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Catch-22: The role for economics in the assessment of information exchanges under Article 81

Economic analysis has a clearly established role in the assessment of alleged infringements of Article 81 EC. It is central, for example, in establishing whether a vertical agreement results in foreclosure, or in estimating the damage suffered by a customer of a cartel. However, economics has typically played a less prominent role in establishing whether a cartel infringement has occurred. But that situation is now changing, spurred by the increased tendency of the European authorities to pursue Article 81 cases against horizontal agreements, such as information exchanges, which fall short of the classic cartel infringement.[1]

This Brief explores the role that economics can play in cases where information sharing is alleged to infringe Article 81. We comment in particular on the "Catch-22" that now stands in the way of enforcement officials who seek to avoid economic analysis by claiming that a restriction is anti-competitive "by object".

The economics of information exchanges

A substantial economic literature exists addressing the effects that the exchange of information between rivals can have on competition. It shows that these effects can be positive as well as negative, and that even when the information relates to key parameters such as prices and output, the impact depends on the specific circumstances of the case.

There are numerous circumstances in which the exchange of information between competing sellers can help to make markets work better. For example, in markets characterised by large fluctuations of demand, firms tend to keep substantial inventories in order to be able to meet demand at peak times. If information exchanges increase firms' ability to forecast demand fluctuations, they can increase economic efficiency by enabling firms to optimise inventories and to avoid shortages or overproduction. Exchanges of information between rivals about turnover or volume forecasts can thus reduce supply chain costs and bring benefits to consumers. Information sharing can also enhance economic efficiency in other ways: by enabling firms to set pricing decisions on the basis of a more complete understanding of the market; by facilitating the diffusion of technological knowledge; by promoting beneficial product standardisation, or innovation; and/or by providing benchmarking evidence that acts as a spur to superior performance.

However, information exchanges can also have anti-competitive effects, primarily by dampening competition and facilitating coordination of competitive behaviour. There are two main areas of concern. First, information exchange can increase the transparency of a competitive parameter (price, capacity, sales, customer identities, etc) that could be employed as a plausible focal point for collusion. In this way, it can help firms to coordinate their behaviour even in the absence of an explicit anti-competitive agreement. Second, it can make collusion more stable by allowing the members of an oligopoly group to monitor adherence.[2]

Since there are no reliable form-based rules that determine on which side of the line any given category of information exchange will fall, economic theory advocates assessing information exchanges under a rule of reason approach, and not on the basis of the form that it takes. This should start by identifying how in principle any given information exchange might harm competition; and then assessing whether that hypothesis of competitive harm is compatible with the facts. Collusion can materialise only if three specific conditions are cumulatively met. First, the market must be sufficiently simple and

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The EC Commission's recent Article 81 action against information sharing by the major European banana shippers (Case COMP/39188 – Bananas, 15 October 2008) illustrates this trend. Economic evidence was employed prominently in this case and contributed to the Commission's decision to abandon one set of infringement allegations and to reduce fines substantially for the other. RBB advised Fyffes and Interweichert in connection with this case.

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This is the same attribute that can also have pro-competitive effects in some cases, a fact that underlines the indeterminacy of the economic effects of such conduct.

transparent for firms to be able to reach an understanding. Second, firms must be able to monitor implementation of the agreement by the other parties and to deter deviations through suitable retaliation measures. Third, the agreement should not be destabilised by external factors such as entry or the reaction of powerful customers.[3]

For example, a concern that exchange of price information could facilitate price collusion might be rejected if the market was too dynamic to sustain price-based collusion. Such concerns may also be rejected if the information exchanges are not sufficiently precise, detailed and/or frequent to allow firms to reach an understanding on a common line of conduct which is likely to weaken competition. Crucially, the level of detail required to achieve coordination depends on the characteristics of the industry. Relatively simple exchanges might be sufficient in a simple industry where firms sell one homogenous product at a uniform price, but they would have to be considerably more detailed to facilitate collusion in an industry where firms sell a large number of different products and negotiate prices individually with each customer.

Assessing the "object" of an information exchange – law or economics?

The legal treatment of information exchanges under Article 81, however, has developed in a very different way from the open-minded effects-based approach suggested by economic theory. Horizontal information exchange is one of the practices that has typically been seen as being anti-competitive "by object" in which the very existence of the conduct is deemed to restrict competition.

Agreements that are anti-competitive "by object" automatically breach the Article 81(1) prohibition, and there is no need for the Commission to establish that they have anti-competitive effect. On the face of it, this suggests that the role for economic analysis in assessing the legality of such agreements is eliminated.[4] However, there is a catch. In para 21 of its guidelines on Article 81(3), for example, the Commission has stated:

> *"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 81(1) to demonstrate any actual effects on the market."*

So according to the Commission, the burden of having to show that an agreement has anti-competitive effect can be dispensed with only when that conclusion on economic effect is so self-evident that it does not need to be established. But in order to establish that that economic analysis is unnecessary the Commission has set itself a condition that requires it to pass an economic test. In Joseph Heller's classic wartime novel, the leading characters were caught in a "Catch-22" whereby they could escape active flying missions only if they could prove they were insane, but were deemed to be sane if they had the good sense to ask not to fly such missions. Whilst the Commission's Article 81 guidelines lack the vitality of Joseph Heller's prose, the phenomenon they describe presents a classic Catch-22 to the enforcement official who seeks to avoid the need for economic analysis by declaring that conduct is anti-competitive "by object".

Admittedly, the test the Commission has set itself does not require a full quantification of economic effects, but it does impose a discipline on the Commission to tell a convincing story of why the conduct in question should, given the economic context, be presumed to be anti-competitive. In the recent bananas investigation, for example, the Commission was, despite its initial objections, persuaded to concede that the exchange of information between competitors about quantities could not have an anti-competitive impact in a context where the Commission itself set rigid banana quotas as part of its (historic) trade regime.[5]

In many circumstances, the need to establish a story of harm need not create a major practical dilemma. For the horizontal price-fixing infringement in which the parties meet

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These conditions are consistent with the established framework for the assessment of coordinated effects in merger control.

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It may still be possible to apply economic analysis to defend such restrictions under the Article 81(3) headings, however.

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The Commission ruling that exchange of price information was capable of having an anti-competitive effect within the quota regime was also contested by the parties' economists and is one of the aspects that is currently under appeal by some of the major shippers.

regularly to exchange detailed information on future pricing targets and monitor past adherence, the object of the agreement is overwhelmingly likely to be to raise prices and restrict output, and the test the Commission has set itself is easily satisfied.[6] But for information exchanges, whose effects on competition are inherently ambiguous, it raises the very real challenge of how to identify the economic circumstances in which the conduct is so self-evidently problematic that no analysis is required.

This legal question was recently addressed in the ECJ Judgment on the T-Mobile Netherlands *et al* case.[7] The case concerned an exchange of information between competing mobile telephone network providers in the Netherlands, seemingly aimed at encouraging collective action to *reduce* the commissions they paid to agents to distribute their products to consumers.

Initially, the Judgment suggests that the object test is satisfied as long as the practice has the *potential* for a negative effect on competition.[8] Taken literally, this would be akin to a general presumption that possession of a kitchen knife is an offence because of that implement's *potential* to cause harm. Possessing a kitchen knife might be deemed acceptable if the bearer of the knife is at home and preparing food, but not if the same knife is found in the possession of someone in a crowded street late at night. Seen in this light, one can see in principle how a requirement to place the conduct in context can play a valuable role, but the big question it raises is what kind of economic analysis and/or reasoning should be applied to distinguish between the benign (e.g. food preparation use) and malign (e.g. crowded street) context.

Next, the ECJ suggests the principle that information exchanges step across the line when they reduce uncertainty.[9] But this principle would – if interpreted narrowly – also lead to wholly unsatisfactory outcomes. Any device that generates information will, by definition, *reduce the uncertainty* facing the recipient to some degree. Indeed, the reduction of uncertainty is precisely the mechanism whereby information can enhance economic efficiency and benefit consumers. Yet better knowledge of market conditions does not necessarily provide firms with the ability to artificially distort market outcomes.

As an illustration, consider the case of a group of fishermen in a small village who sell their output on a national market that is prone to such large price fluctuations that on some days the price is lower than the cost of operating the boat. If the fishermen could predict such extreme fluctuations, they could avoid the losses by not fishing on the low-price days. In order to better predict prices, suppose that the fishermen therefore start exchanging information about expected future prices. Is this conduct anti-competitive? The key question is not whether this exchange reduces uncertainty, but whether it affords the fishermen the ability to influence prices adversely. In this example, the answer to this question is negative, since the fishermen of a small village cannot possibly distort the price of fish on the nation-wide market. Improving their ability to forecast prices does not enhance their ability to control prices any more than an increased ability to forecast the weather would allow the fishermen to control whether it will rain tomorrow.[10]

Perhaps recognising that outright condemnation of conduct that reduces uncertainty would be problematic, the ECJ ultimately seeks to clarify this dilemma as follows (at para 34):

> *"... exchange of information between competitors is liable to be incompatible with the competition rules if it reduces or removes the degree of uncertainty as to the operation of the market in question,* ***with the result that competition between undertakings is restricted"*** (emphasis added)

This final important clause is critical in allowing the Court to avoid the kitchen knife fallacy. By including the requirement to show the "result" that competition is restricted the ECJ has – like the Commission – specified an effects-based test. So the ECJ Judgment has adopted substantially the same position that we observe in the Commission's guidelines.

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This is not to say, however, that such meetings always succeed in raising prices, or that the Commission is right to ignore the actual effects. Such considerations should be central to the fixing of fines and any damages awards arising from the infringement. See RBB Brief 29, "Crime and Punishment (and Deterrence): the role of private cartel damages".

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Case C-8/08 Judgment of the Court, 4 June 2009.

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Judgment, para 30.

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Judgment, para 33.

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This intuition carries across also to more concentrated markets.

Conclusion

Very few *per se* rules are justified in competition law, and form-based approaches to illegality have been progressively eliminated and undermined over the last two decades of reform of European competition law, in favour of an effects-based approach.

On the face of it, the categorisation of information exchanges as conduct that is anti-competitive "by object" seems to provide an exception to the increasing influence of economic analysis. It appears to promise some respite for the enforcement official who seeks to avoid the inexorable movement towards the greater use of economic analysis.

From an economic perspective, however, the notion of a *per se* rule against information exchanges has no merit, and the idea that the tendency of such exchanges to reduce uncertainty should single them out for prohibition is clearly invalid. Information exchanges cover too broad a spectrum of conduct, and their effects are too dependent on the economic context, to approach this area of enforcement with anything other than a structured effects-based approach to the analysis. There is no justification for placing such conduct in the same automatic presumption of anti-competitive "object" category as full-scale horizontal price-fixing.

Both the Commission's guidelines and the recent ECJ Judgment on information exchanges, however, now show how this apparent conflict between the case law and economic thinking can be resolved. An "object" test that requires the Commission to place the information exchange in context, to consider the benign or possible pro-competitive explanations for the conduct, and to establish a clear story of anti-competitive harm, certainly imposes a welcome Catch-22 on those who see the "objects" test as a way to evade the need to tell a convincing substantive story of competitive harm. But it should not prevent competition law enforcers from establishing the illegality of conduct that clearly has malign influence on competition. Most importantly, it has (albeit indirectly) created the role for economics that information exchanges deserve.