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OPINION
LEADERS

Competition law

The American way of trustbusting

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Rooting out price-fixing benefits sound businesses as well as consumers

IN 1970s America five executives convicted of fixing the price of sticky labels ended up having to give lectures about their misdeeds in after-dinner speeches—cruel and unusual punishment for the audience, if not the culprits. Today there is a growing awareness that cartels not only raise prices, but also blunt other benefits of robust competition, from innovation to higher productivity. Accordingly, America's trustbusters prefer to punish market riggers with fines and prison than with black ties and brandy. Their tactics—which combine criminal punishment with the promise of immunity for whistle-blowers—are increasingly being followed across the world. And just as well, because cartels look as if they are more sophisticated and commoner than anyone thought.

That, at least, may be what emerges from raids Britain's antitrust enforcer, the Office of Fair Trading (OFT), conducted towards the end of last month on the country's four large supermarkets. The investigation has only just begun, but one possibility is that supermarket buyers used some of the world's largest consumer-goods companies as a switchboard to swap information that would help them co-ordinate the prices of thousands of products, from soap to cola. Multinational companies including Britvic, Coca-Cola, Mars, Nestlé, Procter & Gamble, Reckitt Benckiser and Unilever have been asked to hand over data to the OFT (see article).

The supermarkets deny any wrongdoing. They complain that trustbusters have become too big for their boots and that they are on a “fishing expedition” designed to assuage populist dislike for big business—especially for powerful retailers. In fact, the grocers do have some grounds for feeling put upon. This week, Britain's Competition Commission, the OFT's sister organisation, published the findings of a probe lasting almost two years into the supermarkets, the third in-depth inquiry in less than a decade. The industry was again judged to be broadly competitive: market shares among the four biggest grocers have shifted, suggesting keen rivalry for customers rather than collusion.

The OFT's raids point to two different lessons. Far from staging a broad anti-business trawl, the OFT seemed to know exactly what it was searching for. It looks as if the regulator had been told what to ask for by a whistle-blower, which suggests the American approach could turn up wrongdoing that investigators would never have spotted before. Indeed so many cartels have been confessed to in Europe that trustbusters, grappling with a huge backlog of cases, are having to ignore some to concentrate on the biggest ones.

A stitch-up in time

Equally alarming is the suggestion that cartels are not just more prevalent, but also more sophisticated than anyone thought. Classic cartels are in dull, mature segments like glass and cardboard, where market shares are stable, brands cannot differentiate products and the cartel's members can easily check for anyone breaking ranks. The startling thing about the OFT's investigation is that it is in branded goods, where co-ordinating a cartel should be hard.

Governments waste a lot of breath on their plans to make the economy more competitive. Helping competition by busting cartels gets you a long way. What will count now is the spine to see through controversial investigations, however much fuss the grocers and the rest of them kick up.

BUSINESS

Investigating price-fixing

Supermarket sweep

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A complicated investigation of Britain's supermarkets looks like the latest example of the use in Europe of American trustbusting techniques. However, in other areas of competition policy deep differences remain (see article)

A FIERCER business battle would be hard to find than that for the £110 billion ($220 billion) that Britons spend on groceries each year. Over the past decade shoppers have switched from one supermarket to another in their millions, crowning new kings of the trade and deposing its once undisputed lords, whose market shares have been as squishy as overripe tomatoes. The greatest winners have been shoppers themselves: they have more choice than ever, and real food prices in Britain fell by about 7% between 2000 and 2007 (though they are rising now, as global food inflation bites).

Yet amid this energetic jousting for market share, a dark secret may also lie at the heart of British retailing. On April 24th and 25th the Office of Fair Trading (OFT), a British competition watchdog, pounced on the four biggest supermarkets—Tesco, Asda, Sainsbury's and Morrisons—in what may turn out to be one of the world's biggest and most widespread investigations into the possibility of price-fixing. The investigation involves thousands of products, from soap to cola, and some of the world's largest consumer-goods companies. Suppliers that say they have been asked to hand over information to the OFT include Britvic, Coca-Cola, Mars, Nestlé, Procter & Gamble, Reckitt Benckiser and Unilever.

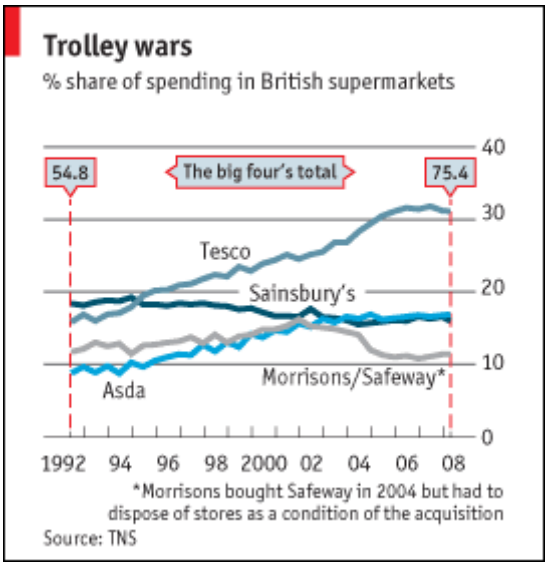
The probe will be a stern test not just of whether Britain's biggest consumer markets are clean, but also of a new approach to tackling price-fixing using American-style trustbusting powers. For even though Europe and America differ profoundly on how to deal with dominant firms and mergers (see article), Europe is enthusiastically adopting the American policy of giving immunity to whistleblowers, a technique that has led to the discovery of cartels in the oddest places.

Fighting in the aisles

The British grocery market is one of the places you would least expect to find price-fixing. Large supermarkets have little reason to collude in the market as a whole. If they did, their reputations would be ruined. And in an industry characterised by economies of scale, keener prices generate not only bigger sales but also lower costs. Internet shopping has increased the pressure: customers can compare prices easily from their own homes.

Sainsbury's, Britain's oldest supermarket, has tumbled in recent years from its long-held spot as the country's favourite grocer to a mere third place. Tesco, meanwhile, has climbed from number two in 1992, with barely one-sixth of the market, to become the clear leader, with almost one-third, according to TNS, a research company (see chart). There are many reasons for Tesco's advance, but price probably ranks high: Christopher Hogbin of Bernstein Research, a firm of investment analysts, reckons its prices are on average about 4-5% lower than those of either Sainsbury's or Morrisons.

Moreover, supermarkets were largely given a clean bill of health on April 30th by the Competition Commission, another British antitrust authority, after an investigation lasting almost two years. Although it was concerned that supermarkets are buying from ever fewer big suppliers these days, which makes it easier for price-fixing to take root, the commission found no evidence that this was actually happening. Its main concerns were to tweak planning laws to get more competition between supermarkets and to make sure big chains do not bully their suppliers.



Every economics student learns that cartels are most likely to crop up when firms have least protection from cut-throat price competition. The typical cartel product—vitamins, paper, petrol, glass, bulk chemicals—is a commodity offering scant opportunity for the branding that might create some pricing power. The industry is usually mature, with stable market shares and little innovation. This dullness has a virtue for a would-be cartel: it makes it easy to check if rival firms are sticking to the market-rigging plan.

With so much theory stacked against the likelihood of price-fixing in groceries, the OFT's unprecedented probe has also drawn unprecedented fire. To many of the supermarkets, which insist they have done nothing wrong, the regulator is on a “fishing expedition”. Yet the OFT is fishing in very specific waters. Its requests have generally been narrow and precise.

It has asked, for instance, for communications between supermarket buyers and named suppliers about specific products at particular times, according to people familiar with the requests. In most cases, the regulator has asked for correspondence relating to defined blocks of time of about 12 weeks, ranging from 2005 to 2008.

Why buyers? They may have an incentive to cheat, even if the industry as a whole is fiercely competitive. Often they are free to set selling prices and are paid bonuses linked to targets on sales and profits relating to the products they manage.

A little-noticed footnote to the Competition Commission's interim reports last year provides another clue. Its review of e-mails found that a supplier had “volunteered” information to a retailer on another retailer's expected future prices. Exchanging information on future pricing of this sort, says Catriona Munro of Maclay Murray & Spens, a law firm, may well be

an infringement of competition law. The e-mails also point to the possibility of a problem deep in the bellies of large organisations, rather than at the top.

It would be wrong to presume guilt on anyone's part at the beginning of an investigation. The regulator, which is not commenting on the case, has yet to accuse anyone of wrongdoing and, even if it finds evidence of skulduggery, is unlikely to do so for at least a year. Yet the level of detail in its requests suggest that the OFT has a clear idea of what it is looking for and hints at the possibility that this probe was sparked by a tip-off by one of the parties involved, the likeliest suspect being one of the big supermarkets.

If that is so, it would not be the first time in Britain that the combination of a threat of stiff penalties (firms may be fined a maximum of 10% of sales) and amnesty for those who confess has set the watchdogs running. Last year the OFT fined British Airways £121.5m for setting fuel surcharges in cahoots with Virgin Atlantic, which squealed first. Several supermarkets and dairies owned up to fixing milk prices and agreed to pay fines of £116m, also last year. Then on April 25th the OFT accused 11 retailers and two tobacco companies of fixing the price of cigarettes between 2000 and 2003.

The common thread that runs through these investigations is the role of whistleblowers: in milk, Arla, a dairy, came forward; in cigarettes, one of the supermarkets, Sainsbury's, confessed.

This reliance on whistleblowers has been imported from America. Trustbusters there have made deals with cartel members for decades, but two changes in the early 1990s made the practice far more effective. The hitherto informal process was given legal backing: the first conspirator to rat on his partners automatically gets full immunity from criminal prosecution. And convicted executives became more likely to go to prison.

Punishment and predictability

Terry Calvani, formerly a member of the Federal Trade Commission, an American regulator, believes the crucial elements of an effective leniency programme are strong sanctions, transparency and predictability. Mr Calvani, now at Freshfields Bruckhaus Deringer, a law firm, says that significant penalties—ideally prison—raise the cost of not ratting; transparency is necessary so that firms know precisely how the system works; and “amnesty policy outcomes” have to be predictable or cartel members will not risk confessing.

After a false start, the European Commission revamped its cartel policy in 2002, making the conditions for amnesty much clearer. At the same time the fines levied on convicted cartels started to increase, inducing more firms to come clean. John Pheasant of Hogan & Hartson, a law firm, reckons cartels are now fined more heavily in Europe than in America. Last year, for instance, four firms were fined a total of €992m ($1.5 billion) for rigging the markets for elevators in Belgium, Germany, Luxembourg and the Netherlands. Leniency seems to be such a success that the European Commission is sitting on what Mr Pheasant calls a “time bomb” of cartel investigations, with more than 200 applications for leniency on file.

Better still for trustbusters, one successful case often begets another confession. When InBev, a brewer, was convicted for its role in a Belgian beer cartel, the firm quickly owned up to price-fixing in several other European countries. As a result, the commission subsequently nabbed three Dutch brewers, fining them €274m for fixing beer prices last year. It is not yet clear whether the OFT's latest investigation had its roots in an earlier run-in between supermarkets and regulators. If it did, it would fit with the pattern seen elsewhere.

Still, it may represent the shape of things to come. What is known of the OFT's new investigation suggests something far more complicated than the standard textbook cartel: it concerns a wide range of branded goods rather than a direct agreement about a single, often dull, product. Like other recent British cases, it seems to involve many parties sharing information in complex and indirect ways. If such an intricate cartel existed, how it could be centrally guided and monitored by its members is hard to fathom. This may also suggest

that any arrangements may have been merely transitory. But only after Britain's trustbusters have sifted the minute evidence will shoppers know whether they have been the victims of a new form of price-fixing.

BUSINESS

Mergers and dominant firms

Oceans apart

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Europe still seems to have less faith than America in the ability of the free market to tame monopolies

AMERICA fosters competition; Europe protects competitors. That jeer is tossed across the Atlantic pretty frequently. Watchdogs on both sides of the ocean play down the idea that the Europeans bite more often than the Americans. But although the gap is far narrower than it was a few years ago, it still exists. The commission (the European Union's antitrust authority) is much likelier than the American Department of Justice (DoJ) to fear that a merger of two big firms or the behaviour of a dominant one will force rivals out of business, raising prices and restricting choice. The Americans are more confident that if powerful firms abuse their strength, they may attract competition rather than crush it.

Illustration by Phil Disley

In March the commission began investigating the proposed purchase by Nokia, a mobile-phone company, of Navteq, a provider of digital maps. A similar deal between Tom Tom, a maker of portable navigation devices, and Tele Atlas, another digital-map firm, is also under scrutiny. Both transactions had been cleared swiftly in the United States. The commission is also examining the behaviour of other high-tech firms—notably Intel, the world's leading chipmaker—even though the companies in question have not perturbed the American authorities.

In one respect—the treatment of “horizontal” mergers, between competitors—Europe's policy has come to look more like America's. This change has come about largely because of setbacks in court. In 2002 an appeal court savaged the blocking by the commission of the merger of Airtours and First Choice, two British travel operators. The commission responded by drawing up guidelines for appraising horizontal mergers. These should now be permitted unless they would leave one company with uncontestable market power or allow the remaining companies to compete less vigorously.

The shift of policy was demonstrated last year when the commission blessed mergers that cut the number of large tour operators in Europe from four to two. The deal between Airtours and First Choice, blocked eight years earlier, would have left the market with three big suppliers.

However, a kindlier European view of “vertical” mergers (between customers and their suppliers) is harder to detect. American authorities have tended to judge that they add to efficiency and help cap prices. As long as there is competition for final sales, consumers will benefit both from cheaper production and from paying one fewer mark-up in the supply chain. The commission has been more wary: in 2001, notoriously, it blocked the merger of General Electric and Honeywell, an avionics firm, which American regulators had waved through.

The courts upheld the decision, but were nevertheless critical of the commission's reasoning. The commission responded to criticism by getting to work on guidelines for non-horizontal mergers, which were published last November. Although one competition regulator reckons there is a now just a “sliver of paper” between the EU and American approaches, the extra scrutiny given to the Nokia/Navteq and Tom Tom/Tele Atlas mergers suggests the EU is still cautious.

Differences in the treatment of dominant firms, especially in fast-changing high-tech industries, also remain—and are if anything more plain. Article 82 of the EU treaty outlaws the abuse of a dominant position. Firms with a large share of a market are forbidden from using their muscle to set unfair prices, restrict output, force customers to buy related products or prevent other firms from challenging their dominance. Section 2 of the Sherman act puts the same restrictions on monopolies in America.

Applying these laws to technology industries is hard. The power of network effects in telecoms, computing and other digitised industries means it makes sense for firms to agree on an industry standard, so that gadgets and software are compatible. But this confers monopolies on the makers or patent-holders of standard kit, which in turn brings them into potential conflict with trustbusters.

Jorge Padilla, an economist at LECG, a consultancy, argues that in markets characterised by rapid innovation and modest barriers to entry, the costs of condemning a sound business strategy or merger are much greater than the harm caused by letting a monopoly slip through the net. In the first instance, efficiency gains are lost and incentives to innovate permanently blunted. In the second, market forces can help repair the damage.

American regulators seem to have become more convinced of this argument than their European counterparts have. The saga of Microsoft illustrates the difference. In 1998 the DoJ charged that by bundling Internet Explorer, its web browser, with Windows, its operating system, Microsoft sought to extend its desktop monopoly into browsers, freezing out Netscape, its main competitor.

The American courts ruled against Microsoft and in April 2000 ordered that the software giant should be split into two—one part owning the operating system and the other owning all other applications. The next year an appeals court said that Microsoft's actions did not warrant dismemberment. The DoJ settled for far more lenient remedies. These would stop Microsoft from bullying PC manufacturers into favouring its add-ons to Windows, but would leave the firm and its most important product intact.

The European authorities persisted with their own fight against Microsoft, which they eventually won last year. As well as paying fines totalling €1.4 billion ($2.2 billion), Microsoft has been obliged to supply a version of its operating system without its media player. It must also license parts of its code to rivals, to make it easier to dovetail their server-based software with Windows.

The commission is now monitoring some other high-tech companies too. It is investigating Intel for using discounts to maintain its dominant position. It claims that rebates paid to

hardware manufacturers who buy most or all of their chips from Intel could be designed to squeeze AMD, its main rival, from the market. Intel is also suspected of more direct predation: selling chips below cost in order to secure clients in the server market. Another tech firm, Qualcomm, which owns the patent for chips used in mobile phones, is accused of overcharging for licences. The commission is also taking another look at Microsoft's past conduct, to see if it obstructed rivals' efforts to make their desktop applications work well with Windows.

The difference in approach is partly explained by economic philosophy. In America there is a greater faith that markets will fix the problem of monopolies and a belief that market leadership in high-tech is transient. A new product may make today's dominant technology redundant tomorrow. Firms compete for the market as much as in it: temporary monopoly is the reward for innovation.

Alongside this belief is another: that if regulators interfere they need to be sure that they are helping competition. That is not easy when behaviour that could bolster monopoly is indistinguishable from vigorous competition. Bundling, one of the sins for which Microsoft was punished, is common practice: every fast-food outlet charges more for separate items than for combined meals. And when a local print shop offers discounts or rebates for bulk orders—Intel's transgression—few imagine it is plotting against consumers.

But in a market where one firm is king, such practices can take on a sinister guise. Dominant firms might use loyalty rebates to stop others from becoming large enough to pose a serious threat. Bundling can be a tactic to compel consumers to buy several things from a firm with a monopoly in one product. It is hard to establish whether such strategies are pro-competitive or nefarious. Antitrust watchdogs have to gauge the tangible short-term benefits of lower prices and convenience against theoretical long-term harm.

America's agencies have tended to judge that too little action is less of a risk than too much. Intervention to protect weaker firms may serve only to blunt competition for the sake of highly uncertain benefits. Andrew Dick, a former DoJ economist now at CRA International, a consultancy, says that for these reasons American competition authorities put their faith in entrepreneurship to tackle monopolies. “Someone will always come along and build a better mousetrap,” he says.

This laissez-faire philosophy has fostered a permissive merger policy too. Two years ago the DoJ raised eyebrows when it approved the merger of Whirlpool and Maytag, even though the new firm would dominate the market for washing machines and clothes-dryers. The department considered that rival firms, at home and abroad, had strong enough brands and sufficient capacity to keep Whirlpool-Maytag in order.

Last month the DoJ sprang another surprise. It said it would not stand in the way of a tie-up between XM and Sirius, America's two satellite-radio providers. Its trustbusters said that “audio entertainment alternatives”, such as AM and FM radio and MP3 players, would restrain the merged firm's prices. Ever since the XM-Sirius deal, lawyers have been wondering just what it would take to get a merger blocked.

Some lawyers see America's hands-off approach as a matter more of legal architecture than of economic creed. Joe Sims, of Jones Day in Washington, DC, reckons that the commission is likelier to bring cases because the European courts are a less powerful check on its discretion. Officials at the DoJ or the Federal Trade Commission (FTC) must make the initial case to a court if they want to halt a merger or challenge a monopolist. The means the courts can act quickly to thwart trustbusters if they decide a case lacks merit.

Last year, for instance, the FTC tried to prevent a merger between Whole Foods Market and Wild Oats Markets, two organic-food retailers. It saw each as the other's main rival in “premium natural and organic supermarkets”. The courts, however, ruled this was too narrow a market definition: other grocers were offering more organic produce and redesigning stores to mimic upmarket outlets.

Europe's courts, by contrast, become involved in antitrust cases only in hearing appeals. Firms may make a legal challenge only after the competition authorities have delivered their verdict. Even then, the courts will overturn decisions only because of errors of reasoning or procedure: they may not rule on the technical details of each case.

More friction, less force

Perhaps the root of the divide between EU and America policy is not in philosophy or legal systems but in history and market structure. Janet McDavid, a lawyer at Hogan & Hartson in Washington, DC, points out that America has a far longer tradition of competition policy. It has had antitrust laws for more than a century: the Sherman act was passed in 1890. And America had a huge head start over the EU as a continental single market.

Europe's market is by far the more fractured. Infrastructure is organised around national boundaries, product markets are still highly regulated and many countries have state-owned or state-backed monopolies. This may justify a more intrusive antitrust policy: much of the commission's activity is aimed at battling unfair state support for companies.

Possibly, America's free-market zeal will fade. One Washington lawyer is advising clients that there is a small window between now and November to push through contentious mergers. A Democratic administration may be more willing to intervene.

But might the EU move closer to America in its treatment of dominant firms? It might—although it is yet to produce long-promised guidelines on Article 82 investigations, because, think some lawyers, regulators want to retain maximum discretion. The inquiry into Intel, which has also been taken up in Japan and South Korea, is one test. If the EU comes down hard on the chipmaker's rebates, it will confirm to many in America that Europe's competition watchdogs really do care more about protecting competitors than about promoting competition.

The intellectual tide favours America's laissez-faire approach. Mergers are now judged by whether they may hurt or harm consumers. Prior assumptions about what might be a desirable market structure play a diminishing role—even in Europe. In assessing horizontal mergers, regulators in Europe as well as America increasingly reason that rivals will emerge or respond if big firms try to gouge consumers. As for dominant firms, yesterday's giants—AT&T, IBM, General Motors—no longer cast such long shadows. Today's behemoths still need close watching, but in fast-moving markets, they have less scope to hold consumers to ransom.