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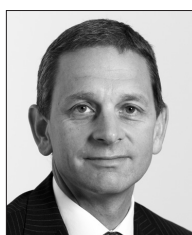
The long and winding road

Benoît Durand and Derek Ridyard of RBB Economics examine the route taken to get to an effects-based approach, focusing on information exchange in the draft guidelines on horizontal agreements



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This article looks at the Commission's latest draft guidelines on horizontal agreements ("the guidelines").¹ We consider how the proposals deal with agreements that involve the exchange of information between competitors and assess the extent to which the guidelines make progress on the road towards a consistent effects-based competition law regime for this type of conduct.

When competitors exchange information, competition enforcers' alarm bells ring. It is a healthy instinct for regulators to be suspicious about any horizontal agreement, and it is undeniable that the information shared with competitors can allow them to reach or stabilise collusive understandings. Yet as acknowledged in the guidelines, "information exchange is very often procompetitive." In the real world, firms make investment or production decisions without complete information about current and future market conditions, and this can lead to costly errors in the way resources are allocated. One important benefit of information sharing is that it helps reduce the uncertainty about the firms' environment, enabling them to make better commercial decisions, which in turn can result in cost savings and welfare gains.

Hence, the Commission is faced with a familiar, though complex, problem. An ideal set of guidelines will identify and outlaw the bad elements, remove suspicion and the risk of unjustified regulatory interference from those elements that are clearly good for welfare and efficiency, and at least provide a workable roadmap for parties to navigate a way through those cases where the actual effects depend on the economic circumstances.

The potential anticompetitive effects of information exchange

A good starting point for this task is to identify the theories of harm that would justify intervention. The guidelines identify two distinct anticompetitive effects, namely that information exchange could lead to either the emergence of collusion, or to anticompetitive foreclosure.

The analytical framework describing how information exchange may lead to a collusive outcome relies heavily on the economics of "tacit collusion." Tacit collusion may emerge

when competitors, through repeated interaction, manage to elevate price above the competitive level, and possibly close to the monopoly level, without explicitly fixing prices or quantities. Competitors will raise prices if through some "meeting of the minds," they reach a mutual understanding on the collusive price level, and a consensus that deviation from the collusive price will be met by some form of punishment.

Helpfully, the guidelines' analysis of this competition concern draws largely on the Commission's approach to co-ordinated effects in horizontal merger control. After all, in substantive terms a merger is essentially a horizontal agreement, and it is therefore only sensible that both policy instruments adopt the same analytical framework. By doing so, the Commission provides a reasonable degree of consistency in the assessment of tacit collusion concerns, and also allows the debate on horizontal agreements to be informed by the body of thinking and case experience amassed in 20 years of active enforcement under European merger control.²

It is significant that since the *Airtours* Judgment and the adoption of its principles in the Horizontal Merger Guidelines, the Commission has rarely raised the prospect of co-ordinated effects as a competition concern in merger control.³ A careful examination of the market features often helps rule out the possibility that co-ordinated effects may arise at all. Many markets are not sufficiently transparent, concentrated, simple, stable and symmetric to support collusion, and so the prospect of co-ordinated effects is inherently very limited.

However, the guidelines consider that information exchange might actually allow firms to change their commercial environment so they could reach a collusive outcome that would not otherwise be feasible. For example, if the information exchange increases market transparency, this could allow firms to arrive at a common understanding on the terms of co-ordination (i.e. find a focal point) and give them the ability to monitor deviation. The Commission may investigate this competition concern in markets where the other conditions appear to rule out co-ordinated effects. In these cases, the information exchange will have to make co-ordination easier to reach or sustain internally in spite of those market conditions.

But as currently drafted, the guidelines' proposed assessment contains two obvious gaps. First, one key component of the Horizontal Merger Guidelines – the condition that “co-ordination is not sustainable unless the consequences of deviation are sufficiently severe to convince co-ordinating firms that it is in their best interest to adhere to the terms of co-ordination” – is simply omitted. Clearly, without a credible punishment mechanism, competitors will not sustain a collusive outcome. By the same token, information sharing between competitors will not permit firms to maintain the collusive price if there is no sufficient deterrent mechanism.

Second, the presence of disruptive forces, such as maverick firms, the threat of entry by potential competitors and countervailing buyer power of customers, which is prominently presented in the Horizontal Merger Guidelines, is not highlighted in the guidelines. However, the actions of these outsiders would prevent competitors who exchange information from reaching a collusive outcome, and indeed this was one of the key facts that led the Court to reverse the *Airtours* decision.

The guidelines also introduce a novel concern, that information exchange between competitors who already tacitly collude would enable them to “target” new entrants in order to preserve the stability of the collusive outcome. It is hard to see how this apparently *ad hoc* theory of harm aids clarity in describing the Commission's future enforcement intentions.

Even accepting that information exchange has effects that can differ from mergers, such gaps between the way that substantively similar concerns are treated should not be allowed to persist in a joined-up competition law regime. The guidelines have done much to bring these strands together, but there is scope to do more.

Whereas the collusion concern is firmly grounded in economic theory and in case experience, the second theory of harm assessed in the guidelines – the promotion of foreclosure as a theory of harm – is highly speculative. The hypothesis that information sharing between competitors could lead to anticompetitive foreclosure finds little if any support in the economic literature, and no empirical evidence is advanced to confirm that this foreclosure is a serious concern. In fact, the paucity of substantive guidance on this point in itself indicates a lack of firm foundations.

In introducing this competition concern, the guidelines open the door to efficiency-offence claims, inviting frivolous complaints from less efficient competitors. When information exchange puts third-party competitors at a competitive disadvantage, there is a risk that their commercial interests

will be harmed. For example, if information sharing between two competitors leads to a significant quality improvement of their products, giving them a significant edge over a third competitor, the guidelines speculate that this could be construed as anticompetitive foreclosure. While the third competitor is harmed in the short run, threatening loss of market share or even exit, consumers might be better off thanks to a superior product offer. The Commission should be cautious in these situations. Competition is inherently a dynamic process. Rivals that fall behind may react by investing to close the quality gap, and even overtake other competitors. If the guidelines provide them with an option to complain instead of competing in this way, economic efficiency and consumer welfare may be poorly served.

Restriction of competition by object

The definition of circumstances in which conduct constitutes a restriction by object is a critical feature of any Article 101 guidelines. For such restrictions, the Commission has no need to conduct an effects-based assessment, and the conduct is thus

assessed under the same legal standard as a cartel, and risks to be fined as such. Yet competitors that have exchanged information have not explicitly agreed to fix prices or quantities, or to share customers and territories. Hence, to justify being excused the need to measure the actual effects, there should be a strong obligation on the Commission to have shown that such conduct would inevitably have a harmful impact on competition.

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The guidelines consider that sharing information about future conduct regarding prices or quantities should fall into this “object” category. On the face of it, outside a cartel agreement it may be difficult to see why competitors would exchange information regarding their intentions about future prices or quantities. However, it is only through the lens of the economics of tacit collusion that one can analyse how information-sharing regarding future conduct may enable competitors to reach a collusive outcome.

For example, learning the future strategy of a competitor through information exchange may confer an advantage that a firm will exploit to beat that competitor and gain additional profit. Anticipating the possibility of such opportunistic conduct, the competitor may not provide genuine information in the first place. Unless some mechanism exists to compel competitors to exchange genuine information, it is difficult to see how such information exchange would enable firms to reach a collusive outcome. Moreover, to attain the collusive outcome, it must be the case that the information sharing and the market conditions are such that co-ordination will actually emerge and be sustained. This requires fulfilment of the conditions that

AB EXTRA – HORIZONTAL AGREEMENTS

have been established in the context of co-ordinated effects in merger cases, and that have been shown often not to apply. In other words, while it is certainly possible to conjecture on how exchange of future pricing or output intentions could facilitate collusion, there is nothing inevitable about that outcome, and an effects-based approach is the only effective tool to carry out this assessment.

Crucially, there are also clearly circumstances in which such information exchange generates substantial efficiency gains. By its very nature, information sharing typically reduces uncertainty, and even sharing intentions regarding future prices or quantities can help minimise uncertainty in a way that enables firms to cut costs and benefit consumers.

For example, consider a group of local fruit growers that are not of sufficient importance to influence prices either on the domestic or on the export markets. Suppose they are organised in a regional association and pool information about expected production volumes, which depend on a variety of factors including weather conditions, in order to improve the planning of their harvests and distribution. Typically, these producers prefer to serve the domestic market as transportation and logistics costs are lower, but any production allocated to the export market has to be harvested early, and therefore each producer might wish to anticipate the allocation of production volumes between domestic and export markets. Information on other regional producers' output levels would help in this respect. Indeed, if overall regional production is high, that increases the risk of unsold inventories on the domestic market. If the chance to recycle these products on the export markets is limited once the fruit is already ripened, the information sharing would help these producers plan their harvest more efficiently and allow them to plan the delivery of perishable fruits so as to boost both quality and output levels.

Before asserting that such information exchange on future production levels is a restriction by object, the Commission should first have to show that they have "such a high potential of negative effects on competition that it is unnecessary for the purpose of applying Article 101(1) to demonstrate any actual effects on the market."²⁴ However, our example illustrates just one of many instances in which such an information exchange will lead to lower prices or higher output levels.

Of course, any restrictive agreement that fulfils the four conditions of Article 101(3) can gain an exemption. This means that finding an information exchange is a restriction by object does not amount to *per se* illegality. But in practice, it creates a presumption of illegality that is difficult to overcome. The evidentiary burden to satisfy Article 101(3) is high. And when the circumstances clearly indicate there is no obvious anticompetitive effect, even when the information sharing concerns future prices and quantities, the adoption of a restriction-by-object approach risks chilling desirable procompetitive conduct, preventing firms from becoming more efficient, and denying consumers their share of the benefits from these efficiency gains.

Conclusions

In summary, the guidelines make some progress on the way to a more coherent effects-based enforcement regime on information exchange. In particular, the adoption of a framework for collusion concerns that draws heavily on the approach taken to horizontal mergers provides a stronger foundation for the analysis than has been evident in previous Article 101 guidance.

However, we have also identified areas in which the guidelines fall short, most notably in their over-inclusive definition of the circumstances in which information exchange should be deemed a restriction by object. Outside of a cartel agreement, there are no simple rules to determine when information sharing is anticompetitive. A blanket prohibition, or any approach that would make these information exchanges *per se* illegal, would risk too many "false positives," condemning information sharing that in a significant number of cases is procompetitive. An effects-based analysis that relies on the economics of tacit collusion is the only effective tool to evaluate whether information sharing is likely to restrict competition. Effects-based assessment is more complicated, but a complex solution is the appropriate response to complex problems, and experience with the analysis of tacit collusion in merger control has shown that a workable effects-based approach to such concerns can be achieved. ■

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Footnotes

- 1 The consultation document was published in May 2010, and can be found at http://ec.europa.eu/competition/consultations/2010_horizontals/guidelines_en.pdf
- 2 Clearly, Article 101 has been in force for many more years than the EUMR, but the number of cases requiring substantive assessment under the merger control provisions far exceeds the number of fully reasoned horizontal agreements under Article 101.

- 3 The ABF/GBI Business case is the only transaction since Airtours in which the Commission objected to a transaction on the basis of co-ordinated effect alone.
- 4 See the Commission guidelines on the application of Article 101(3) of the TFEU at paragraph 21.