Kaplow, Louis: Competition Policy and Price Fixing

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Book's Review: Louis Kaplow, *Competition Policy and Price Fixing*, Princeton University Press, Princeton and Oxford, 2013

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In all developed countries, the condemnation of the collective price fixing process is virtually unanimous. Competition policy lawyers tend to keep the Adam Smith's famous warning in the back of their minds: '*People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices.'* This warning is probably at the origin of the current legal approach against price fixing: the antitrust agency has to find a trace that the presumed guilty met together or established any other form of communication to end in a conspiracy against the public, materialized by a price increase.
Is this approach justified? Are the meanings of such terms like meeting, communication, conspiracy sufficiently clear?
In this very well documented book, Louis Kaplow explores in great detail these questions by reviewing the main antitrust approaches relative to price fixing, trying to discover the most justified one against supracompetitive prices. Should we understand a cartel only indirectly through an expression of its materialization (existence of a formal or informal agreement, explicit agreement, reporting, etc.)? Or more directly through its result materialized on the price level itself? The book presents a well-argued argument in favor of the second approach, namely the direct approach. In other words, the choice between the two approaches may be stated as follows. Since the players' interdependence in an oligopolistic market leads to higher prices, should be the existence of a supracompetitive price sufficient to constitute evidence of an infringement of competition, or should one introduce as a component of this evidence the existence of secret communications and/or secret agreements that would be at the origin of the complained cartel practice?
Most observers of competition law, including courts, believe that oligopolistic interdependence is not enough. But the nature of what needs to be added is not clear. Moreover, it is not clear that it would bring more useful implications in terms of well-being. The effect of collusion on price and welfare is the same whether the collusion results from a simple oligopolistic interdependence (tacit collusion), or is the result of a formal agreement (explicit collusion). The question is then whether what matters most in condemnation of collusion: is it the result of the collusion or the behavior of players in the collusion? Moreover, another possibility arises: a supracompetitive price in an oligopolistic market may be a consequence of the independent individual reactions to an exogenous change in market supply conditions.
The first merit of Kaplow's book is to disentangle these different possibilities. The book also emphasizes the contrast between the economic and legal approaches to the regulation of collusive behavior.
Under the economic approach, one first attempts to determine the existence of collusion that derives from the gap's assessment between the observed price and the marginal cost, after taking into account the two following characteristics: the magnitude of the fixed cost and the shocks that affect the demand and supply conditions.

Under the legal approach, the first step is the determination of whether there exists an agreement. If its existence is sufficiently well documented, the legal sanctions apply: in the United States, these are treble damages to injured customers, criminal penalties on perpetrators including fines and imprisonment, and possibly injunctions against particular practices.

Kaplow argues that the extent to which these two approaches diverge depends importantly on the legal concept of agreement. Some legal utterances distinguish between "express" agreements and "tacit" agreements. "Tacit" ordinarily means that the communication does not necessarily use words or speech (which, by contrast, is what is meant by "express"). The oligopolists' ability to coordinate, even in the absence of explicit agreement, to raise price or more generally increase profit at the detriment of consumers has been treated under the notion of "collective dominance" in a number of important European Court decisions and under the "coordinated effects" label in the US.

The economic approach highlights the difference between independent behavior and tacit collusion. Consider a market where no single dominant firm exists. Competition may be threatened in two ways corresponding respectively to unilateral conduct and collective conduct. In the unilateral conduct, market prices result from independent reactions to some common exogenous shocks. For instance, when market concentration is high enough for non-competitive outcomes to result from the individual profit-maximizing responses of firms to market conditions (situation referred as a price making behavior), firms may be able to exert some market power, even when none of the firms would be considered individually dominant. In this sense, unilateral conduct signifies *independent behavior* which is perfectly legal. The second way in which competition may be threatened is when a number of firms engage in what economists refer to as *tacit collusion*, as a result of which their behavior may approximate that of a single dominant firm. A strong version of the oligopolistic interdependence occurs when the outcome (prices or quantities) may well resemble that of explicit collusion or even of an official cartel. Therefore, tacit collusion need not involve any "collusion" in the legal sense, and in particular need involve no communication between the parties.

The economic approach to collusion highlights the dynamic nature of the competitive process formally represented by the repeated game theory. The main result of this theory, known as the folk theorem, states that any outcome, whether collusive or not, can be supported as a noncooperative perfect equilibrium of the repeated game. This result is both strong and fragile. It is strong in the sense that it shows that a collusive outcome can be achieved in the absence of any agreement. It is also fragile to the extent that the choice of a specific equilibrium within a multiplicity of collusive equilibria requires more or less a certain amount of coordination. This is why, as insightful as it is, Kaplow's analysis lacks an important question: How can one distinguish between bad and good coordination through repeated interaction? (See Patrick Rey and Jean Tirole, Cooperation vs. Collusion: How Essentiality Shapes Co-opetition, IDEI, 2013).

The legal approach is different. The central question is whether the price is the result of an agreement. If there is no agreement there is no violation. Both in the United States and the European Union, the emphasis is on the distinction between unilateral conduct and collective behavior. Unilateral conduct signifies independent behavior which is perfectly legal. Therefore, the central question facing the courts about the pricing is: Is there or not a conspiracy leading to an agreement in determining the market price? The legal approach does not ask the question about the nature of the

observed price: Is it similar or dissimilar to the result that would have been obtained under competition? Thus, it is not the result itself that constitutes an offense. It is only the way to get this result, which is liable to be punished. Therefore, legal prohibitions are typically triggered by certain types of conduct rather than by outcomes themselves.
For concreteness, the prohibition in U.S. antitrust law, Sherman Act §1, makes illegal *"[e]very contract, combination . . . , or conspiracy, in restraint of trade*." In practice, the standard term of art is "agreement," even though that term does not appear in the statute. Thus, the legal question is whether firms' pricing is the result of an agreement. If not, there is no violation. If so, there is a violation, and penalties in the United States include having to pay treble damages to injured customers, being subject to injunctions on prohibited behavior, and criminal penalties, under which firms' executives convicted of price-fixing serve prison terms and firms pay fines.
If section 1 of the Sherman Act does not explicitly use the term agreement, it is not the same in Article 101 of the European Treaty, which states: "*Incompatible with the internal market and prohibited are all agreements between undertakings , decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition to the associations within the internal market , and in particular those which : a) fixing, directly or indirectly purchase or selling prices or other trading conditions, b) limit or control production, markets, technical development or investment, c) share markets or sources of supply, d) apply in respect of trading partners dissimilar conditions to equivalent transactions with conditions placing them at a competitive disadvantage in the competition, e) make the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts* . "
A central question for legal regulation is whether successful oligopolistic interdependence that produces supracompetitive prices should in itself be deemed a violation or whether something additional—perhaps secret negotiations producing a signed cartel agreement, perhaps less formal arrangements—should be a prerequisite to liability. Most contemporary writers believe that the law does and should require more than interdependence. However, it is unclear just what supplement is necessary. One implication of this gap is that it is difficult to identify the extent of consensus or disagreement that exists. In addition, it is appreciated that this view is in tension with a rejection of formalism and an embrace of economically based competition regulation because successful interdependent coordination that produces supracompetitive pricing leads to essentially the same economic consequences regardless of the particular manner of interactions that generate this outcome.
To summarize, the so-called *paradox of proof* is as follows: as the structural market conditions move from a situation where collusion is not possible to a situation where collusion is very easy, a formal proof of the existence of an explicit agreement is less and less needed. If the need to rely on a formal proof of the existence of an agreement is important in cases where collusion is impossible, this necessity disappears in cases where collusion is relatively easy. In addition, the boundary between these two extremes is very difficult to establish (see note 71 in Kaplow - Shapiro, 2007).
To what extent this evidence is found in American jurisprudence collusion? It is possible to detect some traces of this evidence in the way the courts seek indicators

that report greater plausibility of the collusive behavior rather than independent behavior. A priori, as has been said, these indicators are important only in situations where conditions are unfavorable a priori to collusion, since it is only under these conditions that agreements become essential to the smooth running of collusion. Whereas, in situations where conditions are very favorable to collusion, that are designed by Kaplow as the region of the paradox, it is no need to find an agreement to prove collusion because it can exist without any agreement. Looking for evidence of an agreement in these situations is both unnecessary because companies do not need a formal agreement to implement collusion and wrong because even when traces of such agreements are not founded, the conclusion that there was no collusion may be wrong. This is the central point of the analysis of the very well documented Kaplow's book.

Also, can we think that we are always in situations where in the absence of agreement, collusion is very difficult to implement? If this hypothesis were true, we should rather conclude that the agreement is useless because if collusion is difficult to implement, only the existence of trade should be sought to prove collusion.

All this shows that there is a gap between the economic and legal approaches to collusion. The economic approach highlights nor communication nor agreement to analyze the collusion. It is dynamic and strategic interdependence induces actors to seek a non-cooperative equilibrium in their favor. The legal approach is more ambiguous. Seeking traces of an agreement or exchange to prove the existence of collusion, it is cantilevered. On the one hand, this research is unnecessary and wrong in situations where there exist favorable conditions for collusion. On the other hand, this search for a favorable non-cooperative equilibrium can be made very difficult in situations where the conditions that favor collusion are not present. In the absence of hard evidence, it can be very difficult to prove that a given behavior can be explained only by a concerted practice. For example, after the Second World War, the two major producers ICI and Solvay of a variety of soda for the glass had shared the international market according to an explicit agreement (known as Page 1000 assigning continental Europe to Solvay and UK to ICI). At the request of the European Commission in 1972, this agreement was broken. Nevertheless, the market allocation between these two producers remained unchanged. Despite the fact that ICI provided in part from Solvay, the Belgian company has always refused to become an operator on the UK market, despite the price increases that could incite it. The Commission saw in the maintaining of the market's distribution an evidence of the persistence of an implicit functioning of the Agreement Page 1000, even though every company justified its behavior by the fear of competitor's retaliation if it were to enter the market. It is necessary to keep in mind that if Article 101 of the Treaty prohibits any form of collusion that hinders competition, it does not remove to economic agents the right to adapt themselves intelligently to the existing and anticipated conduct of their rivals (see Encaoua and Guesnerie, 2006, p. 70).

Finally, I must confess that all these comments are far from exhausting the richness of the Kaplow's book that I highly recommend to economists and lawyers, as well as those working in competition policy issues than those in charge of its implementation.

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