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Horizontal information exchange – what it means for business: the economists' perspective

Rules of Competition – Risks and Opportunities

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- **Employs ~50 economists specializing in competition law**
- **Key areas of experience**
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  - Cartels and horizontal agreements
  - Vertical agreements
  - Dominance and monopoly inquiries
  - Litigation and damages
  - Regulation
  - State Aid

Information exchange (IE) is assessed under Art 101 of the TFEU

- Art 101(1) prohibits all agreements and concerted practices which have as their object or effect the prevention, restriction or distortion of competition
  - Directly or indirectly fix prices or any other trading conditions
  - Limit or control production, markets, technical development, investment
  - Share markets or sources of supply

- Art 101(3) makes exceptions for agreements and concerted practices that
  - Contribute to improving the production or distribution of goods
  - Promote technical or economic progress
  - Allow consumers a fair share of the resulting benefit

Economic assessment of the impact is not required if there a restriction by object!

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2011 Guidelines on the applicability of Article 101 to horizontal co-operation agreements state, at para 24,

> *Restrictions of competition by object ... by their very nature have the potential to restrict competition ... It is not necessary to examine the actual or potential effects of an agreement on the market once its anti-competitive object has been established*

However, how do we know that a given commercial practice by its very nature restricts or has a high potential to restrict competition?

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In many practical cases economic analysis has an important role to play as the immediate effect of IE is not clear-cut

- What if it is not a full-scale horizontal price fixing, but IE on the state of demand?
- What if there is a proof of IE for one product, but no clear proof for the other products?
- What if there is evidence of IE in some years but no clear evidence in others?

- IE can be anti-competitive, pro-competitive or neutral – there is no general rule
- Competition authorities have to demonstrate the scope, duration and gravity of the infringement
- The theories of harm that are put forward must be internally consistent and accord with the facts of the market

Two theories of harm are usually proposed in relation to IE

- IE may change market conditions so that coordination (collusive outcome) becomes possible, e.g. by
  - Artificially increasing transparency
  - Reducing market complexity or uncertainty
  - Compensating for asymmetries

- IE can lead to anti-competitive foreclosure, e.g. by
  - Placing unaffiliated competitors at significant disadvantage
  - Raising the costs vertically integrated firms' downstream rivals

A number of special conditions required to make IE capable of restricting competition via coordination

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- Firms must be able to reach a tacit understanding as to which parameters they will coordinate on
  - Sufficient simplicity of transactions is required
- Firms must be able to sustain any tacit understanding
  - Ability to monitor the market is needed
  - Ability to punish the deviators is required
- Tacit understanding must be immune from potentially destabilising reactions of firms outside the coordinating group

Importantly, these conditions are explicitly recognised by courts since the *Airtours* judgement

This approach draws largely on the analysis of co-ordinated effects in horizontal merger control

The EC Guidelines on IE also introduce non-coordinated theories of harm

- Guidelines suggest that in some cases information sharing may lead to foreclosure of competitors outside the agreement (e.g. new entrants)
  - E.g. by raising competitors' costs or limiting their capacity to compete

- Whereas the collusion concern is firmly grounded in economic theory and in case experience, the non-coordinated theory of harm is highly speculative
  - No empirical evidence that foreclosure is a serious concern

- On the other hand, non-coordinated theories of harm open the door to efficiency offence claims
  - In the long run this is likely to adversely affect consumer welfare

Presumption that IE is always bad for competition would be inconsistent with economic theory

- IE enables firms to set prices on the basis of a more complete understanding of the market and improve allocative efficiency
- IE helps reduce uncertainty, allowing the firms to make better production decisions resulting in costs savings and welfare gains
- IE increases transparency and may facilitate entry into the market as it helps potential entrants to better evaluate business opportunities
- IE allows firms to benchmark themselves in critical areas against competitors, enhance efficiency, promote innovation and cost reduction

This position is explicitly recognised by the EC's 2011 Guidelines

IE also allows consumers to make well-reasoned decisions

- Economic research shows that the consumers are sensitive to the way information is presented to them
  - In certain cases firms have strategic incentives to obfuscate, e.g. by complicating their tariff structures

- Complex pricing information (e.g. consisting of several components) may confuse consumers and lead to distorted choices

- Access to information helps consumers make most suitable choice
  - E.g. via a price comparison web-site or other intermediary

Well-informed consumers play a key role in promoting healthy competition among suppliers

IE can create welfare gains both for producers and consumers

EXAMPLE

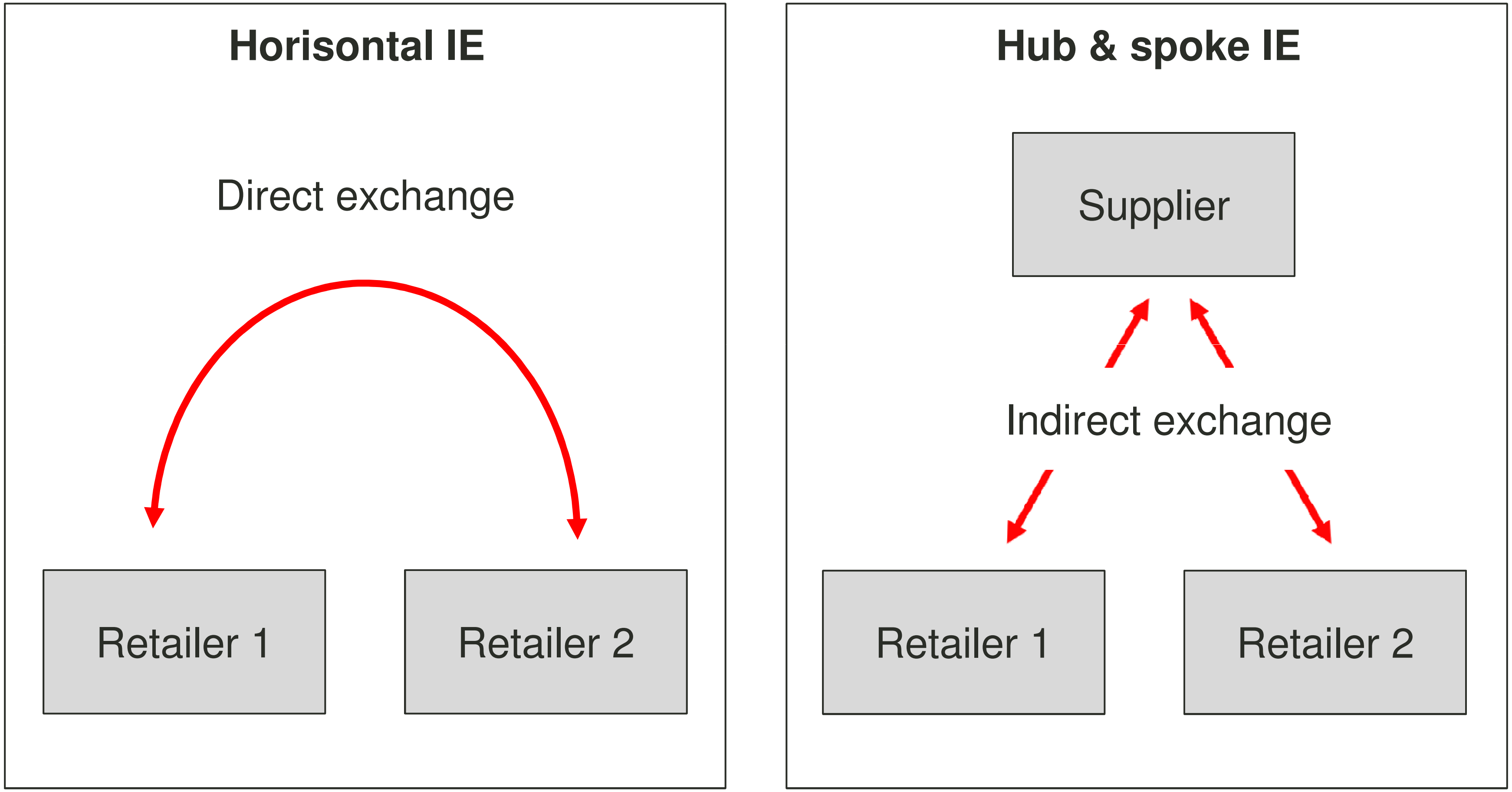
Before IE

- A group of fishermen in a small village sell their output on a national market
- National market is prone to such large price fluctuations that on some days the price is lower than the costs of operating a boat
- Uncertainty about the price has the potential to reduce the fishermen' output

After IE

- Fishermen start exchanging information about expected future prices
- Better predictions allow to avoid losses by not fishing on the low price days
- This IE has the potential to increase aggregate output

Hub & spoke Vs horisontal IE



A frequently proposed theory of harm for hub & spoke IE

- *Retailer 1* discloses to supplier *S* its future pricing intentions
  - Retailer may be taken to intend that *S* will make use of that information to influence market conditions in some way
- *S* passes that information to *Retailer 2*
- *Retailer 2* may be taken to know the circumstances in which the information was disclosed by *Retailer 1* to *S*
  - *Retailer 2* uses the information in determining its own future pricing intentions
- The case is all the stronger where there is reciprocity
  - *Retailer 2* in turn discloses its intentions to *S*

However, hub & spoke IE is less likely to have an anticompetitive motive compared to horizontal IE

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- Horizontal competitors always have an incentive to reduce competition
  - Albeit their ability to do so will depend on the characteristics of the market

- In contrast, IE involving 'vertical' links could hurt the upstream firms
  - Downstream price increase above competitive levels reduce demand
  - E.g. with one upstream supplier and several downstream retailers, the supplier can get maximum profits by stimulating downstream competition

- Therefore, it is crucial to understand **<u>why</u>** upstream firms participate in such IE in the first place
  - Is there some efficiency explanation?

- From the economic viewpoint, the benefits for the supplier are questionable, unless there is also a corresponding reduction in upstream competition

Empirical assessment of the economic effects of IE

Price studies

- Do actual prices correspond to the IE intentions?
- Have prices become more stable as a result of IE?

Margin studies

- Have upstream and downstream margins increased as a result of IE?
- Are margins higher than the relevant counterfactual?

Market studies

- Have market shares become more stable?
- Has the market become more partitioned?

In sum, what is the right economic approach to the analysis of IE ?

- Does IE enable the firms to influence prices adversely? ✓
  - Do the firms collectively have market power?

- Is the industry susceptible to tacit collusion and coordination? ✓
  - Are the firms' incentives sufficiently aligned (symmetry)?
  - Are transactions relatively simple and allow for coordination?

- What does IE change? ✓
  - Does IE provide a focal point for coordination?
  - Does IE help firms to dampen competition, e.g. by facilitating monitoring and by making the market more transparent?

- Is observed behaviour consistent with the competitive outcome? ✓
  - Do firms earn supra-competitive profits (margins)?

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