

A Busy Summer of CCP Events

Acting Director's Letter **Bruce Lyons**



The Centre is looking forward to a wide ranging set of conferences and workshops this summer. Two CCP events in May take our research on the road to share with policy makers and practitioners in London. On 15th May, Catherine Waddams, Tina Chang and Chris Wilson presented some results from their empirical research on Consumer Switching and Decision Making at an open DTI afternoon workshop. Later in the month (25th May), CCP is holding an early evening legal practitioner event in London (kindly hosted by Simmons & Simmons). Steve Davies and Morten Hviid will discuss current research findings concerning the broad range of practices which might be grouped together under the general label 'collusion', including cartels, concerted practices and tacit collusion. They will explore some similarities and differences between these different types of collusion, and confront some provocative issues at the interface of theory and policy. Check our website for further details.

In early July, we are hosting a major conference in Norwich: 'Case Studies in European Competition Policy: The Economic Analysis'. Each case will be analysed by one of Europe's leading academic economists with interests in competition policy. In many of the cases, the author was involved as an expert, while others provide an outsider's view. Cases are taken from both DG Competition and national authorities within Europe. The selection of cases is designed to demonstrate how economics is used (and abused?) in antitrust and merger cases in Europe, and to further its appropriate use in practical competition policy. The conference brings together a unique array of leading competition economists and is aimed at academics, practitioners and policy makers. Presentations will be accessible to both economists and lawyers. The full papers will be published by Cambridge University Press next year in a book to be edited by Bruce Lyons. Check our website for conference details.

Our summer schedule is completed in early September, when the University of East Anglia is hosting the British Association Festival of Science. CCP will be leading a session aimed at raising public interest in competition policy issues.

Meanwhile, we are currently enjoying a two month visit by Greg Shaffer (University of Rochester) who is working with Morten Hviid on the competitive effects of low price guarantees, and with other CCP members on buyer power. Greg's visit is funded by a joint initiative of the ESRC and US SSR. There have been two changes in CCP support staff. We welcome Cheryl Whittaker and Denise Eden-Rogers, and say a fond farewell to Rupert Sheldon. Cheryl will take over Rupert's communications role, so readers should contact her for anything related to publications and publicity.

Finally, I hope you will enjoy the articles in this edition of the Newsletter. Steve Davies argues that partnership restrictions in legal services should be abolished, leaving the market to decide the best organisational form. Michael Harker and Pinar Akman review two recent EC green/discussion papers. Michael argues that the Commission should adopt a 'wait and see' approach and so avoid the pitfalls of adopting concrete rules in the infancy of private enforcement. Pinar identifies some muddled objectives in the Article 82 discussion paper and, gratifying for an economist to hear from a lawyer, prefers the clear focus on consumer harm proposed by the EAGCP report. Andreas Stephan looks more deeply behind the supposed success of the EC leniency programme in unearthing cartels, only to find that, so far, it has mainly succeeded in uncovering those already uncovered in the US! Two of these articles are written by our PhD students, whose research is an important part of CCP activities. The back page highlights four other of our PhD students who are nearing completion. I take this opportunity to congratulate the two Chris's who are moving on to exciting new posts (Pike at the Competition Commission and Wilson at Oxford University).

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Partnership Restrictions in Legal Services: Let the Market Decide¹

Stephen Davies



Introduction

In its White Paper, "The future of legal services: putting consumers first" (October 2005, Cm 6679), the Government has outlined plans to reform the legal services sector in England and Wales. *Inter alia*, these include the creation of a new regulator which would have the power to alter rules of the legal professional bodies – in particular, the current restrictions which prevent solicitors from forming partnerships with barristers, and barristers from forming partnerships with each other, and other professionals. In this article I explain why I think this particular liberalizing reform should be competition-enhancing.

The traditional structure of legal services

Broadly speaking, legal work can be broken down into three categories: (i) non-contentious (e.g. property conveyancing, contracts, wills), (ii) litigation (e.g. issuing proceedings, collecting evidence) and (iii) advocacy in courts. In England and Wales, traditionally, there has been a clean separation between these functions: (i) and (ii) being the preserve of solicitors, and (iii) conducted exclusively by barristers. The consumer's first point of call is the solicitor; in effect, for non-contentious work, this is a standard one stage market: solicitors selling direct to final consumers, but where the required service involves the court, it is a two stage vertically-linked market, the solicitor taking on the role of 'middle-man', introducing the consumer to the barrister². Almost by its nature, any market for professional services will involve an asymmetry of information between the consumer and supplier. In this particular case, many consumers will be unsure of the nature of their particular legal problem, and therefore of the advocacy or advice they require. Moreover, many will have little knowledge about the skills and experience of different advocates, or ability to judge their quality, either ex-post or ex-ante. Legal services are not homogenous - consumers differ in their problems and barristers differ in their skills, knowledge and experience, and there is a potentially important match-making function to be provided by solicitors. This is, of course, not particularly exceptional – few markets are characterised by perfect information on both sides, and a common response to this market imperfection is the existence of the middle-man. However, there is a second type of 'market imperfection' which has fewer counterparts in other markets. This is the unavoidable regulation (both statutory and imposed by the professional bodies) which flows from obligations to 'The Law'. At the risk of oversimplifying, there are two dimensions to this: *Responsibility to the courts and Justice, and Equality before the Law*.

In 2004, there were about 100,000 solicitors, and 9000 solicitor's firms in England and Wales. Most firms are very small: 45% are sole practitioners, but at the other end of the scale, there are some very large partnerships – it has been claimed that the largest 10 firms have a combined market share of about 50%. The Bar is a much smaller profession: there are about 12,000 barristers in independent practice, all being sole proprietors, but most belonging to Chambers. The conventional wisdom is that the Chambers is primarily a structure for sharing common costs, but in which the members are quite independent players on the demand side, in principle, competing with each other. There are currently about 300 Chambers, with an average of about 30 members each.

The case for reform

Because there are two vertical stages, in principle, there could be a variety of corporate structures. Some firms might be unintegrated (i.e. specialised solicitors or barristers), and some might be integrated (providing both functions). In practice, however, professional restrictions rule out the possibility of *horizontal integration* amongst barristers and *vertical integration* between solicitors and barristers. In that sense, these restrictions act as a constraint on the operation of market forces – in particular, the freedom of actors to choose the organisational structure which best suits them.

The case in favour of removal will be, for some people (including the author), fairly conventional, and predictable:

- If barristers were allowed to form partnerships amongst themselves, they would have a new freedom to choose their level of horizontal integration and scale of operations, and to optimize their level of profits, degree of risk, size of portfolio, and anything else which is scale-related.
- If barristers were allowed to form partnerships with solicitors, vertical integration becomes a possibility, with all the usual potential efficiency gains, which I group here under the heading of economizing on transaction costs (reduced uncertainty, improved coordination etc.).

Of course, it might be argued that, in this particular market, the gains from integration would be minimal and outweighed by the costs. For example, some people argue that the institution of the Chambers already effectively provides barristers with access to scale economies. More generally, 'control loss' might constrain efficiency savings. Others have argued that barristers value their independence and the variety of work which they can choose as sole proprietors, but which might be denied if they were forced into big law firms. In principle, each of these counter arguments might be correct. But this leads me to the higher-level reason for removal of restrictions, and this is simply that:

- with certain qualifications, 'the market knows best'. The removal of partnership restrictions would not mean that sole proprietors or vertically unintegrated firms would be prohibited, and if, indeed, the gains from integration did not materialize, they would continue to flourish. It is

important to stress the case in favour of reform is not some doctrinal belief that integration is inherently better than specialization, only that the two structures should be allowed to compete with each other: in any free market, *competition is not only between firms, it is also between organisational forms*. An important part of this argument is evolutionary. In a dynamic world, in which consumer tastes and technology may be fast changing, it is important that firms have the ability to respond by, amongst other things, modifying their corporate structure. By permitting alternative corporate structures, we provide new opportunities for innovation (putting together innovative packages of different services), entry, and investment. Such flexibility might be crucial in response to a world which is beginning to change rapidly outside (and inside) the legal profession.

The case for retaining restrictions

The most pervasive counter arguments, in support of retaining current partnership restrictions, are the following.

1. The traditional strict demarcation between solicitors and barristers has become blurred in recent decades, largely because solicitors have been increasingly able to fulfill the traditional functions of barristers – most notably with the emergence of “Solicitor-Advocates”. As such, some of the gains from vertical integration are already available.
2. The existing separation of duties between barristers and solicitors already yields the most efficient organization, exploiting to the full the benefits of specialization.
3. The wider public interest might be compromised, notably, because conflicts in interests within partnerships might place at risk the traditional cab-rank rule, under which, in principle, every citizen has equal access to barristers
4. Competition may be dampened amongst both barristers and solicitors

In Davies (2005), I explain more fully why I find none of these arguments persuasive. In brief, the implication of (1) and (2) is that there would be no advantage in allowing integration – either because it already exists, or because it would be less efficient than specialization. But, if this is the case, the existing structure would have little to fear and would survive unscathed from competition. In refuting (3), I rely largely on the opinions of others, more knowledgeable than me on the workings of our legal system³. I will devote the rest of this article to (4), since this is where the argument is slightly more open.

Competition: do private and public interest necessarily coincide?

Does the market always know best? Following the liberalisation of *any* market, we should expect suppliers to respond in their own self-interest. In this case, this would mean switching to an integrated corporate structure if it was profitable to do so. Where these new profitable opportunities are cost-driven, there is no divergence – private and public interest coincide. On the other hand, if the new opportunities are profitable because they soften competition, then fears about new corporate structures might be justified: change might be in the private, but not

the public, interest. This fear has been articulated in two concrete forms in particular.

Reduced competition and choice between barristers?

This is an argument against horizontal integration amongst barristers. The fear is that barristers within the same partnership could not properly act for clients whose interests conflict. It follows that, if partnerships were permitted, this would automatically reduce the choice available to the consumer, and this danger would be most pronounced in specialised branches of the law. However, there is a compelling reason for doubting this outcome: why should independent barristers choose to join large partnerships if this would indeed drastically reduce the number of cases in which they could act? Unlike nearly every other market, advocacy requires competition since there are always at least two sides to any case. So, while it is true that dominant partnerships in any specialism would deny consumers much choice (because of conflicts of interest within partnerships), equally, they would deny the members of that partnership much custom!

Smaller solicitors would be disadvantaged?

This is an argument against vertical integration. Under the present structure, all solicitors ‘fish in the same pool’ – all have access to the independent bar. But if partnerships were allowed, this might lead to an increased number of in-house barristers for the larger solicitors, thereby reducing access for smaller solicitors. However, this depends very much on the extent of substitutability and nature of competition *within* the solicitors’ profession. Insofar as one might expect most vertical integration to occur within the largest solicitors, and, so long as they do not see themselves in competition with small high street solicitors, an obvious solution for the smaller firms is to seek expert opinion and advocacy services from the larger firms. Worries about foreclosure are only real if the largest solicitors (i) tie up a significant proportion of currently independent barristers, and (ii) have an incentive to foreclose their smaller high street brethren. Both assumptions seem to me to be questionable. There are good reasons to believe that many barristers will prefer to remain independent, and it is unclear what would be the motive for the larger solicitors to squeeze out the smaller solicitors. The large City Law firms have quite different customer bases than do high street solicitors.

On balance then, I do not find any persuasive reason for retaining current professional partnership restrictions. As a competition economist, I can see that liberalization *might* lead to future concentrations and market power, but there is this potential in any market, and the appropriate safeguard is competition policy, not partnership restrictions.

¹ This article is based on “The economic implications of partnership restrictions in the legal services sector and their possible removal”, S W Davies (2005), <http://www.dca.gov.uk/legalsys/davies.pdf>

² Interestingly, this strict distinction between barristers and solicitors is not made in the other major Common Law jurisdiction, the United States, although it can be observed, to a greater or lesser extent in other Common Law jurisdictions in the English-speaking world.

³ See, for example, Clementi (2004) “Review of the Regulatory Framework for Legal Services in England and Wales” para 81 and p.131.

Private Enforcement: Fix it First or Wait and See?

Michael Harker



The Commission's recent Green Paper on *Damages actions for breach of the EC antitrust rules*¹ lauds the potential benefits of a new paradigm of enforcement for EC competition law. In setting the context, Competition Commissioner, Neelie Kroes stated: *"Businesses and individuals who suffer losses because of illegal activities such as cartels have a right to compensation. Currently, this right is all too often theoretical because of obstacles to exercising this right in practice. This Green Paper sets out options for making that right a reality, and so making companies that break the competition rules pay for the harm that they do."*²

The national courts are encouraged to award damages (and other remedies) to those harmed by infringements of EC competition law. The puzzle is that while these rights have clearly been enforceable for some time, there has been an extremely low incidence of private competition cases across Europe. It appears that the 2001 judgment of the European Court of Justice (ECJ) in *Courage v Crehan* has done little to fortify would-be litigants, despite the fact that the court was clearly giving its imprimatur to private actions:

*"...[T]he full effectiveness of [EC competition law]... would be put at risk if it were not open to any individual to claim damages for loss caused to him [by conduct]... liable to restrict or distort competition. Indeed, the existence of such a right strengthens the working of the Community competition rules and discourages [conduct]... liable to restrict or distort competition. From that point of view, actions for damages before the national courts can make a significant contribution to the maintenance of effective competition in the Community."*³

As a matter of EC law, and absent any specific European harmonisation measure, national courts must give effect to EC law through the existing procedural and remedial mechanisms in national law (the principle of remedial and procedural autonomy). This principle is subject to two important qualifications: rights existing in EC law must be given equivalent protection to comparable rights in national law (the principle of equivalence); and the procedural and remedial measures in national law must not make excessively difficult the exercise of such rights (the principle of effectiveness).

The Green Paper represents a distillation of substantial research across the Member States of the EU, highlighting obstacles (and innovations) which have had the effect of dampening (encouraging) private enforcement.⁴ It moves on to lay out a range of "options" over how private enforcement might be facilitated, including: the altering of cost rules and rules over discovery in order to provide would-be litigants with more incentives and information to sue; on the specifics of how damages ought to be

quantified; on what are the appropriate rules of standing; and whether a "passing-on" defence ought to be permitted.

As a survey of current practice and options, it has much to recommend itself.⁵ However, the strategic aims of the Commission are far less clear. A Green Paper is by definition a tentative report, meant to stimulate discussion without any firm commitment to action. In this respect, however, the document is very "green". The Commission explicitly states that it "has not yet decided if actions – legislative or otherwise – are necessary" and nor "does it yet have a view about whether any possible action is best taken at the EU level or at the level of the Member States".⁶

How might this be taken forward? There are two options: a harmonisation measure for the private enforcement of competition law (displacing the principle of remedial and procedural autonomy) or simply an exhortation by the Commission of how national courts should further private enforcement. The former option has the advantages of providing a clear and coherent set of rules which may facilitate private litigation and create a level of certainty for would-be litigants, while at the same time ensuring a "level playing field" thereby reducing the possible distortions of forum shopping. On the downside, however, it might be that such an approach will foreclose any debate or competition among the legal systems of Member States over the best way in which to scope procedures and remedies which will lead ultimately to the best outcomes in the light of the underlying aims of EC competition law and the Treaty.

In the US, some 90 per cent of federal antitrust cases are brought by private plaintiffs. Over time, commentators there have lamented upon some of the serious systemic problems which can result from the incentive problems associated with private enforcement. The judiciary appear to be increasingly sceptical about the veracity of claims – particularly those brought by rival plaintiffs – and this has led to a number of pro-defendant precedents, most notably in respect of predatory pricing. This emerging consensus in the US – which is the only jurisdiction in the world where private enforcement is the dominant mechanism of enforcement – reveals some of the potential pitfalls of private enforcement.

Given the relative "infancy" of private enforcement in Europe, and the lack of experience of both the Commission and the national courts, the "wait and see" option is surely the best way forward. Maintaining a dialogue between the national courts and the ECJ (through the preliminary reference procedure) is superior because it allows for a process of learning over time. The alternative of adopting concrete rules now – the effects of which may be uncertain and possibly perverse – would not be in the interests of a coherent system of competition law in the long run.

1 Com(2005) 672 Final.

2 Commission launches consultations on facilitating damages claims for breaches of EU competition law, IP/05/1634 (20/12/2005).

3 C-453/99, paragraph 26 to 27.

4 The Commission commissioned the law firm, Ashurst, to conduct a comparative study on the current state of the law in the EU Member States:

<http://europa.eu.int/comm/competition/antitrust/others/actions_for_damages/study.html> (07/04/06).

5 For a fuller discussion see: Commission Staff Working Paper - Annex to the Green Paper (COM(2005) 672 final).

6 MEMO/05/489, 20/12/2005.

Two Cheers for the EC Discussion Paper on Article 82

Pinar Akman*



EC DG Competition finally published the discussion paper on the application of Article 82EC in late December, 2005.¹ The paper sets out the Commission's application of the provision to exclusionary abuses and leaves exploitative abuses for future work. The paper discusses issues such as the relationship between Article 82EC with other provisions, market definition, principles for finding a dominant position, the general framework for the analysis of exclusionary abuses and its application to some specific types of exclusionary abuses, and concludes with the analysis of aftermarkets.

The policy of the Commission and the jurisprudence on Article 82EC have been criticised for not being grounded on sound economics and the current form-based approach being inferior to an effects-based approach.² In an effects-based approach, the main concern is the improvement of consumer welfare. In the paper, the objective of Article 82EC with regard to exclusionary abuses is cited as that of protecting competition on the market as a means of enhancing consumer welfare and of ensuring an efficient allocation of resources.³ It is clearly stated that the concern is to prevent exclusionary conduct of the dominant undertaking which has the potential to limit the remaining competitive constraints so as to avoid consumer harm. It is competition rather than competitors to be protected.

Whereas the EAGCP Report emphasises the need for the competition authority to explain in each case the harm for consumers and indicate precisely the relevant consumer welfare effects⁴, the stance in the paper appears to be an implicit assumption that exclusionary behaviour necessarily harms consumers unless the contrary can be proved by the company.⁵ It is presumed that harm to intermediate buyers generally means harm to final consumers. This interpretation of the paper means that the Commission has still not made it clear enough how the protection of competition is to be separated from that of competitors.

The paper defines exclusionary abuses as "behaviours by dominant firms which are likely to have a foreclosure effect on the market, i.e. which are likely to completely or partially deny profitable expansion in or access to a market to actual or potential competitors and which ultimately harm consumers."⁶ Harm to consumers is an additional factor to foreclosure to find behaviour exclusionary which would mean that the differentiation between the prevailing categories of abuse, i.e. "exclusionary" and "exploitative", may no longer be sustainable since "exclusionary" would, as a result of the Commission's understanding, require *exploitation* of consumers as well. This could thus be interpreted as a move towards a single type of abuse, i.e. "exploitative".⁷ Nonetheless, the paper later argues for the conformity of its definition with that of the ECJ in *Hoffmann-La Roche* which does not look for harm to consumers.⁸

According to the paper, Article 82EC prohibits exclusionary conduct that produces actual or likely anti-competitive effects in the market and that can harm consumers directly or indirectly.⁹ This differs from the test in the EAGCP Report under which competition is deemed to be harmed *only when* consumers are harmed. Hence, the EAGCP Report takes the position that the standard for assessing whether a conduct is detrimental to competition or not should be derived from the effects of the practice on consumers.¹⁰ Contrarily, the discussion paper looks for anti-competitive effects in the market *and* possible harm to consumers. In other words, they are not seen as one and the same thing. Moreover, the test proposed in the paper does not look for proof of any actual or possible harm to consumers. Although consumer welfare is presented as the ultimate concern¹¹, nowhere in the paper it is explained in detail *how* an assessment of the effects on consumers will be made. Such an approach brings with it the danger of interpreting harm to *competitors* as harm to consumers and thus, protecting competitors rather than consumers.

The paper is overall a welcome attempt in that it seems to be adopting a more *effects-based* approach towards Article 82EC in general and proposing a more disciplined framework. There is a tendency for the acknowledgement of an overarching consumer welfare standard. Nonetheless, it is not always clear whether an appropriate separation between competitive harm, competitor harm and consumer harm is made. It lacks rigour by not setting out manifestly how consumer harm is to be assessed and it is not obvious how a more effects-based approach will be implemented. It is also not that clear to what extent the paper is introducing reform rather than systemising the current application. Several opportunities which could have been used to provide a more satisfactory reply to the criticisms and to embrace recommendations, especially those of the EAGCP Report seem to have been missed. This will hopefully be done in the following discussion paper on exploitative abuses or in the guidelines the Commission will adopt.

*The author would like to thank Michael Harker and Morten Hviid for helpful comments on the longer version of this note.

1 "DG Competition discussion paper on the application of Article 82 of the Treaty to exclusionary abuses" Brussels, December 2005 can be found at <http://europa.eu.int/comm/competition/antitrust/others/discpaper2005.pdf> (the "paper").

2 The most comprehensive study arguing for an effects-based approach is the Report by the Economic Advisory Group for Competition Policy on "An Economic Approach to Article 82" which can be found at http://europa.eu.int/comm/competition/publications/studies/eagcp_july_21_05.pdf (the "EAGCP Report"). An effects-based approach focuses on the presence of anti-competitive effects that harm consumers and is based on a case-by-case analysis, grounded on sound economics and facts, *ibid* p. 2. A form-based approach concentrates on the type of conduct, *ibid* p. 5.

3 Para. 54.

4 EAGCP Report n. 2 above pp. 8-9, 10.

5 See e.g. para. 123.

6 Para. 1.

7 See E. M. Fox "What is Harm to Competition? Exclusionary Practices and Anticompetitive Effect" (2002) 70 Antitrust Law Journal 372 questioning whether there is ultimately only one type of abuse, that is exploitative.

8 "Abuse" is defined there "... as an objective concept relating to the behaviour of an undertaking in a dominant position which is such as to influence the structure of a market where, as a result of the very presence of the undertaking in question, the degree of competition is weakened and which, through recourse to methods different from those which condition normal competition in products or services on the basis of the transactions of commercial operators, has the effect of hindering the maintenance of the degree of competition still existing in the market or the growth of that competition" Case 85/76 *Hoffmann-La Roche & Co AG v Commission* [1979] ECR 461, para. 91.

9 Para. 55.

10 EAGCP Report n. 2 above, pp. 7-9. It is argued there that otherwise, the authority may be tempted to confuse the protection of competition with the preservation of a particular market structure which would merely have the effect of protecting the competitors, *ibid* p. 9.

11 See e.g. paras. 4, 54, 55, 88.

Making Firms an Offer They Can't Refuse? ...Are You Sure?¹

Andreas Stephan



Cartels and Leniency Programmes are a popular subject for articles and speeches emanating from DG Competition. In part this is because of the colourful nature of collusive agreements involving international conspiracies with meetings of top executives in the smoke-filled rooms of Swiss hotels. Mergers and State Aid simply cannot compete with such glamour and the simple and easily comprehensible notion that companies coming together to rip off buyers is a bad thing. Since the late 1990s there has been an explosion in the volume of cartels prosecuted by the European Commission, with fines running into billions of euros. The 'Notice for the non-imposition or reduction of fines in cartel cases' (96/C207/04) introduced in 1996, and reformed in 2002, is hailed as the vanguard of this success, apparently making firms an offer they can't refuse: reveal your cartel and we won't fine you a penny! ...but hurry, only one immunity deal per cartel!

Despite criticism from lawyers and economists alike for its lack of clarity due to vague wording, and lack of certainty as to how a firm will be treated after coming forward, the 1996 leniency notice is viewed as a success by the European Commission. As early as 2001 the then Competition Commissioner, Mario Monti said that "it has played an instrumental role in uncovering and punishing secret cartels" (IP/01/1011).

With cases involving the 1996 leniency notice largely completed, and as everyone holds their breath to see how fruitful the revised 2002 notice will prove to be, we are now in a position to assess just how successful the policy really was.

On the face of it one cannot help but be impressed by the figures: leniency was introduced in July 1996 and by February 2005, 33 horizontal cartels were punished with €3.9bn imposed in fines. However, under closer scrutiny the apparent success hides two secrets: Firstly, *rather than playing a central role in inducing firms to come forward and reveal cartels, it appears that most European leniency success in this period came about as a result of prior and simultaneous US success.* Secondly, *most of the uncovered cartels operated in one concentrated industry (chemicals), were linked to each other and had either failed or were failing by the time leniency applications were made.*

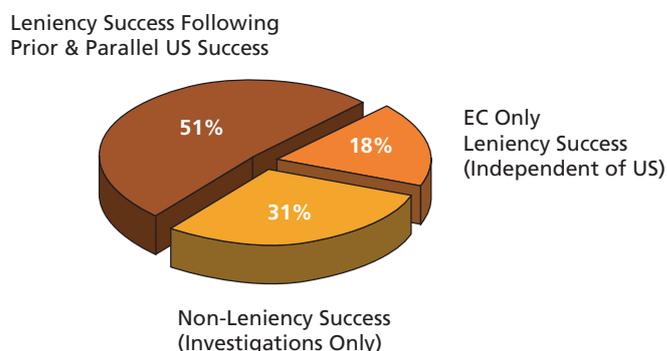
Free-riding on Uncle Sam?

The US has a far more sophisticated cartel enforcement regime than the EC mainly due to the existence of plea-bargains, better private enforcement helped by the availability of treble damages, and the imprisonment of individuals. Since

1993, its Corporate Amnesty (leniency) Program has offered stronger incentives for firms to reveal cartels than those offered by the European leniency notice prior to the 2002 reforms. Consequently, most international cartels in this period were revealed and punished in the US prior or broadly simultaneously to the EC.² European investigations and fines (as well as those of other jurisdictions) typically followed behind, with final Commission decisions usually delivered between 2-4 years after the first US fine was imposed. Where US investigations preceded those of the EC, applications for leniency in Europe were clearly a consequence of the Antitrust Division's success. Where leniency applications were made more or less simultaneously in both jurisdictions, the motive to reveal a cartel will have been *mainly* the stiffer US sanctions and clearer, more generous amnesty program.

If we distinguish those European horizontal cartel cases with a prior or simultaneous US equivalent investigation (in the period Jul 1996 – Feb 2005) we find that of the €3.9bn in fines imposed during the period, €1.96bn (14 cartels, all of them international), or just over half of the total cartel policy success was actually attributable to prior or simultaneous US success. This amounts to almost three quarters of the policy success apparently resulting from the leniency notice.

Figure 1: Sources of EC Cartel Enforcement Success in terms of Fines Imposed.

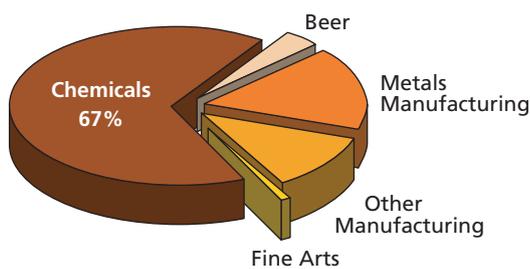


Only about 18% of the total fines imposed involved cases revealed through the 1996 leniency notice independently of prior or simultaneous US success. This represents just six cartels, five of which had failed by the time they were revealed to the Commission due to industry crises and distrust between cartel members. It appears that only in the *Copper Plumbing Cartel* was a firm that was party to an active cartel, actually induced into approaching the Commission.

Chemicals: the usual suspects

The second secret of the 1996 leniency notice concerns the industry breakdown of leniency success. If the leniency notice was as successful as the fines would suggest, then one would hope to see the detection of unrelated otherwise stable and profitable cartels in different industries. What we mainly find instead is a series of linked, largely failing cartels operating in just one troubled industry.

Figure 2: 1996 Leniency Notice Success: Industry Breakdown (in terms of Fines imposed Jul 1996 – Feb 2005)



In fact, 67% of fines (€1.8bn) ostensibly imposed as a result of the 1996 leniency notice (46% of all cartel policy success in the period) were incurred by the chemicals industry. What is more, a closer inspection of the 11 chemicals cartels reveals that they had largely failed before the European Commission was approached. All were international cartels, with US equivalent prosecutions and connected to each other by virtue of the fact that most chemical firms were involved in more than one infringement. For example three of the firms involved in the *Food Flavouring* (Nucleic Acid) cartel were also involved in *Amino Acids/Lysine*, and one was involved in *Amino Acids*, *Organic Peroxides* and *Sodium Gluconate* cartels contemporaneously. Crucially all these cartels can be traced back to *Amino Acids/Lysine* and *Vitamins*, the first two major infringements to be uncovered. Following the investigation of these, it was perhaps inevitable that the others in the industry would follow. For instance the *Methylglucamine* and *Methionine* cartels ceased to operate as a direct consequence of investigations into the *Vitamins* cartel (COMP/E-2/37.978 at 153) probably because *Aventis SA* was a member of all three infringements.

As well as the consequences of such investigations, many of the cartels had largely failed because of conditions in the chemicals industry. In the *Vitamins* cartel, only three of the nine sub-cartels were still operating when the US Antitrust Division opened its investigation in late 1997 – the other six had by this time collapsed. The problems in the Chemicals industry that caused these cartels to fail are identified in the Commission decisions and in industry journals. They included:

- Entry of new Chinese producers in the early and mid 1990s.
- Decline, overcapacity and rising costs, compounded by the Asia crisis of the late 1990s.
- Unforeseen substitutability and low entry barriers.
- Arguing and distrust between cartel members.
- Currency fluctuations resulting in arbitrage.
- Mergers, acquisitions and restructuring resulting in changing identities and capacities.

Implications for cartel enforcement in Europe

These findings suggest that rather than destabilising active cartels and inducing infringing firms into coming forward, the

1996 leniency notice largely succeeded in uncovering cartels that had already failed because of prior/parallel US investigations and crises within the industry. If this is the case, then the 1996 notice may have actually provided a way for firms to tame the endgame of collusion, and possibly harm their former cartel partners, by revealing the infringement in return for immunity while their competitors faced hefty fines. In an economic sense, this amounts to reducing the cost of collusion for those committing the infringement. As well as granting immunity to the first firm to reveal, the leniency notice also provided (and still provides) fine discounts to the other infringing firms in return for cooperation and even for merely not contesting the facts of the case.

There is no doubt that the reformed 2002 leniency notice is a substantial improvement over its predecessor in terms of the incentives it offers firms to reveal a cartel. However it still suffers from some of the inherent procedural uncertainties that existed in the original 1996 leniency notice. In addition, many leniency programmes on the member-state level within the E.U. are still based on the 1996 notice and thus still contain its intrinsic weaknesses.

The US amnesty program remains more effective than the EC leniency notice, regardless of the 2002 reforms, due to the existence of much higher US sanctions; in particular the availability of treble damages for injured parties and the imprisonment of company directors. There is no doubt that the US will continue to lead the way in international cartel enforcement for the foreseeable future.

Nevertheless, the Commission is moving the European cartel enforcement regime in the right direction with one-stop-shops for leniency and increased private enforcement possibly around the corner. In the meantime, it is important to keep European leniency success in perspective and to interpret the record fines imposed on cartels purportedly uncovered by the leniency notice with great caution and a degree of apprehension.

1 This article is based on an empirical paper: Stephan, A (2005) "An Empirical Assessment of the 1996 Leniency Notice". CCP Working Paper 05-10 (available on our website)

2 These cartels were revealed in the US either through investigations by the Department of Justice Antitrust Division or through the Corporate Amnesty Program.

**“It’s Bad to Talk.”
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Final Year CCP PhD Students

Andrew Bugg is in the third year of his PhD and is planning to obtain funding for postdoctoral research. Part of Andrew's research looks at competition issues in agricultural markets. Firstly, he has used econometric cointegration analysis to show that the introduction of price transparency through the 2001 US Livestock Mandatory Reporting Act may have provided anti-competitive effects on the US beef wholesale sector¹. Secondly, Andrew has empirically investigated whether owner motivations are consistent with neoclassical models of profit maximisation within the UK speciality food sector. A full theoretical model is derived that allows owners to consider, not only profit, but also utility in their choices of price, product quality and production method. He finds empirical evidence that utility maximising owners set higher levels of each². Additional forthcoming research includes modelling consumer behaviour at farmers' markets and valuing farmers' markets as a shopping experience using on-site surveys³.



- ¹ "The Livestock Mandatory Reporting Act: Has Information Pooling Led to Anticompetitive Behaviour in the US Beef Industry?" CCP Working Paper 05-6
- ² "Business or Pleasure? Owner Motivations in the UK Speciality Food Sector", CCP Working Paper (forthcoming)
- ³ "Investigating Consumer Choice Behaviour for Typical Food Sold at Farmers' Markets", Soon available at <http://ssrn.com/author=512235>, (forthcoming)

Luke Garrod is in the third year of his PhD and is also planning to obtain funding for postdoctoral research. His research considers how economic theory is affected by simplifications in agents' strategic behaviour. Luke considers two applications of a theoretical model of collusion where firms employ price matching punishments rather than the more conventional, harsher 'Nash reversion' punishments. Firstly, he illustrates that this model can provide some unusual consequences for pricing over the business cycle as deviating from collusion is most beneficial when demand or marginal cost is high. Secondly, Luke illustrates how, under this scenario, firms may use surcharges to facilitate collusion during temporary cost shocks¹. In Luke's other work, he considers how loyalty cards may facilitate oligopolists, but not monopolists, to profitably discriminate between sophisticated and impulse buyers². Finally, outside of competition policy, Luke has conducted an experiment which provides evidence that the majority of subjects' behaviour cannot be described by inequity aversion³.



- ¹ Garrod, L "Surcharges as a Facilitating Practice" CCP Working Paper (forthcoming)
- ² Garrod, L "Loyalty Cards, Durable Goods, Competition and Boundedly Rational Consumers" CCP Working Paper (forthcoming)
- ³ Garrod, L (2005) "Further Decomposition of Ultimatum Game Behaviour: Are Agents Really Inequity Averse?" UEA Discussion Paper, available at <http://ssrn.com/abstract=844745>

Chris Pike is close to finishing his PhD and started as an assistant economist at the Competition Commission in May. Chris's thesis examines R&D incentives in the pharmaceutical industry. Part 1 concerns the distribution of incentives for product development over a spectrum of technological improvement. Within a switching cost model he compares pricing equilibria under no regulation and under so-called 'price ratcheting' regulation and finds empirical support for these equilibria in US and UK datasets. The effects of regulation are shown to improve efficiency by skewing incentives towards the development of more innovative products at the expense of derivative "me-too" products. However, increasing the numbers of exclusionary patent rights threatens to undermine small profit level R&D projects. Part 2 assesses whether the intended incentives survive under both mounting transaction costs, and the working solutions developed to deal with them. These are socially wasteful and in a bargaining model with time varying outside options he finds that, given imperfect information, their effectiveness is dubious and may ultimately inhibit the development of socially valuable products.



Chris Wilson is close to finishing his PhD thesis and is due to start an ESRC postdoctoral fellowship at Oxford under Sir John Vickers in October. His research considers how policy should be best used to regulate firms' attempts to gain market power through 'obfuscation' strategies that make it hard for consumers to make comparisons between firms. Firstly, he shows that the damages to consumers from such strategies can be very large and can exceed the damages from some other alternative anti-competitive strategies¹. He then illustrates how moderately enforced consumer protection policy may actually enhance the ability of advertising to mislead consumers and how such an effect may impact upon competition². Finally, with Catherine Waddams, he uses two datasets to show that an alarming proportion of consumers in the UK electricity market appear to lose out when switching between firms³.



- ¹ "Markets with Search and Switching Costs" CCP Working Paper (forthcoming)
- ² "The Effects of Consumer Protection on Sales Signs, Consumer Search and Competition" CCP Working Paper 05-9
- ³ "Some Evidence of Irrationality in Consumer Switching Decisions: When More Firms May Mean Less Benefit" CCP Working Paper 05-4 (Under revision)

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