

BOS 2- Atypical Cartels

“Hub and Spoke” Cases and Special Considerations for Atypical Cartels

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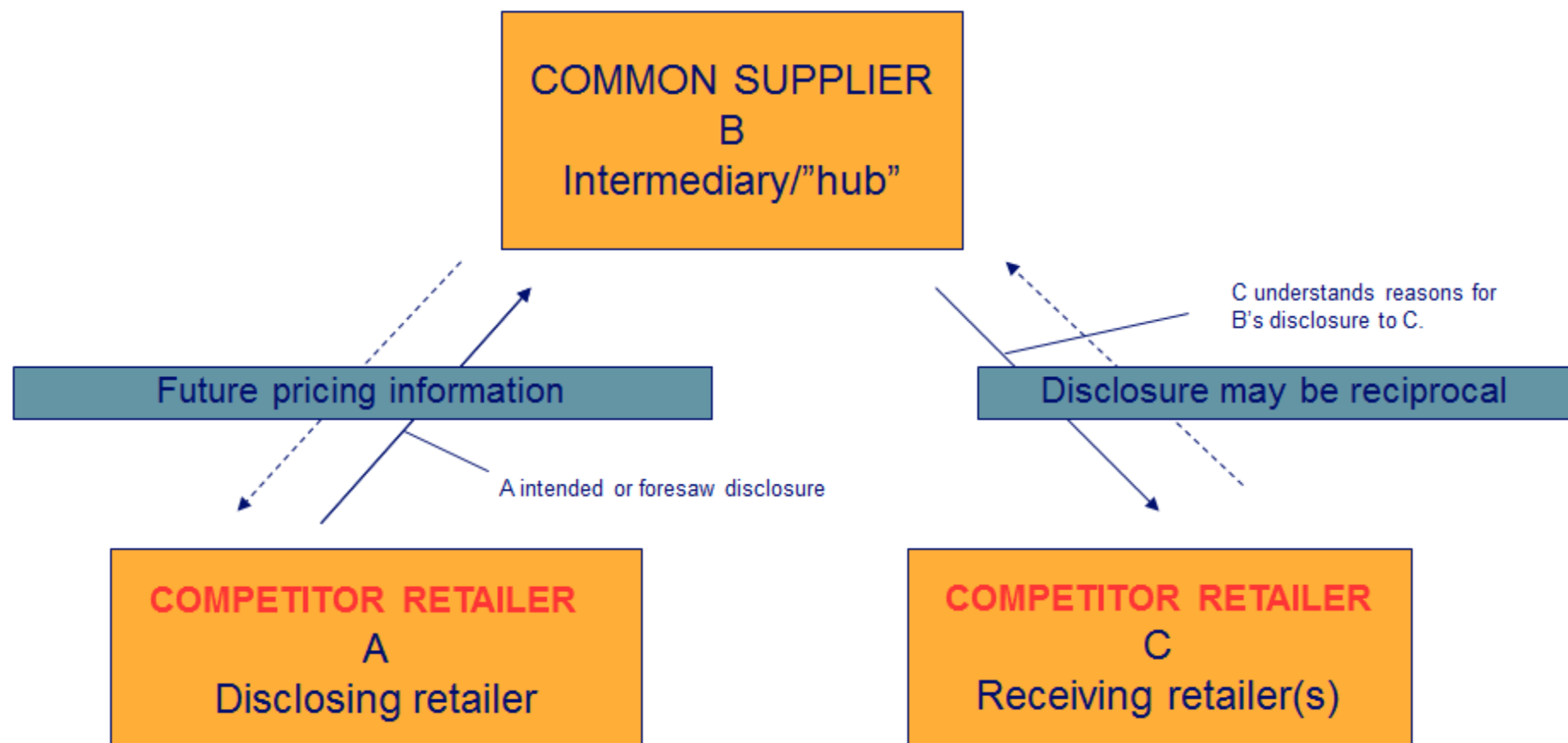
What is a “Hub and Spoke” Cartel?

- In essence: horizontal price fixing, via a vertical link
- With thanks to the UK Office of Fair Trading:

1. The transmission of future pricing information from one retailer (A) to another retailer (C) via an intermediary (B) – the horizontal element is key to this type of infringement
2. An intention on the part of the disclosing retailer (A) that the information will be passed on to a competitor (i.e. C) – it is this intent that distinguishes potentially legitimate from illegitimate disclosures
3. An understanding on the part of the receiving retailer (C) of the circumstances in which the information was disclosed

NB: Unilateral disclosure sufficient – no need for reciprocity. Infringements stronger where that occurs

The test for establishing Hub and Spoke (2)



Future pricing information is passed from A-B-C. Evidence of the exchange may be more cogent where there is a reciprocal disclosure of future pricing information from C-B-A.

“Hub and Spoke”: The Frontier

- Why do we discuss it here?
 - It is said to be one of the “frontiers” of cartel enforcement
 - But is really an issue of cartels and *per se* / “by object” offences?
- US and UK authorities have pursued high profile cases
 - E-Books case (Apple and publishers; DOJ civil suit)
 - Dairy products (UK OFT)
- The cases are unusual, and different from “cartels”
 - In each case, arguably unique context
 - In each case, arguably pro-competitive or other factors

UK Dairy Products case

- Alleged collusion among supermarkets, using dairy suppliers as conduit for price information in respect of price increases
- OFT and CAT acknowledged possible legitimate vertical price communications to supplier:
 - Discussion of retail pricing during promotion funded by supplier
 - Price decrease may require increased supplies/stock
 - Retail price point for new product
 - Recommended resale prices printed on product or advertising
- But the test of hub and spoke:
 - Did Supermarket A intend or foresee that prices provided to Supplier B would be communicated to Supermarket C? C understands reasons for B's disclosure (CAT 2012)

But the Dairy Products situation was unusual

- Foot & Mouth disease was decimating cattle population and farmers were squeezed for revenues
- Significant political concern that farmers needed higher revenues, and this required higher milk prices
- Dairy products are key for supermarkets, fear of undercutting would lead all business to other supermarkets
- Discussions among suppliers and retailers to “*resolve the farmers’ current problems*” (para. 228 CAT), and a broader political crisis, really suitable for being dealt with as a per se/by object cartel case?

E-Books: The Market Apple Faced

- The case is about implementation of a new business model that led to increased prices at retail level
- Facts
 - Amazon had a 90% market share in e-books.
 - Amazon engaged in loss-leader pricing, charging \$9.99 for a best seller—often several dollars below the wholesale price.
 - Books created “pull” for Amazon’s vastly larger e-commerce business.
 - Publishers openly criticized Amazon’s e-book-pricing strategy for “cannibalizing new best-selling hardcovers, which are the mainstay of the publishing business.”
 - Some began delaying release of e-books (“windowing”).

Apple Already Had an Alternative Model



App Store

- Apple is operating iTunes and the App Store on “agency” models that put the content owner in control of pricing.
- Apple can be relatively agnostic to pricing under this model, since its 30% cut of the publisher’s price will almost certainly be profitable.

What are the questions of law?

- The basic question of law
 - Does antitrust law prevent Apple from proposing its agency model to publishers knowing that since they openly dislike Amazon's pricing they would likely use the availability of the new model to reign-in Amazon, quite possibly leading to higher e-book prices?
- But for us here today, talking about atypical cartels, the question is different, and more limited:
 - **Absent evidence of the publishers colluding horizontally and Apple assisting them, should such a case be investigated as a cartel – i.e., as a “per se” or “by object” case?**

No evidence of joining horizontal agreement

- In its case, DOJ conflated Apple's knowledge and acceptance of an outcome (agency model and higher prices) with knowledge of a horizontal agreement among publishers
 - They are not the same thing: Publishers could all have the same complaint about Amazon and the same idea of how to address it without conspiring.
 - And critically, someone in Apple's position would always make a guess about what the publishers wanted and advocate a win-win
- There was no evidence that Apple had knowledge of a *conspiracy* as such
- If so, should the case not have been looked at as a rule of reason case and pro-competitive explanations explored?

What are the other experiences

- Some UK cases more clear cut, others collapsed
 - Replica Kits; Games and Toys; Tobacco
- German and Belgian authorities have shown interest
 - 13 April 2010 German Federal Cartel Office Guidance Letter
- No mixed vertical/horizontal cases at EU level
 - *Bananas* often cited, but all were *horizontal* competitors
 - No intent test in law, but the “foreseeable” test could be applied?
 - Many legitimate reasons for disclosing prices to suppliers (brand management), and between suppliers/retailers (price bluffing)
 - In EU law, are these cases not best approached as Art 101(3) cases balancing benefits to consumers v. restriction of competition?

How do (or should) other systems look at this?

- How far can “hub and spoke” be pushed?
 - Driven from spokes (yes? *Dairy*) or from hub (no? *Apple*)
 - Are there pro-competitive explanations (a new entry story? *Apple*)
 - Are there other elements? (*Dairy*)
- Why are the main cases so “atypical”?
 - In essence, where there is real horizontal collusion, no need to rely on hub and spoke notion and the vertical link
 - Economists conclude that *per se* approach is not justified
 - Hub is not required to collude, nor stabilises cartel (Van Cayseele)
 - Interests of supplier and retailer are rarely aligned, except in the unusual cases (which do not justify *per se* approach)
 - This suggests that mixed horizontal/vertical cases are rarely suitable for *per se* cartel enforcement, but require economic assessment?

What are the Lessons for Atypical Cartels?

What are the lessons?

- Atypical cartel matters warrant special analysis
 - The conduct/evidence less clear than “smoke-filled room” cases
 - The entire picture may not be clear to each alleged participant in the conduct (e.g., information sharing and “hub and spoke”)
 - Customers may know about the conduct
- Both companies and enforcers must look at such cases with special attention

The special considerations for companies

- These cases come to the lawyer as a “problem”
 - It is up to the lawyer to define the problem
 - But above all find a solution
- The solution can be to decide: No real risk of scrutiny or challenge
 - No violation of law as pro-competitive?
 - Not “per se” -- Efficiency defenses (information exchanges)
 - Mixed vertical and horizontal aspects contribute to efficiencies
 - Other defenses? (new entry?)
- The more marginal, the more statute of limitations is a factor in self-reporting
- Above all, such cases have less clear fact patterns than the classic “smoke filled room” cartel cases
- Not all potential violations of law must be reported

Leniency may be, or may not be the solution

- Immunity and leniency comes at a cost
 - A long and expensive process becomes very likely
 - Scope of reported case may be different from ex officio case?
 - Likelihood of customers asserting damages claims increases
 - Consequences for employees (criminal investigation even if nothing?)
 - Admitting to conduct being illegal creates a serious image problem for management and board of directors
 - Shareholder value affected
- In essence, leniency is only attractive where net benefits
 - Upsides must be clear and permanent
 - Avoiding fines is not enough if damages claims are a certainty
- Leniency is only attractive if ensures a predictable outcome

In a marginal case, is leniency the solution?

- The key questions for the potential applicant:
 - Do you have access to all the facts required to define an offence
 - Can you see all the facts (hub and spoke), or are they hidden to some?
 - Is the legal qualification clear?
 - Is the violation clear?
 - Is it a *per se/by object* offense
 - Does leniency limit your ability to argue efficiencies and other defences
 - Must you admit to an offence that you cannot (yet) be sure is an offence?
 - Or just the facts (perhaps the elements of the offence, which if not complemented by other elements are insufficient?)
 - Leniency systems are not the same around the world
 - Are you better off fighting?
 - The answer may depend on the jurisdiction?

Special considerations for enforcers: How to approach “atypical cases”

- First, enforcers should always incentivize leniency
 - Encourage applications, but of *bona fide* cartel agreements
 - Accept that in marginal cases, some will opt for 2nd in, not immunity
 - Allow incomplete stories to be told, and don't require applicants to “fill in” the story where the facts are unknown
 - If no case, keep it confidential, forever; But reserve the “slot”
- Second, enforcers should not incentivize embellishments
 - Dangerous where there is an incentive to cement a leniency story
- Last, when in doubt, enforcers should not pursue as a cartel
 - If a plausible defense, enforcers should acknowledge it and not take the short cut of calling something a *per se* offense or “cartel”