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One size does not fit all cartels

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ONE SIZE DOES NOT FIT ALL CARTELS

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The European Commission's assessment of co-ordinated conduct often appears blind to shades of grey. Without much exaggeration, it can be described as follows: every contact among competitors involving potentially sensitive information constitutes an infringement *by object*, every infringement by object is a cartel, and every cartel is very serious and must be punished with extremely high fines. While we agree that strong and credible enforcement towards cartels is a key pillar of competition policy, this black and white – or, rather, "all black" – approach is too simplistic. Practices investigated under the "cartel" heading vary widely, spanning from information exchanges to hardcore cartels. Recognising the differences between cases is essential, both to correctly characterise the compatibility of conduct with competition law, and to set proportionate fines where infringements do occur.

In this article we address three issues. First, we argue that a blanket application of the object infringement category, although administratively convenient, is not justified and should be avoided. Instead, a case-by-case assessment is necessary. This should take into account, among other factors, whether a plausible theory of harm can be identified. That is, the existence of a *causal link* between the conduct and some probable consumer detriment should be demonstrated in order to establish an infringement by object.

Second, we show that considerable differences exist also among cartel practices, both in their form and in their impact on consumers. This conclusion is borne out by theoretical considerations, by practical experience and by empirical studies. We discuss some of the criteria that can be applied to undertake this assessment.

Third, we argue that the differences between cases, described above, are not sufficiently taken into account in the calculation of fines. In practice, all infringements are treated as cartels, and cartel fines are calculated on the basis of a "co-efficient" that varies very little – typically between 16 percent and 19 percent. As a result, fines tend to be set on a very similar basis in spite of the important differences in the nature of the conduct, in the economic context and in the actual effects on competition. Irrespective of the *absolute* level of fines (which is a different issue), this raises questions about the *relative* level of fines across cases and the consistency of the current policy with the principle of proportionality.

Object or effect?

The commission's Guidelines on the application of Article 101(3) TFEU provide the following definition:

"Restrictions of competition by object are those that [...] have such a high potential of negative effects on competition that it is unnecessary for the purposes of applying Article [101](1) to demonstrate any actual effects on the market." [1]

It is easy to see how this criterion is fulfilled in a hardcore cartel case. When companies agree to fix prices according to precise schedules, set up mechanisms for monitoring the implementation of the agreement and to punish deviations, etc., it is plain that the *"potential of negative effects on competition"* is very high.

Yet such hardcore cartels comprise only a portion of the total of cases where a cartel is alleged. A substantial number of cases investigated by the commission under the cartel "heading" focus, instead, on information exchanges and on other "grey area" conduct that falls short of a classic horizontal conspiracy. In such cases it is critical to ask whether a plausible theory of harm exists which is consistent with the facts of the case. Such a theory should provide a clear causal link between the specific conduct at hand and some likely detriment to consumers – that is, collusion which raises prices to consumers. The theory should take into account the nature of the conduct and the economic context in which this takes place. This is recognised by the Court of Justice. For example, in *GlaxoSmithKline* the court held that:

"in order to decide the anticompetitive nature of an agreement, regard must be had inter alia to the content of its provisions, the objectives it seeks to attain and the economic and legal context of which it forms part." [2]

Importantly, the purpose of such a theory is not to demonstrate the existence of actual anticompetitive effects, but merely to show that such effects are possible and highly likely to materialise. This is consistent with the Guidelines, which explain that *"[the object] presumption is based on the serious nature of the restriction and on experience showing that restrictions of competition by object are likely to produce negative effects on the market"* (§21, emphasis added). If a plausible theory of harm, consistent with the facts of the case, cannot be identified, then the likelihood of adverse effects on consumers cannot be presumed and the existence of an anticompetitive object should, therefore, be called into question.[3]

Practices investigated under the 'cartel' heading vary widely, spanning from information exchanges to hardcore cartels

Information exchanges are a case in point. Economic theory and empirical analysis have shown that their effects on competition can be positive or negative, depending on circumstances. This is recognised by the EC Guidelines on horizontal co-operation agreements.[4] As a consequence, negative presumptions are generally inappropriate and a case-by-case assessment is required. Indeed, while the Guidelines introduce the *presumption* that exchanges of information on future prices constitute infringements by object, they fall short of considering this a *per se* abuse – a presumption is by definition rebuttable. This approach seems both pragmatic and sensible, as there may be circumstances where even exchanges of future price information may not have anticompetitive effects. A better knowledge of future prices does not necessarily provide the ability to raise market prices above the competitive level, just as the ability to forecast tomorrow's weather does not enable us to change it. For example, information on rivals' prices can be used to better undercut them rather than to match them. Although such information may well be used anticompetitively, each case has to be assessed on its own merits.

A coherent theory of harm needs to show how the conduct in question is likely to give rise to a collusive market outcome in the specific context of the case at hand. To be consistent with economic theory, the theory of harm should verify the necessary conditions for the existence of collusion, which have been described by European courts in *Airtours* and *Sony/BMG*.[5] For example, simply stating that an information exchange must have anticompetitive effects because it "reduces uncertainty" does not amount to such a theory. The argument that the companies "cannot have failed to take account of the information received" is equally weak. By definition, all information reduces uncertainty and any additional knowledge is inevitably "taken into account." Therefore a mechanical application of these "criteria" amounts to a *per se* rule of illegality. Instead, the question that one should address is whether the specific information exchange is likely to give rise to collusion in a market that would otherwise be competitive.

Competition authorities recognise the current trend whereby hardcore cartels have become increasingly rare, while the number of "grey" collusion cases is growing. Officials often interpret this trend as a sign that companies are becoming more skilled at hiding the proof of their wrongdoing. According to this interpretation, the differences between cases, described above, would be primarily differences in the available evidence rather than in the substance. In other words, "grey" cases would be those where we see only the "tip of the iceberg."

This would justify treating all cartels the same way, because a big iceberg is always lurking underwater, even when we see only the tip. Yet another interpretation is also possible. Namely, that competition policy is actually succeeding in deterring the worst kinds of anticompetitive conduct. It would be ironic if the commission, which motivates the recent large increase in the level of fines with the need to deter cartel behaviour, interpreted the facts in a way which denies any effectiveness to their own policy.

Different cartels have different effects

Even if we restrict our attention to genuine cartels (i.e. where the "object" categorisation is well justified), we still find a wide variety of cases. Agreements can vary for example in their scope: they can cover the entire market or just selected customers and/or products. They can vary also in their accuracy and detail, ranging from extremely precise and extensive hardcore agreements to vague and approximate forms of co-ordination on average prices.

Moreover, the same form of co-ordination can have widely different effects depending on market characteristics. For example, an agreement to "raise prices by five percent" may be very harmful in a homogenous product market where the same price is applied to all customers; but it is likely to be much less effective in a market where each supplier sells hundreds of differentiated products and where prices are negotiated bilaterally and privately with each customer. Co-ordination is also more difficult in markets where demand and/or costs are liable to change unpredictably, where innovation is frequent or where customers have countervailing buying power, to cite only a few factors. Such criteria are recognised by the Horizontal Merger Guidelines[6]: *"The more complex the market situation is, the more transparency or communication is likely to be needed to reach a common understanding on the terms of co-ordination."*

The conclusion that the effects of cartels differ substantially from one case to another is confirmed by empirical studies. Notwithstanding the serious methodological criticism that has been raised about these studies, and while the results differ, they all support the conclusion that cartels' effects on prices vary substantially from one case to another.[7]

Differences in the nature of the conduct and in the economic context where it takes place lead to widely different effects on consumers

For example, one such study (quoted by the commission in its recent consultation on private damages actions) finds that cartel overcharges can range from zero to 70 percent.[8] While the average cartel overcharge is claimed to be circa 20 percent, in 50 percent of the cartels analysed by this study the overcharge was substantially different from the mean, namely less than 10 percent or more than 30 percent (with an approximately equal split of cases in these two groups). This confirms that cartels vary widely in their effects, to the point that average overcharge estimates (even if they were based on a robust methodology) provide little if any guidance to assess the effects in a specific case. Moreover, such studies are likely to understate, if anything, the variability of cartel overcharges, in particular because they are likely to underestimate the number of infringements which have little or no effect.[9]

Proportionality and fines: one size does not fit all

As we have seen, co-ordinated practices vary widely in their nature and context, as well as in their effects. They range from information exchanges (which may even be pro-competitive) to hardcore cartels, with numerous "shades of grey" existing in between these two extremes. In turn, differences in the nature of the conduct and in the economic context where it takes place lead to widely different effects on consumers.

Yet the commission takes little account of all these differences when setting fines. This is for two reasons. First, virtually all contacts between competitors are considered as infringements by object and are treated as cartels. As a consequence, differences in the nature of the conduct are blurred and fines are calculated according to the same (cartel) methodology in all cases. If the new section on information exchanges in the Guidelines on horizontal co-operation agreements is to be more than a theoretical exercise, it is to be hoped that in the future the commission will not systematically treat these practices as cartels, but will adopt a more differentiated approach in the way it assesses the conduct and sets the fines. Second, cartel fines appear to take little account of the specificities of each case. In practice, they are set on the basis of a "co-efficient" that varies very little across cases and is typically somewhere between 16 percent and 19 percent.

Footnotes

1 O.J.E.U. 2004/C 101/08 (27.4.2004), paragraph 21.

2 See Joined Cases C-501/06 P, C-513/06 P, C-515/06 P, and C-519/06 P, judgment of 6 October 2009, at paragraph 58.

3 F. Rosati, "Échanges d'informations et autres comportements coordonnés : Pour une théorie de l'entente", Concurrences 4-2008; RBB Brief "Catch 22: The role for economics in the assessment of information exchanges under Article 81 analyses in practice", available at www.rbbecon.com

4 O.J.E.U. 2011/C 11/01 (14.1.2011), paragraphs 57 and 58.

5 See the EC Guidelines on Hor. Coop. Agreements, op.cit., paragraphs 75-76.

6 O.J.E.U. 2004/C 31/03 (5.2.2004), paragraph 47. See also paragraph 45: "It is [...] easier to coordinate on a price for a single, homogeneous product, than on hundreds of prices in a market with many differentiated products. Similarly, it is easier to coordinate on a price when demand and supply conditions are relatively stable than when they are continuously changing." See also the EC Guidelines on Hor. Coop. Agreements, op.cit., paragraphs 77-85.

7 In particular, these studies are likely to suffer from "publication bias", namely, the fact that effective cartels are more likely to be studied by researchers and the results of those studies are more likely to be published. M. Boyer and R. Kotchoni, for example, find that the data on which such studies are based "are subject to model error, estimation error and publication bias" ("The econometrics of cartel overcharges", Cirano paper 2011s-35, August 2011). See also the criticisms raised by C. Ehmer and F. Rosati in "Science, myth and fines: do cartels typically raise prices by 25%", Concurrences 4-2009.

8 EC Draft guidance paper on quantifying harm in actions for damages (June 2011), paragraphs 122-123.

9 As a result of publication bias; see footnote 6.

10 Commission's Decision of 15 October 2008 in case COMP/39188.

Irrespective of the *absolute* level of fines (which is a distinct issue), this lack of differentiation raises questions about the *relative* level of fines across cases and the consistency of the current policy with the principle of proportionality.

Moreover, this mechanical and undifferentiated approach in the calculation of fines is inconsistent with the general trend towards a more effects-based analysis that the commission has been pursuing in other areas of competition law enforcement. It is also inconsistent with the commission's stated desire to see a greater development of private actions that provide compensation for damage suffered by customers. Decisions that take into greater account actual effects would help to connect competition law enforcement with the consumer impacts that are deemed important in these other areas and would avoid potentially serious inconsistencies between the level of fines and the level of damages. They would also provide the commission with an opportunity to use its expertise and information to advance the debate about the economic impact of competition law infringements on real consumer outcomes.

There are various ways in which the actual significance of infringements can be reflected in commission decisions. In the *Bananas* case,[10] for example, importers were accused of having exchanged information on their future "quotation prices" – a sort of "list price." This information exchange was portrayed in the Decision as a "cartel." However, the Decision granted the parties a 60 percent reduction of the fines on account of the fact that the information exchanges related to "quotation" rather than actual transaction prices, and because there was strong economic evidence to suggest that the commission's own quotas regime on bananas at that time left little or no room for the conduct in question to affect consumer prices. This case shows that even within the straitjacket of an object infringement case, the commission has some discretion to take into account arguments about the economic context and the likely effects of the conduct when setting fines. We see the exercise of such discretion as a highly desirable move in the right direction, though a fuller solution to the enforcement problems in this area would probably require more fundamental reform. ■

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