costs of complying with quality regulations may constitute barriers to entry.

3. Enforcement approaches and case management

9. President of the Office of Competition and Consumer Protection ("OCCP") has been closely observing the construction sector, as industries with only several producers are undeniably more prone to cartel activity than others. So far, the OCCP's experiences mainly refer to the building materials, i.e. their

production and distribution. The most frequent anti-competitive behaviour encountered in Poland is fixing of resale prices and other trading conditions, e.g. profit margin between the producers and the wholesalers.

10. As the construction sector is diverse in nature, it is difficult to list all individual markets. The construction works can be roughly divided into four categories: new home building and renovation, heavy construction, institutional and commercial construction and civil engineering. However, from the point of view of a competition authority it is more adequate to examine it from the perspective of:

- building services market;
- construction-materials market (production, distribution).

11. While conducting the proceedings in the construction sector the Polish authority applies the same tools and procedures as those used in other sectors. Just like in all other cases a market study, including the determination of the structure of the analysed market and the degree of concentration is the first step. In the course of the proceedings various documents, data, files, by-laws of the construction associations are collected. Moreover, press and firms' websites are monitored.

4. Fixing of resale prices - OCCP's experiences

12. One of the first important decisions in the field of construction market was issued in September 2006. The President of the OCCP initiated antitrust proceedings on suspicion of a restrictive agreement between a paint producer Polifarb Cieszyn-Wrocław and the owners of seven DIY hypermarkets: Bricomarche, Castorama, Leroy Merlin, Nomi, Obi, Platforma and Praktiker.

13. The documentation collected by the Office, i.a. during the dawn raids at the entrepreneurs' premises, showed that the hypermarkets received a special discount for maintaining the prices of paints and varnishes at the level established by the supplier (or higher). A withdrawal from the agreement resulted in the loss of the discount provided by the seller and also, in some cases, with a refusal to supply.

14. During the proceedings, the OCCP established that Polifarb was the party which initiated the conclusion of the agreement (in a special letter to the abovementioned entrepreneurs it assured that the introduced solution will be beneficial for both sides) and became its main beneficiary. The aim of those practices was to end a "price war" among the stores and to introduce uniform prices for paints and varnishes produced by the company.

15. In the course of the proceedings one of the parties to the agreement supplied the President of the OCCP with a number of documents which significantly contributed to the clarification of the matter. It also actively cooperated during the proceedings in that it immediately provided all required information. In view of the above the President of the OCCP decided to reduce the fine imposed on this entrepreneur to PLN 50 000 (0,002% of its annual turnover). Other DIY hypermarkets received fines amounting to 3% of their annual turnover, while Polifarb, which initiated the agreement and was its main beneficiary, suffered a fine equivalent to 5% of its annual turnover.

16. In April 2007 the President of the OCCP imposed a fine of PLN 10 million on the participants of an illegal agreement in the drain pipes retail distribution market. In the course of the proceeding the authority established that an unlawful agreement was concluded by five producers of drain pipes.

17. The company ZTS Garmat was the initiator of the agreement. The proceeding proved that in May 2001 the producer of drain pipe systems entered into an illegal agreement with four distributors fixing sale prices of the offered products. In the contracts or the annexes thereto the companies agreed on maximum

amount of the discounts for further resale depending on *inter alia* the monthly volume of purchase. The initiator applied sanctions for not complying with the imposed limit. Moreover, the entrepreneur reserved himself the right to monitor the participants' behaviour by means of examining their invoices.

18. The application of the discount system meant in fact setting the minimal prices. The costs of the unlawful agreement were incurred by all market participants. The sellers were deprived of the ability to shape the prices individually, the consumers of the possibility to choose the cheapest products.

19. A similar type of agreement was also concluded in the retail distribution of ceramic tiles market. Fines imposed on the participating companies amounted to over 600 thousand zloty.

20. Finally, the most recent decision concerns again the paints and varnishes sector. An antimonopoly proceeding was initiated in December 2006. The Office checked whether Castorama, the owner of 36 DIY stores located all over Poland, and ICI, a painting products manufacturer, fixed the minimum retail price of fourteen products.

21. The proceeding showed that at least since 2004 the companies have been fixing not only the final retail prices of ICI's paints and varnishes, but also the constituents of the prices, such as the profit margin. The enterprises were acting in a deliberate and conscious way, gaining unjustified benefits for many years, and have not changed their conduct despite the launch of the antimonopoly proceeding.

22. The practice had anti-competitive effects first of all within the ICI brands. Artificial inflating of prices by one of the company's clients (Castorama) influenced the prices used by ICI's remaining business partners. Consequently, consumers were forced to pay the prices fixed by the participants of the agreement, which would not be the case in the state of undisturbed competition. Paints and varnishes offered by ICI are one of the most popular ones on the market.

23. A different case has been investigated since 2006. It is a proceeding against eight cement producers suspected of conspiracy. The reason to initiate the explanatory proceedings were numerous signals indicating the possibility of a mechanism being in place – at least since the late 1990s – which the major Polish cement producers would use to fix prices, partition the market and limit the supplies. In the course of the proceedings an inspection on the premises of the suspected companies was performed in co-operation with the Police. It was the largest operation of this kind in the history of the Polish competition authority.

24. The OCCP's employees simultaneously entered the offices of 8 cement producers and 3 entrepreneurs suspected of supporting the cartel (e.g. by facilitating exchange of sensitive information), in 13 locations all over Poland. They were accompanied by about 100 police officers, including highly qualified forensic technicians. A substantial amount of evidence was gathered. The proceeding is still ongoing.

25. Restrictive agreements in the cement market are relatively frequent in many European countries. In Poland, already in 1934, as a result of a compulsory dissolution of the cement cartel, the price of this building material dropped from around 70 to approx. 20 zlotys per ton.

26. In conclusion, it can be said that the majority of the cases investigated by the Polish competition authority concern fixing of resale prices in the sector of production and distribution of building materials. It does not mean that this is the only activity under observation: building firms often have to proceed through public procurement procedure, therefore bid rigging in the construction industry must also emerge as an important target for the OCCP.

27. The construction boom in Poland caused an increase in the prices of building materials. Some of the firms take advantage of high demand to reduce the deliveries and therefore to lift the prices even more. It has been especially notable with respect to plaster boards or thermal insulation materials. Furthermore, in the market of production and distribution of such products there are only few players, which makes the sector prone to cartel activity.

28. Many economic analyses show that prices grow faster where the competition among producers is less intensive, while in sectors, where robust competition prevails, prices of products tend to stay in place for a longer time, e.g. in Poland there are almost three thousands window producers and even with a high demand for their product, a rather limited increase of prices, mostly related to rising production costs, was noted. Competition between these entrepreneurs is so fierce that they are not in a position to raise prices without very good reasons.

4.1 Mergers

29. As for the problematic merger cases, one is especially worth mentioning and concerns a concentration between CRH Deutschland and E. Schwenk- companies operating in the sector of production and sales of concrete.

30. Having analysed the planned transaction, Polish competition authority issued a conditional clearance. By the end of 2008, CRH Deutschland will have to sell to an independent buyer all the shares in the Res-Bet company it owns. Leaving this firm in the hands of CRH Deutschland would lead to a strong increase in concentration in the Rzeszów region.

5. Cost overruns

31. Referring to the problem of costs overruns i.e. costs increase, that arise in the course of building works, this most probably will not be resolved by the OCCP if it concerns legal relationships between entrepreneurs. Such disputes are to be settled in civil litigation. However, if the unexpected price increase amounts to an abuse of dominant position (excessive pricing), the competition authority has an obligation to take the necessary measures.

6. Conclusions

32. So far, the experience of the Polish competition authority does not seem to bear out the view that competition law violations tend to occur in the construction industry especially frequently.

33. This sector, however, is sure to develop at a rapid pace for years ahead, as the poor state of the infrastructure demands large investments. This need will only be accentuated by the fact that Poland co-hosts the European Football Championship in 2012. It will make construction sector one of the priorities in the OCCP's enforcement activities.