Can a sequence of insignificant lessenings in competition ever become significant? The case of mergers after cartels

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Can a sequence of insignificant lessenings in competition ever become significant? The case of mergers after cartels

Steve Davies, Professor of Economics

In merger control, a competition authority (CA) will only intervene if it expects the merger to lead to a Significant Lessening of Competition (SLC) in the relevant market. This obviously prompts the question of when a lessening of competition becomes significant. Part of the answer is that an SLC is unlikely in those cases where the merger only involves a relatively small turnover and/or only causes a small increase in concentration. For this reason, many authorities typically apply size thresholds – mergers are waved through unless the threshold is exceeded.¹

While such thresholds make good sense in providing legal certainty and avoiding unnecessary bureaucracy, this article is concerned with a potentially troublesome possibility. Suppose there is a series of ‘small’ mergers in the same market, none of which individually would significantly lessen competition, but when taken in their entirety might do so. In other words: can a series of insignificant lessenings of competition become significant when they are combined? And, if so, what should the CA do about it?

Just such a possibility has arisen in our recently completed study (Davies and Ormosi, 2004) of whether cartel breakdown provokes a period of intensive merger activity amongst the former cartelists, intended to re-establish collusion tacitly. For a sample of 84 European cartels our research shows that in half there was merger activity, sometimes very intense, in the years following the cartel’s breakdown. Using a novel application of recurrent event survival analysis we find that mergers are significantly more frequent in the immediate post-cartel period, especially in markets which are less concentrated. Moreover, in a significant minority of concentrated markets in which there were mergers, both the magnitudes of market shares and the response of financial markets were consistent with the possibility of coordinated effects.

In this article we now extend that work by examining how, if at all, competition authorities reacted to these mergers after cartels. We have been able to collect sufficient market share data to estimate the likely impact of 83 of the mergers. Of these, rather surprisingly, only half were investigated by
either the European Commission or a national Competition Authority. Of these, most (34) were cleared without remedies (Table 1), and in only 7 were remedies agreed, of which only 1 had any impact on the market shares in the previously cartelised markets.²

Table 1: Merger investigations by CA’s in previously cartelised markets

<table>
<thead>
<tr>
<th>Total mergers Investigated of which:</th>
<th>ΔHHI&gt;250</th>
<th>ΔHHI&lt;250</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investigated</td>
<td>83</td>
<td>21</td>
</tr>
<tr>
<td>cleared</td>
<td>41</td>
<td>11</td>
</tr>
<tr>
<td>remedied</td>
<td>34</td>
<td>7</td>
</tr>
<tr>
<td>Uninvestigated below turnover threshold</td>
<td>7</td>
<td>4</td>
</tr>
</tbody>
</table>

Table 1 reveals that this relative inactivity is largely explicable by the ‘small’ size of most of the mergers. All of the 42 uninvestigated mergers involved a turnover below the EC’s minimum disclosure threshold, and in 30 of the 41 cases which were investigated the increase in concentration (as measured by the increase in the Herfindahl index (ΔHHI)) implied by the merger would have been lower than the level identified in the EC’s merger guidelines as significant (ΔHHI<250).

To illustrate, consider the Industrial Thread cartel. At the time of its breakdown (1996, after a leniency application, this was officially detected by the EC in 2000), this cartel involved nine active players (Table 2). The market was dominated by two firms, Amann and Coats, although there were also three medium sized members each with a market share of roughly 10%, and three other much smaller ‘fringe’ firms. Based on our market share estimates, the HHI index at the time of cartel breakdown was 1870 – a level of concentration not necessarily associated with serious competition concerns.

However, in the three years after breakdown, and then later in 2008, the top two acquired all three of their middle sized rivals – unopposed by the competition authorities largely because the sizes of the individual transactions and the increments in concentration were relatively small. Nevertheless, when taken together these acquisitions rendered the market twice as concentrated as initially. Thus, a cartel had now been replaced by a tight duopoly of two roughly equal sized firms. Ceteris paribus, such a market structure would undoubtedly raise concerns of potential tacit collusion – had it been the result of a single large merger rather than the consequence of a series of much smaller ones an in-depth investigation would have been merited.
We find that mergers are significantly more frequent in the immediate post-cartel period, especially in markets which are less concentrated.

Table 2: Industrial Thread Cartel

<table>
<thead>
<tr>
<th></th>
<th>Estimated market shares</th>
<th>Acquired by:</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1996</td>
<td>2009</td>
</tr>
<tr>
<td>Amman</td>
<td>26</td>
<td>39</td>
</tr>
<tr>
<td>Coats</td>
<td>20</td>
<td>36</td>
</tr>
<tr>
<td>Oxley</td>
<td>10</td>
<td>-</td>
</tr>
<tr>
<td>Barbour</td>
<td>8</td>
<td>-</td>
</tr>
<tr>
<td>Belgian Sewing</td>
<td>6</td>
<td>6</td>
</tr>
<tr>
<td>Guetermann</td>
<td>5</td>
<td>6</td>
</tr>
<tr>
<td>Beze</td>
<td>3</td>
<td>3</td>
</tr>
<tr>
<td>Zwicky</td>
<td>1</td>
<td>3</td>
</tr>
<tr>
<td>Estimated HHI index</td>
<td>0.187</td>
<td>0.340</td>
</tr>
</tbody>
</table>

Moreover, this particular case turns out to be only an example of a frequent story – there is a sizeable number of post-cartel markets in which subsequent mergers lead to market structures potentially amenable to tacit collusion. As a rough rule of thumb we identify as a necessary condition for collective dominance in a market that the combined market shares of the two leading firms must exceed 50% (but neither has more than 50% individually). 19 of our 83 markets satisfy this criterion. There are 11 in which the market was already potentially collectively dominated prior to the mergers, and 8 in which a sequence of mergers post-cartel resulted in a market structure with two dominant firms with a combined market share in excess of 50% (shown in Table 3). In each of these 8, intervention was minimal: of 22 mergers, only 7 were investigated and only 1 was remedied.

Table 3 Other cases where mergers lead to dominant duopolies

<table>
<thead>
<tr>
<th>Cartel</th>
<th>Mergers</th>
<th>Investigated</th>
<th>Uninvestigated</th>
<th>Below turnover threshold</th>
<th>$\Delta$HII &gt; 250</th>
</tr>
</thead>
<tbody>
<tr>
<td>Copper Fittings</td>
<td>3</td>
<td>0</td>
<td>3</td>
<td>3</td>
<td>3</td>
</tr>
<tr>
<td>Industrial Thread</td>
<td>5</td>
<td>0</td>
<td>5</td>
<td>5</td>
<td>2</td>
</tr>
<tr>
<td>Copper Plumbing Tubes</td>
<td>3</td>
<td>1</td>
<td>2</td>
<td>2</td>
<td>1</td>
</tr>
<tr>
<td>Specialty Graphite</td>
<td>2</td>
<td>0</td>
<td>2</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td>Carbonless Paper</td>
<td>1</td>
<td>0</td>
<td>1</td>
<td>1</td>
<td>0</td>
</tr>
<tr>
<td>Alloy Surcharge</td>
<td>2</td>
<td>2</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Ferry Operators</td>
<td>3</td>
<td>2</td>
<td>1</td>
<td>1</td>
<td>0</td>
</tr>
<tr>
<td>UK Tractors</td>
<td>3</td>
<td>2</td>
<td>1</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>22</strong></td>
<td><strong>7</strong></td>
<td><strong>15</strong></td>
<td><strong>15</strong></td>
<td><strong>9</strong></td>
</tr>
</tbody>
</table>

As can be seen, all 15 uninvestigated mergers were ‘small’ according to the EC’s turnover threshold, but taken together they led to collective dominance in their respective markets. Moreover, in 7 of these 15 we estimate that, even when treated separately, the merger had a more than trivial impact on concentration ($\Delta$HII>250). This evidently occurs in those cases where the cartel market, often defined very narrowly, is small relative to the merger size threshold.

These results reinforce our unease about the use of size thresholds in merger control: a sequence of relatively small mergers may have a significant deadening impact on competition, although none in itself seems significant. Moreover, they are particularly striking given the nature of our sample. This is not a random sample of markets. On the contrary, a market in which there was once a cartel suggests that collusion is a practicable option for firms. With the cartel now busted, it is sensible to be more than usually vigilant on the potential for coordinated effects from mergers.

The policy implications of this paper are by no means obvious in general. After all, at what point does a CA become aware (if at all) that it is observing such a sequence of mergers? And how could it justify intervening in one case, having let others through? Perhaps previously cartelised markets deserve particularly close attention by competition authorities – with minimum thresholds put to one side in these special cases.

1: The UK is a rare exception in not have minimum size threshold, preferring instead voluntary notification by merging parties.
2: In the other 6, merging firms were highly diversified and/or multinational and the remedies impacted only on the parties’ activities in other markets than the previously cartelised markets.

This article is based on the paper “Mergers after cartels: How markets react to cartel breakdown” by Peter Ormosi, Ph.D.; Stephen Davies; Martin Graffenberger which will be published in the forthcoming edition of the Journal of Law and Economics, November 2015.
The sharing economy: A theme for regulation in the digital age

Nikolaos Korfiatis, Lecturer in Business Analytics and Regulation

We can now use platforms such as Airbnb and Uber to find alternatives to licenced providers of a number of services such as hotels and taxies. Most of the recent attention by investors to the so-called “disruptive” potential of digital platforms, which allow the co-exploitation of an asset by more than one agent, draws on the discussion of whether such a possibility creates opportunities for consumers and companies.

While consumers generally tend to welcome the possibilities that are given to them in finding better alternatives to traditional service channels from a price point of view (e.g. renting a spare room for a short stay rather than staying in a hotel), quite often this poses difficulties for companies and traditional agents in these markets. This presents a regulation gap where traditional licencing barriers to entry become obsolete once digital technology takes over.

Why is this happening now? What is new in terms of technology that has enabled the introduction of such innovations to traditional markets? How does traditional economic theory deal with these cases? With regards to the latter, a possible linkage can be made to Buchanan’s seminal paper on Club Goods (1965)¹. What motivates such a concept is the missing gap between Samuelson’s classification of purely “private” and purely “public” goods, with the ultimate aim of determining the optimal cost and benefit arrangement that will allow club goods to find an optimal service and price level. The answers to why club goods have become more prominent are (a) the development of digital technology that has enabled better coordination among the individual agents and (b) the addition of a trust layer represented by mutual evaluation by both sides. Platforms that allow agents to join a club and other agents to offer a club good have resulted in better levels of price and service for the consumers themselves.

Nonetheless, while the price positioning creates a better alternative for consumers and increases competition for services, the question from a regulatory point of view can be centred on two aspects: (a) Do the traditional service providers have to deal with unfair competition and (b) Are other classes of consumers, such as long-term residents, kept out of the market, for example because the supply side has better incentive to offer a short term lease hold on their rental?

To reflect on what kind of regulatory concerns a regulator may deal with it would be useful to concentrate in this note on two examples where protests from traditional agents have become apparent; Uber and Airbnb. Uber is a popular taxi-hailing app that was founded in 2009 in San Francisco and has become a popular example of how mobile technology can transform a traditional market such as taxi transport. Uber operates in three modes; UberTaxi, UberBlack and UberPOP.
The latter is a two-sided app where anyone with a driving licence may turn their vehicle into a taxi and collect customers. UberTaxi and UberBlack use qualified drivers to serve normal taxi and limousine customers. Airbnb was founded a year earlier (2008), also in San Francisco, with the aim of better serving lodgers and renters in their matching process. It has since expanded internationally and currently dominates the market for short-term rentals of various types, ranging from standard accommodation, to single rooms, to apartments and flats in major cities around the world.

With respect to Uber, the regulatory jurisprudence so far has resulted in a mixed reception. Some local authorities question whether Uber drivers qualify as taxi drivers and thus whether they have the right to collect fares. In London, an action against Uber was brought before Transport for London last year by the incumbent operators of Hackney Carriages (black cabs) with the argument that Uber interferes with their right to be the sole users of taximeters in the Greater London area. While the case resulted in a consulting ruling from the High Court, Uber was allowed to operate based on the gap in the definition of whether the Uber smartphone application should be considered a taximeter. In this case, the technological development has posed a clear gap in legislation. Other rulings, such as the case brought to the German courts in Berlin and Frankfurt by taxi drivers’ associations, resulted in some of Uber’s services (UberPop) being banned nationally. The rulings cited the fact that [Uber] violates the current transport law by allowing unregulated vehicles and unqualified drivers, who are also not insured for such operations, to serve customers.2

Airbnb has faced similar challenges based partly on its rapid adoption by private renters as a way to gain share in the short-stay market traditionally served by hotels. In cities with large fluctuations in demand, such as tourist destinations in the summer or cities hosting events, Airbnb offers a cheaper alternative because it allows for new entrants to the market. Despite this, cases have been brought to courts about the side effects of Airbnb’s operations compared to traditional hotels. In New York last year the Attorney General filed a legal proceeding against Airbnb3 arguing that it violates local real estate law on the availability of records on renters of apartments (and, subsequently, if they have the right to rent the apartment). In continental Europe a similar ruling by a Berlin court gave the right to landlords to evict tenants for subletting their property on Airbnb without consent. While Airbnb’s model is based on matchmaking, the financial incentives it creates for renters may lead to negative spillovers on the wider housing market. In many cities Airbnb has been accused of being a large cause of limited supply of rental properties, due to landlords having a greater incentive to rent to short-term lodgers rather than long-term residents. This can have a negative effect and crowd out tenants living in places with high seasonal demand. On a more positive note, Airbnb was welcomed by the organisers of the Rio 2016 Olympic Games as an alternative accommodation partner4 for contributing to an increase of available accommodation space during the Olympics.

A major question is whether a regulator should intervene to set rules about the levels of service required and the extent that existing rules should be adapted to the digital age. In several areas of innovation it seems that regulators tend to catch up after a short time, but sometimes they are very late (e.g. regulation concerning self-driving cars). In any case, exploring from the perspective of regulation and making sure that competition is fair and proper regulations are enforced can help unleash the great consumer welfare increases that these services can offer.

2: http://fortune.com/2015/03/18/german-court-ban-uber/
Vertical relations in business do not all operate in identical ways. While the wholesale structure remains the common business format in the bricks-and-mortar environment, the prevalence of the agency structure in online markets indicates some transformations in supply and distribution chains. By examining and comparing the two structures, recent CCP research reveals the different preferences of suppliers and retailers over business formats, and explains why the rise of the agency structure implies a better position of retailers and how consumers may benefit from it.

Today individuals rarely purchase goods directly from the manufacturer. We buy daily essentials from high street shops and supermarkets, as well as via a variety of online retailers. Goods are now starting to pass through more elaborate supply and distribution chains, with the majority of transactions rarely being achieved without the involvement of other parties. The vertical relations which characterise these supply and distribution chains operate in various ways which could have a positive or a negative effect on the consumer, making it important for us to understand what these effects are. Moreover, the choice of how a supply and distribution chain is structured in a particular industry may tell us something about the industry itself and is hence worthy of further study.

Among the various business formats observed in practice there are two common ones, a wholesale structure and an agency structure. Under the wholesale structure (Figure 1a), retailers buy from suppliers and resell to final consumers,
e.g., florists buy roses at flower markets and resell them in store. It is the suppliers who first set wholesale prices and then retailers set retail prices. Under the agency structure (Figure 1b), suppliers set prices and retailers merely help make transactions happen. In return, retailers receive shares of revenue specified by themselves in the first place, e.g., under fixed price listings, eBay sets a “final value fee” rate and receives a fraction of sellers’ total revenues.\(^2\)

**Figure 1. The Wholesale Structure and the Agency Structure**

a. The Wholesale Structure  

While the wholesale structure remains the standard in the bricks-and-mortar environment, the agency structure is becoming increasingly predominant in online markets with giant online retailers such as Amazon marketplace, Apple, eBay, Google and various booking websites adopting it. Recent theoretical studies tend to examine the agency structure alongside the (in)famous e-book case.\(^3\) However, there is a lack of research providing a systematic analysis of the agency structure per se as well as detailed comparisons of the wholesale and agency structures, which constitute the basis of understanding the changes in vertical relations.

Elsewhere I have taken the initial steps towards this goal by comparing the outcomes under the two structures and examining firms’ preferences in relation to business format. Since competition intensifies as the goods and services available become more similar to each other, the degree of differentiation within each level of the vertically related market can also be translated to the degree of market power of firms in that level.\(^4\) It would then be interesting to see how the relative degrees of market power affect firms’ preferences over business format, and whether that explains the popularity of one structure in certain markets. In a simple representative model, I characterize the vertical relation first by the wholesale structure and then by the agency structure.\(^5\) I find that retail prices are always lower under the agency structure, so it seems that agency pricing causes no per se harm. Was the Department of Justice then wrong to force publishers to move away from the agency structure for e-books despite the price rise when it was adopted? It is possible the price rise may plausibly have been driven by, among other factors, the Most Favoured Nation clauses adopted at the same time and which directly undermine the incentives for rival retailers to cut price.\(^6\)

Regarding profitability, I find that suppliers always prefer the wholesale structure whereas retailers prefer the agency structure for a wider range of degrees of differentiation. This generally suggests that a vertically-related market would operate under the wholesale structure if suppliers possess relatively higher market power, and would operate under the agency structure if retailers possess relatively higher market power. Immediately, this explains why the agency structure is initiated by retailers in practice – suppliers never have the incentive to switch away from the wholesale structure. For large online retailers with strong network and negotiation power, their preferred business format may be part of the “take it or leave it offer” they have for suppliers where suppliers may be vulnerable and have no choice. For instance, it appears that it was Apple who persuaded publishers to adopt the agency structure.\(^7\)

Moreover, my findings suggest that the relative profitability of the alternative schemes for retailers is sensitive to the degree of product differentiation at the supplier level: as long as it is not too low retailers are better off under the agency structure. This is interesting because it contrasts with our conventional understanding of the relationships between firms’ profitability and degrees of differentiation at different levels of the market. Given that they do not collude, firms in general would benefit from high degrees of differentiation at their own level and low degrees of differentiation at the other level of the market, such that they can exercise market power. This is true under the wholesale structure but not under the agency structure, as I find that retailers under the agency structure actually benefit from high degrees of differentiation at the supplier level. That is, the two parties’ incentives are better aligned under the agency structure.

The relative profitability of the alternative schemes for retailers is sensitive to the degree of product differentiation at the supplier level: as long as it is not too low retailers are better off under the agency structure.

In fact retailer profits, as well as industry profits, are maximized at the point of perfect differentiation at both levels of the supply and distribution chain characterized by the agency structure. That is, if degrees of differentiation at both layers of the market are high enough the agency structure is effectively a more efficient
Do you have a good background in microeconomics but want to learn more about practical competition policy?

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The powers of National Regulatory Authorities (NRAs) in energy in the EU have been converging over the course of the past decade. Regulators’ powers as regards the regulation of infrastructure networks and market supervision have been expanded and deepened through EU legislation. Regulators have seen an increase in their consumer protection duties and additional responsibilities concerning security of supply and energy efficiency targets, market transparency and cross border cooperation. The process has accelerated in the past 3 years as most Member States have transposed the provisions of the Directives of the Third Energy Package into national law. Regulatory powers are a crucial element of an NRA institutional design. However the literature has, thus far, overlooked the issue.

“Regulatory powers” are the set of statutory competences regulatory authorities possess to steer or correct the conduct of market agents. These include both the issues in the remit of regulatory authorities and the extent of their monitoring, decision-making, enforcement and dispute settlement powers on those issues. Hence, regulatory powers are distinct from NRAs’ missions, which consist of the set of objectives they should strive to achieve; and from their regulatory practice, which comprises the regulatory techniques chosen to fulfil the missions. They stand in the middle between the missions and the practice.

Investigating regulatory powers is perhaps especially important in the case of NRAs which are in charge of regulating infrastructure in a market integration context, such as the European Union. This is because their endowment of powers, or lack thereof, impact not only on the national level but also on neighbouring markets and at the supranational level.

It is therefore surprising to realize that this issue has been rather neglected in the literature on NRAs, which has overwhelmingly focused on the topics of independence (in particular, independence from government) and accountability. These topics have come to constitute the very idea of what a “good” regulatory authority is: independent and accountable. Far from contesting the validity of this claim, I would argue additional facets of NRAs should be taken into account in institutional analyses, such as the extent of their powers.

Regulatory powers are only occasionally mentioned and/or briefly described in contributions usually having a different focus, mostly relating to either of the two above-mentioned topics. Very few contributions (Genoud and Finger, 2002; Lawrence, 2002; Gianfreda and Vantaggiato, 2013) treat the issue of regulatory powers in more depth.

One reason for this neglect may be that regulatory powers are a complex jungle of legal provisions, which seem to lend themselves to little more than descriptive analysis. Moreover, the literature seems to have subsumed the topic of regulatory powers under that of independence, so that if an NRA can be said to be independent it must also have the necessary armory of powers to pursue its missions. Hanretty and Koop (2012), however, rightly warn against conflating breadth of powers with independence: an NRA can have many powers but exercise them with no independence, and vice-versa.

Powers and independence are two distinct concepts, which require distinct analyses. The issue of independence has perhaps a more readily evident “political flavour” to it: scholars often use the principal-agent framework to explain the delegation of authority to NRAs, in line with academic literature, which framed the relationship between Congress and independent regulatory commissions in the USA. In the European context, political principals are seen as reluctant to lose control over strategically and electorally important infrastructural sectors. They are thus expected to limit
Regulatory powers seem to have been considered less controversial. Regulators, however, have always been acutely aware of the importance of their powers. In the early 2000s European energy NRAs, gathered into their regulatory network ERGEG (the European Regulators’ Group on Electricity and Gas), compared and contrasted their respective prerogatives and found they were greatly different not only with regard to their independence but also with regard to their statutory powers. Some had been allowed broad decision-making powers and discretion since their establishment (e.g. the UK and Italy); others were consultative bodies (e.g. Spain). Yet others found themselves in a middle ground, having been allowed some decision-making powers combined with proposal powers (e.g. France). Some NRAs (e.g. Finland) did not perform any ex ante regulation.

The Second Energy Package, adopted in 2003, sought to introduce some similarity across NRAs by outlining a core set of ex-ante regulatory powers they should possess. They consisted mainly of access and network tariffs regulation, monitoring and supervision. As for independence, NRAs were required to be independent from industry, but not from government.

In 2006, the ERGEG released a report taking stock of the powers held by the various NRAs and suggesting that the powers granted to regulators by the Package provisions were insufficient to allow them to cooperate towards achieving the Internal Energy Market. In particular, lack of powers with regard to cross border issues was seen as particularly detrimental to market integration. The report recommended decision-making independence from government be assured. It also suggested there could be institutional and legislative ways to collectively empower NRAs by enhancing the role of the ERGEG itself, enabling it to oversee EU markets and investments.

In 2009 the Third Energy Package addressed all of these concerns. Besides introducing ownership unbundling, it required NRAs to be independent from both industry and government; it created the Agency for the Cooperation of Energy Regulators (ACER), successor of ERGEG, with the mission to oversee EU markets and decide on cross border issues; and it listed a much longer set of both ex ante and enforcement powers the NRAs should be endowed with.

In mid 2011, by which time all Member States had to implement the requirements of the Third Package, NRAs still varied considerably with regard to their powers, with some NRAs being much less empowered than others. This was particularly true with regard to their enforcement powers (Vantaggiato, 2014). Moreover, some NRAs which appeared to be well endowed with regulatory powers (e.g. Romania, Hungary, and Bulgaria) were found to lack sufficient independence by the 2011 European Commission Report on Energy Markets1. It must also be noted how regulatory powers are not set in stone, but can be given and taken back by government, as happened in Italy (one of the best empowered and independent NRAs in the EU upon its establishment) on various occasions (Rangoni, 2011).

For all these reasons, it seems appropriate to:
1. Check whether the powers of energy regulators in the EU have actually been converging;
2. Speculate about the factors driving this convergence;
3. Formulate recommendations about the necessity of integrating the independence and powers perspectives in assessing NRAs, to gain explanatory power.

A further intriguing topic of analysis could concern the usage which NRAs have made of their independence and powers across the years and as the components of their boards change.


References
A competition authority’s concern about a cartel usually ends when it has been busted. However, is this really the end of all problems in the market? In other words, can we assume that markets return to normal competition ensuring optimal welfare? An increasing number of studies put this into question. A new CCP research paper provides worrying insights: post-cartel tacit collusion might be a common problem that is worse in very harmful cartels. This threatens the deterrent effect of fines against cartel infringers.

A new CCP research paper overcomes this lack of data by relying on a laboratory experiment in order to test several hypotheses with respect to the sources of post-cartel tacit collusion that are discussed in the literature and identifies two causes. First, each firm knows that reducing the price from the cartel price towards the competitive price will likely provoke price reductions by competitors as well. The firms anticipate this and continue to charge the former cartel price in order not to trigger a downward spiral lowering their profits. This behaviour is termed as collusive price hysteresis. Second, the firms can learn about each other in the preceding cartel. Several periods of interaction and communication allow them to develop insights into the other firms’ strategies and establishes trust between them. As a result the firms can rely on their past cooperative experience when choosing prices, facilitating continued collusion.

The findings suggest that post-cartel tacit collusion is a common problem after the end of cartels, particularly if the cartel did not collapse before detection. It follows that competition authorities and economists should be careful while estimating cartel overcharges in order to determine fines and compensation to be paid by the former cartelists. If industry prices after the end of the cartel are used as competitive benchmarks of what the industry price should have been during the cartel periods if there had not been a cartel, the resulting cartel overcharge estimates will underestimate the true harm. Further, a deterrent effect of cartel fines might not be sufficient if firms continue to profit from the cartel after it has ended: Fines are designed to discourage cartel formation based on the profits generated by it during the cartel periods only. However, if firms anticipate that they will continue to earn above-competition profits after the end of the cartel, the fines will not be high enough in order to render forming the cartel unattractive. Even worse, the most stable and harmful cartels might be those deterred the least as they might be able to collude tacitly most effectively.

If post-cartel tacit collusion is the problem, then what is the solution? In other words, what can a competition authority do to prevent tacit collusion after the end of communication? After all, tacit collusion is not illegal. The CCP research paper suggests that tacit collusion after cartels can be hindered by...
relying on debarment programmes for managers engaged in cartels. In these programmes, the managers that were running the cartel are disqualified from continuing to work in the same industry or in similar positions in other industries. Such programmes, which are in place in only a handful of countries such as the USA and the UK, can disrupt tacit collusion after cartel detection, because removal of the people involved in the conspiracy renders learning and trust in the cartel useless. Knowledge about past cooperation between key personnel is not very helpful if these key personnel have been removed from office. On top of that, it destabilises the cartel in the first place. In the presence of a debarment programme investing risky trust into other firms and build up a reputation as a trustworthy cartel member is less attractive as all the “investment” is gone if the cartel is detected. Anticipation of this aspect renders cheating in the cartel more attractive.

In the experiment groups of three participants took the role of managers and controlled firms in the same market for twenty periods and chose prices. Initially it was possible for the managers to communicate to each other about price. This ability to coordinate on prices was unexpectedly removed after the tenth period, and they had to choose prices without any communication for another 10 periods. In some treatments, a debarment programme was simulated by rematching all participants in the experiment with two new partners in period 11 when communication was disallowed.

Figures 1 and 2 show how market prices developed after the end of communication in period 10 when a debarment programme was lacking or in place. In both figures the average market price for all groups is shown but separated between markets in which cartels formed during communication (blue line) and markets in which there was competition at all times (red line).

As can be seen in Figure 1, in markets without a debarment programme firms that previously formed a cartel continue to charge prices above those of firms that engaged in competition at all times — post-cartel tacit collusion (PCTC) can be observed. However, in the presence of a debarment programme prices in former cartel markets immediately collapse towards the competitive level indicated by the prices in markets that did not form any cartel, as shown in Figure 2.

Taken together the findings suggest that competition authorities should rely on effective antitrust enforcement to reduce the effects of post-cartel tacit collusion. Sufficiently high fines and leniency programmes should deter cartel formation as much as possible. Further, debarment programmes for managers involved in cartels may be implemented and consequently enforced to minimize the negative welfare effects of post-cartel tacit collusion. However, a debarment programme is only effective if it targets the true source of the conspiracy: the removal of a junior manager from a company will not fix the problem if their successor receives similar orders from the true instigators of the conspiracy. This calls for further research into the internal hierarchy and operations of cartels.
Six months on and evidence abounds that the ESRC’s investment in us reaps ongoing rewards. Our momentum combined with our core of expertise continues to deliver research valued across the spectrum of our stakeholders. We have launched our new Subscription Membership Scheme for public sector organisations and are pleased to report that three organisations, the CMA, Ofgem and Ofwat have already signed up. This provides the Centre with a modest level of core funding. It also formalises important interactions between academics and the public sector, with members receiving further access to the Centre’s research, ideas and expertise, and will support continued development of evidence for policy makers.

We have also recently taken the opportunity to review our Advisory Board. For more than a decade the board has provided us with important and hugely valued debate, feedback and direction, ensuring we are anchored in policy relevant research, and we are very grateful for their commitments and insights. We look forward to working with our new board. Kate Collyer from the CMA, Jacqueline Minor from the European Commission, Stephen Pudney from University of Essex and Ellen Sweet-Escott from Aviva join us as new members; the Bank of England’s Paul Fisher remains on the board as do our Chair Thomas Sharpe QC, myself as Director and Amelia Fletcher as the Centre’s Deputy Director.

CCP members have recently attracted a number of new small and medium sized grants, including a grant from DG Competition to provide a report on ex-post Merger evaluations on the EU, involving Peter Ormosi, Franco Mariuzzo and Richard Havell. The resulting report will systematically review studies on European mergers and provide a methodological framework for evaluation of policy enforcement.

The publication of this issue also coincides with our 11th Annual Summer Conference, this time focusing on “Competition in the Digital Age”. The conference brings together researchers and practitioners from Computer Science, Economics, Law, Management and Political Science to discuss a number of the challenges to competition policy arising from the increased use of the internet. I am sure that the two days will provide a better appreciation of which genuine new challenges are being created by the internet, era and which are merely known issues in new guises.