The Public Interest-Defense in Cartel Offenses

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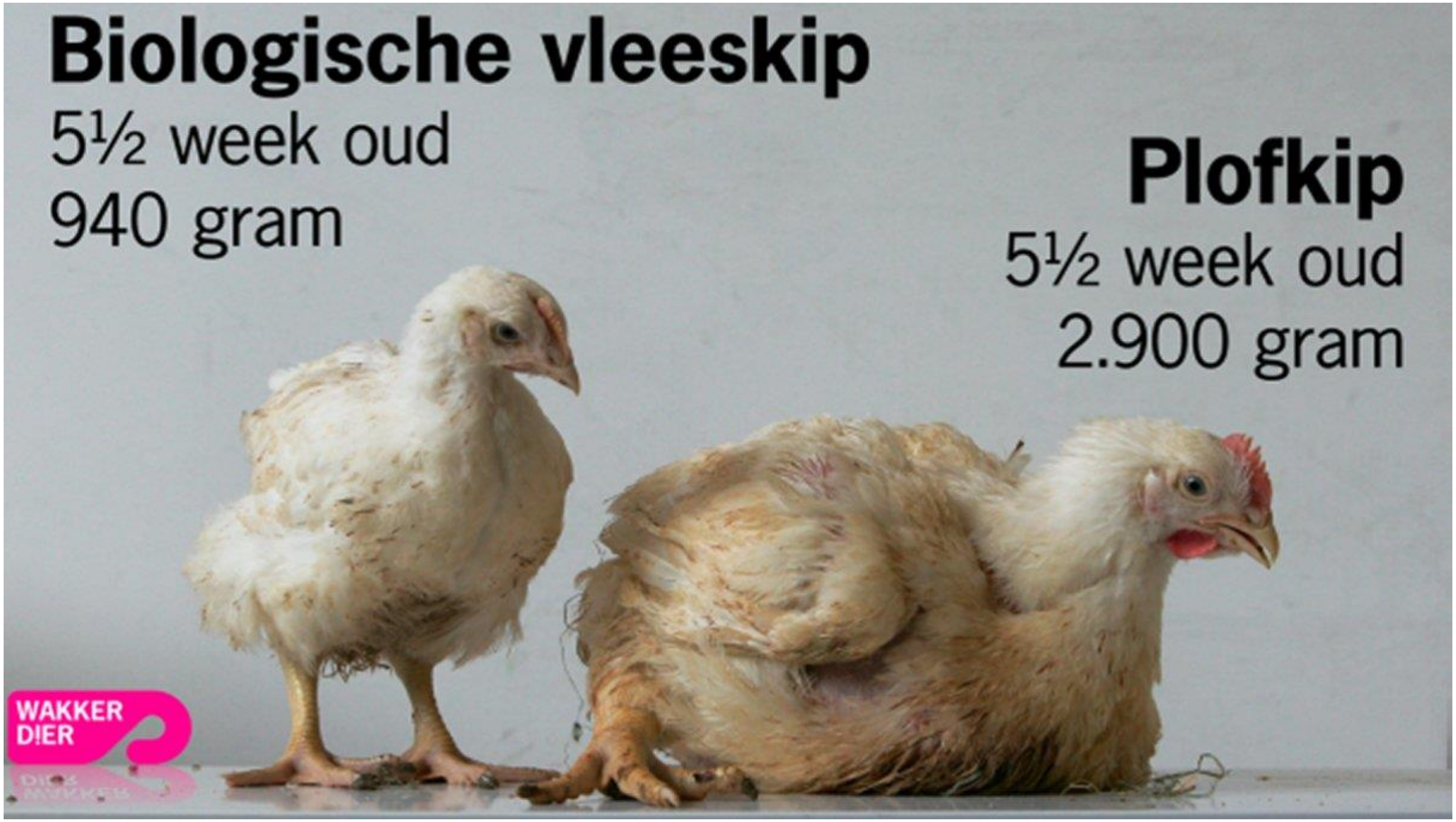
The National Energy Agreement

See: Kloosterhuis and Mulder, *JCLE* (2015)

The Chicken of Tomorrow



See: ACM (2015)

Case IV.F.1/36.718, *CECED* (1999)

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Article 101
(ex Article 81 TEC)

1. The following shall be prohibited as incompatible with the internal market: 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 within the internal market, and in particular those which:

(a) directly or indirectly fix purchase or selling prices or any other trading conditions;

(b) limit or control production, markets, technical development, or investment;

(c) share markets or sources of supply;

(d) apply dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;

(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.

2. Any agreements or decisions prohibited pursuant to this Article shall be automatically void.

3. The provisions of paragraph 1 may, however, be declared inapplicable in the case of:

— any agreement or category of agreements between undertakings,

— any decision or category of decisions by associations of undertakings,

— any concerted practice or category of concerted practices,

which contributes to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit, and which does not:

(a) impose on the undertakings concerned restrictions which are not indispensable to the attainment of these objectives;

(b) afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products in question.

Source: TFEU, *Official Journal*, 9 May 2008

Dutch Policy

- Minister of Economic Affairs, Policy Rules WJZ/14052830, 6 May 2014, Article 2:

“In the application of Article 6(3) of the competition law [the Dutch equivalent of 101(3) TFEU] the Authority for Consumers and Markets considers in its assessment of the conditions whether […] in agreements that restrict competition made to enhance sustainability, a fair share of the improvements benefits "users" in the long run.”

- ACM vision paper, May 2014

Four requirements for a "Public Interest-Defense"

1. Benefits have to be objective and clearly visible
2. A fair share of the benefits has to go to consumers – at least compensating them
3. The restrictions must be necessary to obtain the benefits – "cartel-specific"
4. Sufficient residual competition must remain

Some Considerations

- Cartel coordination may reduce externalities and improve upon under-provision of public good
- Companies arguably have superior knowledge (self- or co-regulation)

- Consumer awareness and corporate social responsibility have bounds
- Horizontal agreements carry direct and indirect risks of collusion
- “Sustainability” sufficiently vague to allow many interpretations
- Hard for a competition authority to assess – in particular also ex post
- Dubious sustainability claims for free pass to collude – undermines deterrence

- Why would a cartel promote sustainability? – Schinkel & Spiegel (2015)
- Is compensation of consumers ever possible? – Schinkel & Toth (2016)

Balancing the Public Interest-Defense in Cartel Offenses

- Suppose public interest benefits are there (beyond volume effects), cartel-specific
- Public interest interpreted as a public good – non-excludable, non-rivalrous
- Fair share is exact compensation, instantaneous
- Unit pricing

- Higher price for the private good *versus* willingness to pay for public good
- Can price rise finance sufficient public good in compensation?
- Samuelson (1954), Lindahl (1958), Diamond & Mirrlees (1971): taxation
- Bergstrom et al. (1986), Bernheim (1986): crowding-out
- Kotchen (2006), Besley & Ghatak (2007): corporate social responsibility

Public Goods Model with Voluntary Private Contributions

$$max_{g_i,x_iy_i} U_i = a_i \frac{G^{1-\theta}}{1-\theta} + b_i \frac{x_i^{1-\theta}}{1-\theta} + c_i \frac{y_i^{1-\theta}}{1-\theta},$$

$$s.t.\, g_i + p_x x_i + p_y y_i \leq w_i,$$

$$g_i \geq 0,$$

$$G = \sum_{i=1}^{n} g_i + g_N + g_F,$$

- Competitive equilibrium (partial): Under-provision of the public good

- Contributors and non-contributors

- An individual is more likely to contribute if:
  - His wealth is sufficiently high
  - Other contributions are sufficiently low
  - If he attributes a relatively high value to the public good
  - If prices of the private goods are high

- Public good provision (and utility) is independent of the wealth-distribution, as long as contributors set is constant (Bergstrom et al., 1986)

- Neutrality of distortionary taxes game-specific (Bernheim, 1986; Andreoni & Bergstrom, 1996)

Comparative Statics at Play

$$(p_x, g_F = 0) \text{ versus } (p_x^c > p_x, g_F > 0)$$

$$\triangle U_i = V_i^*(p_x^c, p_y, W, g_N + g_F) - V_i^*(p_x, p_y, W, g_N)$$

$$p_g \hat{g}_F \leq \Pi(p_x^c, p_y, W, g_N + \hat{g}_F) - \Pi(p_x, p_y, W, g_N),$$

- Substitution-, income- and crowding out-effects (in contributors economy)
- Hardest to compensate consumers need not be the most harmed
- Public good compensation is not capped – whereas monetary compensation is
- Some consumers may actually gain from price increase
- Cartel contributions crowd out private contributions

Who is to be compensated?

European Commission (2004), Guidelines on the Application of Article 81(3), recital 87:

“The decisive factor is the *overall impact on consumers of the products within the relevant market* and not the impact on individual members of this group of consumers”

Shaw (2002): “the average” consumer

Two contributors, Non-sustainable Compensation

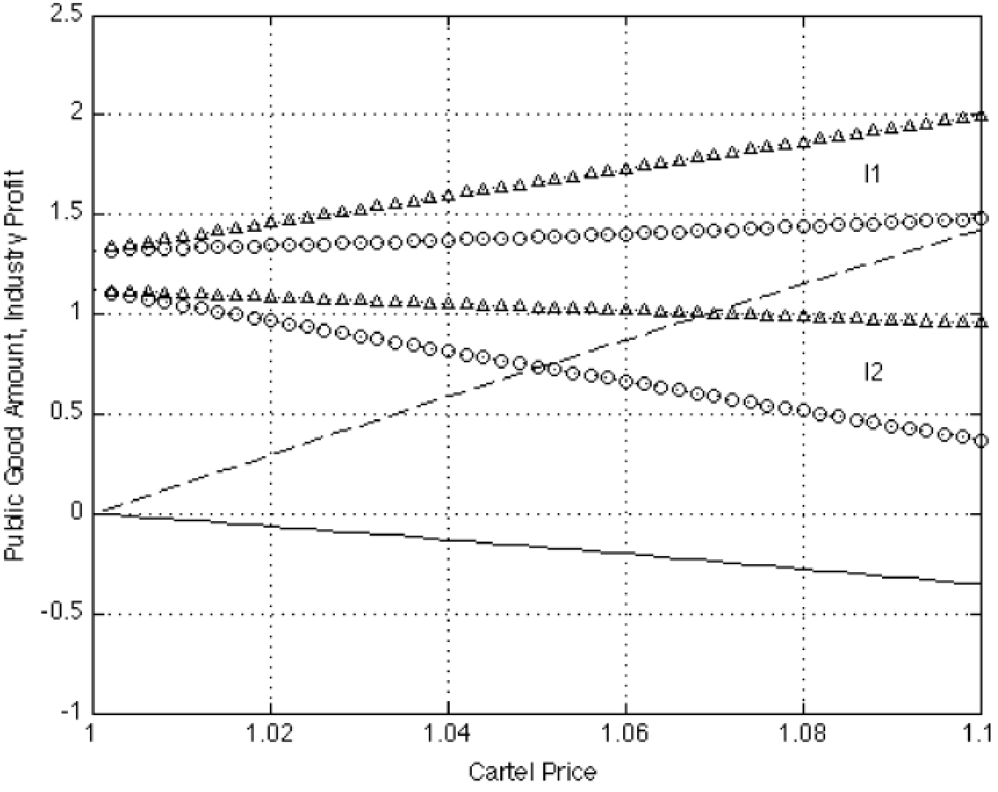

Figure 1: No sustainable public interest-defense.

No-contributors Economy

Suppose condition (10) is not satisfied for any individual i, so that $g_i = 0$ for all i and only $G = g_N + g_F$ enters into every individual's utility. The compensating amount of public good then is

$$\hat{g}_F = \left(g_N^{1-\theta} + \frac{1}{\sum_{i=1}^{n} \alpha_i a_i} \left[Z(c) - Z(p_x^c) \right] \right)^{\frac{1}{1-\theta}} - g_N,$$

in which

$$Z(p) = \sum_{i=1}^{n} \alpha_i \left(b_i \left(\frac{w_i}{(p + (\frac{c_i p}{b_i})^{\rho})} \right)^{1-\theta} + c_i \left(\frac{w_i}{(1 + (\frac{b_i}{c_i p})^{\rho} p)} \right)^{1-\theta} \right),$$

for $p = c$ and $p = p_x^c$, respectively.

With both $D_x(p_x^c, \hat{g}_F)$ and $p_g \hat{g}_F$ fully characterized, using the fact that locally $p_g \hat{g}_F|_{p_x^c = p_x} = 0$, we find that $\left. \frac{\partial \Pi}{\partial p_x^c} \right|_{p_x^c = c} \geq 0$ for infinitesimal cartel price rises if and only if

$$\sum_{i=1}^{n} \alpha_i a_i \sum_{i=1}^{n} \frac{w_i}{c + (\frac{c_i c}{b_i})^{\rho}} \geq \frac{p_g}{c} g_N^{\theta} \sum_{i=1}^{n} \alpha_i b_i \left(\frac{w_i}{c + (\frac{c_i c}{b_i})^{\rho}} \right)^{1-\theta}. \tag{12}$$

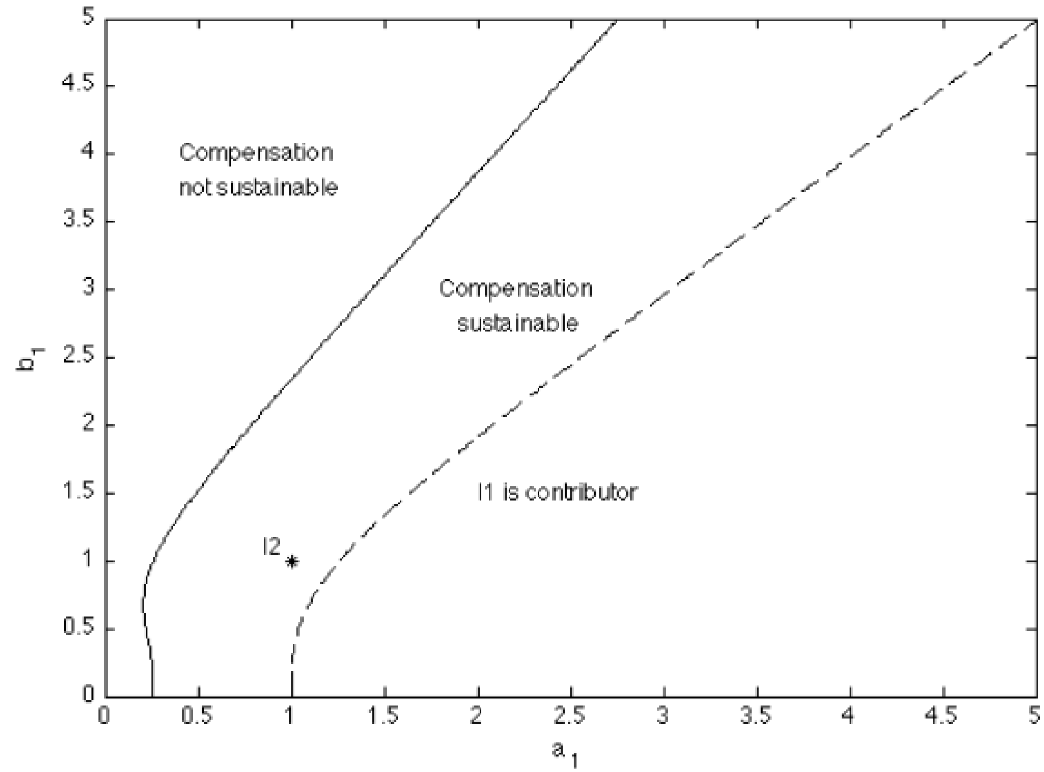

Figure 2: Sustainable public interest-defense space in a no-contributors economy.

Contributor Economies

The compensation cartel is sustainable in an all-contributor economy for an infinitesimal cartel price rise if and only if

$$\sum_{i,j}^{i\neq j}\left(\alpha_j a_j\left(\frac{b_i}{a_i}\right)^{\rho}+\alpha_i a_i\left(\frac{b_j}{a_j}\right)^{\rho}\right)\geq p_g^{\rho-1}\sum_{i,j}^{i\neq j}\frac{\alpha_j a_j-\alpha_i a_i}{a_i^{\rho}a_j^{\rho}}\left((b_j c_i)^{\rho}-(b_i c_j)^{\rho}\right), \tag{14}$$

in which $\sum_{i,j}^{i\neq j}$ is the sum over all unique pair of two different individuals (i,j) in the total of n consumers.

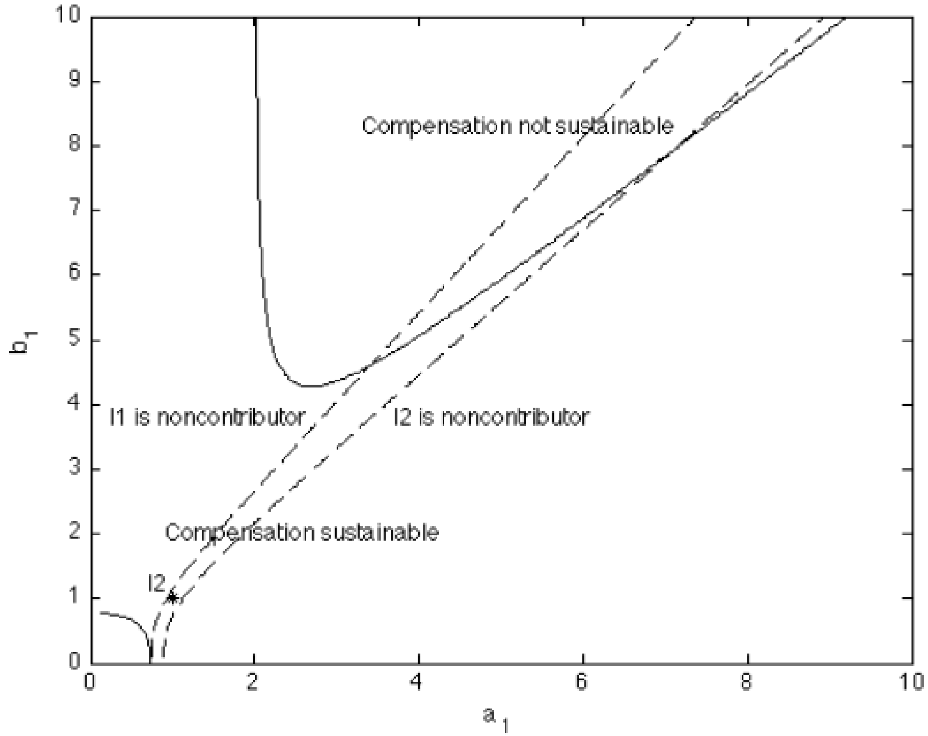

Figure 3: Sustainable public interest-defense space in an all-contributors economy.

Cartel-provision often Unsustainable

•Crowding out of private contributions by cartel contributions

•Those to be compensated most have self-selected through private good consumption as low willingness to pay types …

•plus they have a large exposure to harm through quantity consumed …

•despite substitution away from the cartel commodity

•Policy asks those to pay for the public good (via private good), who value it least (orthogonal to Lindahl-pricing)

Concluding Remarks

- Production cartel may increase *tied* SCP to the benefit of consumers in special cases
- Collusion may theoretically improve upon *general* under-provision of public goods
- Typically, compensation must be required – discouraging tied sustainability
- Compensating cartel-provision often unsustainable

- Huge information requirement for competition agency: all people's preferences (idem Pareto)
- No unambiguous welfare measure available
- Taxation and/or regulation seem superior to "self-regulation"

- Pushing boundaries of "users" – ongoing revision of the Dutch policy rule