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Cover Pricing and the Overreach of 'Object' Liability Under Article 101 TFEU

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This paper uses the example of cover pricing to show a possible overreach of liability under Article 101 TFEU, in relation to arrangements deemed to have the 'object' of restricting competition. Cover pricing is where a bidder seeks a non-winning bid from a competitor so that he can participate in a tender process without securing the contract. The wide meaning of 'concerted practice' means that a potential breach of Art. 101 may arise even where the party receiving the request refuses to provide a cover bid. It is important that a restriction by object (which leads to the finding of an infringement regardless of whether the practice was implemented or had any harmful effect) applies only to the most serious arrangements between undertakings. It is shown that cover pricing very rarely has any anti-competitive effect and indeed the alternative (lawful) behaviour, of openly announcing a non-intention to win the contract, is more likely to reduce competition. It is nevertheless treated as an object restriction, mainly because it involves direct communication between competitors of pricing intentions. Art. 101 may therefore be unable to distinguish some arrangements with ambivalent effects from the most serious cartel practices. It is argued that a greater effects analysis is needed (either in applying the law or calculating penalties), to ensure fairness and proportionality.

Keywords: Competition Law, Article 101 TFEU, Cartels, Cover pricing, Object, Effect.

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1. Introduction

Article 101 TFEU (ex 81 EC) prohibits certain restrictive arrangements between independent undertakings, which have as their object or effect the restriction of competition. Undertakings are defined very widely for the purposes of competition law (essentially every entity engaged in an economic activity)[2] and the prohibition is designed to capture not only agreements but also concerted practices. These include any form of coordination between competitors that knowingly reduces the risks of competition.[3] The design and application of Article 101 is deliberately wide to capture forms of coordination between competitors that fall short of an explicit agreement. Cartel like anti-competitive outcomes (higher prices, lower production, market sharing and bid-rigging) can come about through the mere exchange of sensitive information – in particular that relating to future pricing or output intentions. The wording of Article 101(1) has been replicated and adapted by a large number of competition law regimes around the world, many influenced and guided by European case law. Within the EU every Member State has a domestic equivalent to Article 101 that must be consistent with EU law.[4]

Two separate investigations by the UK Office of Fair Trading (OFT), now the Competition and Markets Authority, found that cover pricing in tenders have the object of restricting competition, in violation of Chapter I of the Competition Act 1998 (the UK equivalent to Article 101 TFEU).[5] Cover pricing is where a firm wants to submit a bid that will <u>not</u> result in them winning the contract. To do this it contacts a rival bidder for a 'near-miss' bid; a figure a little higher than the rival's bid that will ensure it is not awarded the contract but still appears

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[2] Case 41/90, *Höfner and Elser v. Macroton GmbH* [1991] ECR I-1979

[3] Case 48/69, *ICI v. Commission,* (1972) ECR 619, paras 64-68

[4] By virtue of Article 3, Regulation 1/2003. In the UK, s. 60 Competition Act 1998 creates an obligation on the competition authority to deal with questions arising under Part I of the Act in a way that is consistent with the treatment of corresponding questions arising in Community Law.

[5] The first investigation related to flat roofing contracts: OFT Decision CA98/1/2004 'Collusive tendering in relation to contracts for flat-roofing services in the West Midlands', 16 March 2004 (Case CP/0001-02). The decision was upheld on appeal to the Competition Appeal Tribunal: [2005] CAT 4. The second investigation relates to building contracts: OFT Decision CA98/02/2009, `Bid rigging in the construction industry in England' 21 September 2009 (Case CE/4327-04). Several of the firms found to have violated competition law appealed to the Competition Appeal Tribunal, who, while cutting the fines substantially, confirmed that cover pricing is an object agreement under Chapter I, Competition Act 1998.

competitive. It therefore involves direct communication with a competitor concerning a future pricing intention. This rival will then know that the firm seeking the cover price is not seriously bidding for the contract. Cover pricing was apparently driven by the procurers' threat to remove from their tender lists any contractor who failed to bid for every tender.[6] Putting in a convincing bid risked winning a contract they could not honour and also involved 'the significant time and expense incurred in calculating genuine figures for a tender'.[7] It is these factors that drove the culture of cover pricing in the industry. Firms helped each other out because they might themselves need to seek a cover price for a future tender. In both cases the practice was treated as an 'object' arrangement, meaning it amounted to an obvious restriction of competition and was therefore deemed illegal without the need to engage in any analysis as to its effects. For the purposes of this paper we focus on cover pricing as it was described in these two decisions. In particular, we assume it occurs as isolated incidents and not as part of a more sophisticated reciprocal arrangement also involving compensation between bidders. This would amount to conventional bid-rigging.

This paper questions the treatment of cover pricing under Competition Law and uses it to illustrate the overreach of Article 101 TFEU in relation to arrangements deemed to have the *object* of restricting competition. First it focuses on the requirement that there be an 'agreement' or 'concerted practice' involving two or more undertakings. This captures all communication between competitors about future pricing intentions, even if it comes about as the result of purely unilateral action by the firm seeking the cover price. In particular, a firm risks breaching competition law by unwittingly receiving such a communication from a competitor. Unlike conventional price fixing arrangements, which will generally require explicit coordination, the firm receiving the information will immediately know that there is one less serious bidder than they previously thought. If this has any effect on the competitiveness of the bid it submits, this effect cannot be undone – even if the firm does not respond to the request

[6] The OFT's 2009 decision on construction companies also concerned a minority of firms engaged in compensation payments to rivals who did not win the contract. This is more akin to bid-rigging; a well established 'hard-core' infringement of Article 101 TFEU (ex 81 EC) and Chapter I, Competition Act 1998.

[7] *Kier Group Plc and others v Office of Fair Trading* [2011] CAT 3, para. 19

for a cover price. The wide application of 'concerted practice' is rightly designed to capture forms of collusion that fall short of an agreement, but it means that greater importance is placed on the other key element of the prohibition: whether the arrangement has the object or effect of restricting competition.

The paper goes on to question whether cover pricing was wrongly treated as having the object of restricting competition. The objective of cover pricing is not to restrict competition – something apparently accepted by both the OFT and the Competition Appeal Tribunal (CAT). In addition, we demonstrate using simple economics, that cover pricing has only a very limited anti-competitive effect so long as there is at least one bidder who is unaware of rivals seeking a cover price. Indeed, the firm receiving the cover price request actually has no interest in responding to it. Its most anti-competitive move might be to publically announce the approach, so that *every* bidder knows a competitor is not serious and thus weakening the intensity of competition for the contract. An analysis of the relevant case law shows that cover pricing falls into the restriction by 'object' category, despite its ambivalent anti-competitive effects and the comparatively strict reading of 'object' in *Groupement des cartes bancaires*.[8]

We argue that, despite a number of good justifications for not considering effects when determining 'object' restrictions, the example of cover pricing demonstrates how it is unable to distinguish between the most harmful practices it was intended to capture and more ambivalent arrangements involving direct communication between competitors. In particular, object applies wherever the competition authority is able to provide a convincing narrative of significant harm (regardless of actual effects) and this can only be effectively challenged where firms are able to raise Article 101(3) type efficiency arguments. If object is to operate in this way for reasons of legal certainty and enforcement, then proportionality demands a fuller assessment of effects be employed when calculating penalties.

[8] Case C-67/13 P, *Groupemont des cartes bancaires (CB) v European Commission.* 11 September 2014.

2. Agreement or Concerted Practice?

As explained in the introduction, Article 101 TFEU engages both agreements and concerted practices. These can amount to any coordination between competitors that knowingly reduces the risks of competition.[9] There is no bright-line between an agreement and a concerted practice; indeed the European Commission and courts do not generally specify whether an agreement exists, only that there is evidence of cooperation between undertakings.

Agreement for the purposes of Article 101 TFEU centres on whether the undertakings 'have expressed their joint intention to conduct themselves on the market in a specific way'.[10] Odudu points to parallels between this and agreement under the law of contract, suggesting that there will normally exist an offer and a subsequent acceptance of that offer.[11] In cases of bid-rigging, where competitors decide the winner of a tender and the price in advance, the existence of offer and acceptance is evidenced in written communication between firms deciding on the winner of each tender.[12] Odudu also suggests that offer and acceptance can be inferred from conduct in the market place, citing the example of 'apparently unilateral conduct'. This is where 'conduct appears unilateral but its aims cannot be achieved without the assistance of others'[13]. Citing the example of cover pricing in the OFT's *Flat Roofing Services* case, he goes on to suggest that where an offer is made, compliance with the terms of the offer is treated as acceptance.[14] So cover pricing may amount to an agreement where the firm receiving the request for a cover price obliges its competitor by fulfilling this request. However, what if the firm receiving the request for a cover price refuses to respond? Is he in violation of competition law simply by receiving the request?

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[9] *ICI v Commission* cited *supra* note 3

[10] Case T-41/96 *Bayer AG v Commission* [2000] ECR II-3383 at 67, citing Case 41/69 *ACF Chemiefarma v Commission* [1970] ECR 661 at 112.

[11] Odudu, *The Boundaries of EC Competition Law: The Scope of Article 81* (OUP, 2006) p61.

[12] E.g. *Flat Roofing Services* cited *supra* note 5

[13] Odudu, *supra* note 11, p65

[14] Odudu, *supra* note 11, p67; *Flat Roofing Services* cited *supra* note 5

In order for a concerted practice to exist, there must be some communication between undertakings that falls short of an agreement, but nevertheless reduces the risks or uncertainty of competition. This is usually evidenced by some common parallel conduct.[15] Purely independent decisions, taken intelligently by firms responding to market conditions, cannot constitute a breach of Article 101.[16] Where communication is made between competitors, for example about pricing intentions, there is a presumption under EU Competition Law that a concerted practice will follow.[17] It is clear in the case law that 'conduct cannot be regarded as furnishing proof of concertation unless concertation constitutes the only plausible explanation for such conduct'.[18] Thus communication will create a presumption of a concerted practice under 101, but that presumption can be rebutted where there is another plausible justification for the conduct. It is also worth noting that according to *T-Mobile Netherlands BV v Raad van bestuur van de Nederlandse Mededingingsautoriteit,* a concerted practice can arise from an isolated exchange of information; there is no requirement for repeated exchanges.[19]

In *Flat Roofing,*[20] cover pricing was treated as a concerted practice by the OFT and the CAT. In *Construction Bid-rigging,* as is common in Article 101 cases, an effort was not made to determine whether the practice was an agreement or a concerted practice. Keeping in mind our competitor who receives a request for a cover price but does not wish to respond, we turn first to the question of whether there is an agreement. It is difficult to discern an offer and acceptance here. All that has occurred is the transfer of information that the rival firm requesting the cover price does not want to bid and win this contract. At no point was this rival an actual competitor for the contract. What therefore is the acceptance? Once the offeree has received this information and knows that one of its competitors is not serious about bidding, any effect on his consequent conduct will occur regardless of whether he fulfils the request.

[15] For example in Cases 40-48/73 etc *Coöperatieve Vereniging 'Suiker Unie' UA v Commission* [1976] 1 CMLR 295
[16] *Suiker Unie* cited *supra* note 15, citing *ICI v Commission* cited *supra* note 3, para. 4
[17] Case C-49/92 *Commission v Anic Partecipazioni SpA* [1999] ECR I-4125, para. 121; Case C-199/92 *Hüls AG v Commission* [1999] ECR I-4287, para. 162.
[18] Joined Cases C-89/85 etc. *A. Ahlström Osakeyhtiö v Commission* [1993] ECR I-1307, at 71
[19] Case C-8/08, *T-Mobile Netherlands BV v Raad van bestuur van de Nederlandse Mededingingsautoriteit* [2009] ECR I-4529, para. 59.
[20] *Apex Asphalt and Paving Co Limted v Office of Fair Trading* [2005] CAT 4 paras 250-1

Where he responds by refusing to provide a cover price, the decision not to bid but seek a cover bid amounts to a unilateral act, not a bilateral arrangement. We know from *Bayer* that unilateral action cannot be an agreement. Conduct is unilateral when its aims can be achieved 'without the express or implied participation of another undertaking'.[21] In cover pricing, arguably both the aims and effect can be achieved without the express or implied participation another undertaking. The firm seeking the cover price will not put in a winning bid, whether they receive a response or not. A response will simply make their token bid seem more competitive. Odudu appears to suggest that the response to a request for a cover price can become the offer and the subsequent bidding, the acceptance.[22] However, this risks establishing an agreement on the basis of two disjoined elements. The firm receiving the request was going to bid anyway. The firm making the request was never serious about bidding, even before contacting its rival. Offer and acceptance can only be said to occur where the firm responds to the request.

Turning now to concerted practice, we reiterate the definition from *Suiker* that it is, 'a form of coordination between undertakings which, without having been taken to the stage where an agreement properly so-called has been concluded knowingly substitutes for the risks of competition cooperation in practice between them'.[23] In the *Dyestuffs* case this was also given expression as 'eliminat[ing] all uncertainty between them as to their future conduct and, in doing so, also eliminat[ing] a large part of the risk usually inherent in any independent change of conduct on one or several markets.[24] In the *Construction Bid-Rigging* appeals, the CAT focused on the motivation of seeking a cover price to protect a firm's reputation, arguing that the risk of placing a ridiculously high bid to avoid winning the contract (and subsequent loss of reputation) was part of the uncertainty and risk of competition. Cover pricing removed this risk and therefore adversely affected competition.[25]

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[21] *Bayer* cited *supra* note 10, para. 71; discussed in Odudu, *supra* note 11, p65; Black, 'Grades of Correlation: The Spectrum from Independent Action to Collusion, and Its Implications for Antitrust' (2003) 2 Comp Law 102-109.
[22] Odudu, *supra* note n 11, p67
[23] *Suiker Unie* cited *supra* note 15
[24] *ICI v Commission* cited *supra* note 3, para. 101
[25] *Kier Group* cited *supra* note 7, para. 96

If we assume that there is no legitimate explanation for cover pricing other than that it restricts competition, finding that a concerted practice exists where there has been any reduction in uncertainty raises a major problem: what can an undertaking do to protect themselves when a request for a cover price is received? From the moment they receive it a concerted practice exists. As Odudu states, 'even though a commitment as to how the information will be used is absent, undertakings receiving information cannot fail to consider it when determining their future conduct; conduct is inevitably influenced'.[26] It will be impossible to ignore the knowledge that the bidder contacting them is not serious about winning the contract. In this respect the damage – if we accept that cover pricing is harmful – will have occurred in a more immediate and absolute manner than more conventional price fixing. Indeed, it is fundamentally different because the firm seeking the cover price is not saying 'I want to raise prices with you', it is saying 'I do not want to take part in the process at all'. The fact this may nevertheless amount to a concerted practice, means that Article 101 TFEU could potentially capture other communications unwittingly received by competitors. For example a communication from a competitor to say it will soon be closing down. This reduces uncertainty by revealing that there will soon be one fewer competitor in the industry. The problem is that these outcomes can come about perfectly lawfully by a firm simply making an announcement to the world about its intentions. Indeed, as discussed in section 4 of this paper, this can actually result in a greater anti-competitive effect than a practice like cover pricing, because the knowledge becomes common to all other competitors, not just the firm receiving the request.

3. Object or Effect?

The concept of 'concerted practice' is deliberately wide to prevent firms from slipping outside the net of Article 101 simply by employing mechanisms that do not involve an agreement or direct communication between competitors. This sort of behaviour is closer to what we would describe as tacit collusion, but does involve some kind of coordination. We can accept this as a

[26] Odudu, *supra* note 11, p84

necessity, but far greater importance is consequently placed on the finding of whether an arrangement has the object or effect of restricting competition. In particular, there is a heavy responsibility borne by competition authorities and the courts as to the limits of 'object' arrangements. This is because an 'object' arrangement is deemed to be a serious restriction of competition, regardless of its actual effects. Some have drawn parallels between this and inchoate offences ('attempts') in criminal law.[27] In fact, it amounts to treating an attempted infringement with the same severity as a successful one, with implications for the level of penalty subsequently borne. Thus, in cases such as *Polypropylene*, significant fines were imposed for the existence of mechanisms to control and monitor quantity and raise price, even though these mechanisms were generally unsuccessful.[28]

In *Société Technique Minière* (STM), the ECJ stated that:

> [Object and Effect] are not cumulative but alternative conditions, indicated by the conjunction 'or', suggest first the need to consider the very object of the agreement, in the light of the economic context in which it is to be applied… Where, however, an analysis of the said clauses does not reveal a sufficient degree of harmfulness with regard to competition, examination should be made of the effects of the agreement[29]

The operation of Article 101 was given further expression in *European Night Services*:

> In assessing an agreement under [Article 101] account should be taken of the actual conditions in which it functions, in particular the economic context in which the undertakings operate, the products and services covered by the agreement and the actual structure of the market concerned unless it is an agreement containing obvious restrictions of competition such as price-fixing, market-sharing or the control of outlets.

[27] Opinion of A.G. Trstenjak in Case C-209/07, *Competition Authority v Beef Industry Development Society Ltd,* [2008] ECR I-9291, para. 46; Opinion of A.G. Kokott in *T-Mobile* cited *supra* note 19, para. 47; Discussed in: Bailey, 'Restrictions of Competition by Object Under Article 101 TFEU' (2012) CMLR 49: 559-600 at 563-4

[28] Case 86/398 (1986) OJ L230/1 at 89

[29] Case 56/65 [1966] 1 CMLR 357 at 375; This has been consistently confirmed by the ECJ, for example Joined Cases C-501, 513, 515 & 519/06, *GlaxoSmithKline Services Unlimited v Commission,* [2009] ECR I-9291 at para. 58, citing Joined Cases 96-102, 104, 105, 108, 110/82, *NV IAZ International Belgium and others v Commission.* [1983] ECR 3369, para. 25;

> In the latter case, such restrictions may be weighed against their claimed pro-competitive effects only in the context of [Article 101(3)] of the treaty, with a view to granting an exemption…[30]

According to the Commission's horizontal guidelines, object is said to apply to agreements 'presumed to have negative market effects'.[31] The *Beef Industry* case clarified that 'object' is a legal presumption that competition is restricted 'where the necessary consequence of the agreement was the restriction of competition'[32]. Odudu interprets this as meaning that a 'restriction of competition is the inevitable consequence of the agreement'.[33] However, it was accepted that 'account must be taken of not only its content, but also its legal and economic context[but] only of the elements of the legal and economic context which could cast doubt on the existence of a restriction of competition'.[34]

There is in fact no bright-line between 'object' and 'effect' categories, with observers warning for some years of a possible creep towards an ever-wider meaning of object.[35] This came to a head with the decision in *T-Mobile,* in which it was held that 'in order for a concerted practice to be regarded as having an anti-competitive object, it is sufficient that it has the *potential* to have a negative impact on competition. In other words it must *simply be capable* in an individual case…' (emphasis added)[36] Further confusion was subsequently caused by the judgement in *Allianz Hungaria Biztosito*, where an attempt was made to formalise the object test along similar lines.[37] Jones and Sufrin suggested the approach in *T-Mobile* was 'overly-

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[30] Cases T-374/94 [1999] ECR II-3141 at 136
[31] Commission Guidelines on the applicability of Article [101] of the EC Treaty to horizontal cooperation agreements (2001) OJ C3/2; See also Guidelines on the application of Article [101(3)] of the Treaty, O.J 2004, C101/97 at para. 21.
[32] *BIDS* cited *supra* note 27, para. 17 and AG Opinion at para. 44;
[33] Odudu, 'Restrictions of Competition by Object – What's the Beef?' [2008] Comp Law 11
[34] *BIDS* cited *supra* note 27, AG Opinion at para. 50.
[35] It is notable that competition authorities frequently refer to an arrangement as having the 'object and/or effect' of restricting competition, but unless this is accompanied by some detailed effects analysis, it amounts to an 'object' treatment of the given case.
[36] *T-Mobile* cited *supra* note 19, para. 31. Discussed in Jones and Sufrin, *EU Competition Law,* 5th ed. (OUP, 2014), pp 212-213
[37] Case C-32/11 *Allianz Hungaria Biztosito Zrt and Others v Gazdasagi Versenyhivatal*

expansive and, indeed, rather worryingly vague and broad'.[38] They pointed out how the *T-Mobile* analysis appeared to blur the object / effects distinction. In particular, 'the suggestion that any agreement with the potential to have a negative impact on competition is restrictive by object could, at its broadest construction, do away with the need for effects analysis completely'.[39] This loose application of 'object' therefore risked capturing conduct that was ambivalent or only harmful in very limited circumstances. Bailey was a little less sceptical, suggesting that the wording in *T-Mobile* should be understood within the factual context of the case. He added that the court may simply have been stating that 'a finding of anti-competitive object does not depend upon an assessment of its actual impact on competition'.[40]

The trend towards an apparently over-expansive application of restriction by object is thought by some to have been halted by ECJ in *Groupement des cartes bancaires*.[41] In his opinion, AG Whal called for a 'restrictive interpretation' of object, suggesting it to be reserved for 'conduct whose harmful nature is proven and easily identifiable…'[42] The ECJ went on to set aside the Commission's decision in its entirety, largely because it blurred the distinction between object and effect. In particular because:

> …when the General Court defined the concept of the restriction of competition 'by object' within the meaning of that provision, it did not refer to the settled case-law of the Court of Justice… thereby failing to have regard to the fact that the essential legal criterion for ascertaining whether coordination between undertakings involves such a restriction of competition 'by object' is the finding that such coordination reveals in itself a *sufficient degree of harm to competition*.[43] [emphasis added]

Killick and Jourdan argue that it 'reconfirms the longstanding orthodoxy that a restriction by

[38] Jones and Sufrin, *supra* note 36, p213
[39] Jones and Sufrin, *supra* note 36, p213; See also Meyering, 'T-Mobile: Further Confusion on Information Exchanges Between Competitors' [2010] J.E.C.L. & Pract. 30
[40] Bailey, *supra* note 27, p589; This view is also supported in Nazzini and Nikpay, 'Object Restriction and Two-Sided Markets in EU Competition Law after Cartes Bancaires' Comp. Pol. Int. 10(2). Autumn 2014, pp 157-172.
[41] *Cartes Bancaires* cited *supra* note 8
[42] Opinon of AG Wahl in *Cartes Bancaires* cited *supra* note 8, para. 56; Discussed in: Killick and Jourdan, '*Cartes Bancaires*: A Revolution or a Reminder of Old Principles We Should Never Have Forgotten?' (2014) Comp. Pol. Int. pp.14-3.
[43] *Cartes Bancaires* cited *supra* note 8

object must display a 'sufficient degree of harm' to competition and include only these types of coordination between undertakings that 'can be regarded by their very nature as being harmful'.[44]

Thus even under the restrictive approach apparently taken in *Cartes Bancaires*, the key to applying the object category is the degree of harm. In the Construction Bid-Rigging Case, the OFT justified its decision to treat cover pricing as 'object' on two grounds. First, they argued that cover pricing was deceptive from the perspective of the procurer, who wrongly believes that there is one more serious bidder than exists in practice. Second, they argued that the practice had an adverse effect on price because the firm solicited for a cover price knows that at least one rival bidder is not competing for the contract.[45] They therefore argued that the practice was by its objective nature a restriction of competition, even though they accepted that there may not have been a direct inflation of prices in any particular instance.[46] The OFT also made reference to the CAT's previous decision in *Apex Asphalt and Paving Co Limted v Office of Fair Trading*, in which it upheld the starting point of the fine and stated, 'Concertation the object of which is to deceive the tenderee into thinking that a bid is genuine when it is not, plainly forms part of the mischief which [Chapter I, Competition Act 1998] is seeking to prevent'[47]. In the present case, the CAT said:

> There is no doubt that 'simple' cover pricing constitutes an infringement of the Chapter I prohibition, but in our view the practice is materially distinct from 'bid-rigging' as ordinarily understood … Cover pricing is less serious than conduct of that kind […] Its purpose is not (as in a conventional price-fixing cartel) to prevent competition by agreeing the price which it is intended the client should pay.[48]

On appeal the Competition Appeals Tribunal accepted that cover pricing is an object agreement under Chapter I, Competition Act 1998 (and therefore Article 101 TFEU). The CAT did cut the

[44] Killick and Jourdan, *supra* note 42, p6, quoting *Cartes Bancaires* cited *supra* note 8, para. 50.
[45] *Kier Group* cited *supra* note 7, para. 20
[46] *Kier Group* cited *supra* note 7, para. 88
[47] [2005] CAT 4 paras 250-1
[48] *Kier Group* cited *supra* note 7, paras 94 and 100

fines imposed on construction firms for cover pricing substantially because they felt effects were not adequately considered when the OFT calculated the fines.[49] While an interesting aside, we will not here pursue the implication that the competition authority will eventually have to engage with effects when they set fines, nor with the methodology used to calculate the fines.

Thus despite recognising that cover-pricing was less serious than bid-rigging and disagreeing on the appropriate penalty, both the OFT and Competition Appeals Tribunal still treated cover pricing as an arrangement that had as its object the restriction of competition. This is the category of infringements considered to be the most serious infringements of Article 101 and therefore the most harmful. The question we now seek to answer is the extent to which cover pricing can actually have an anti-competitive effect.

4. Where is the harm in Cover Pricing?

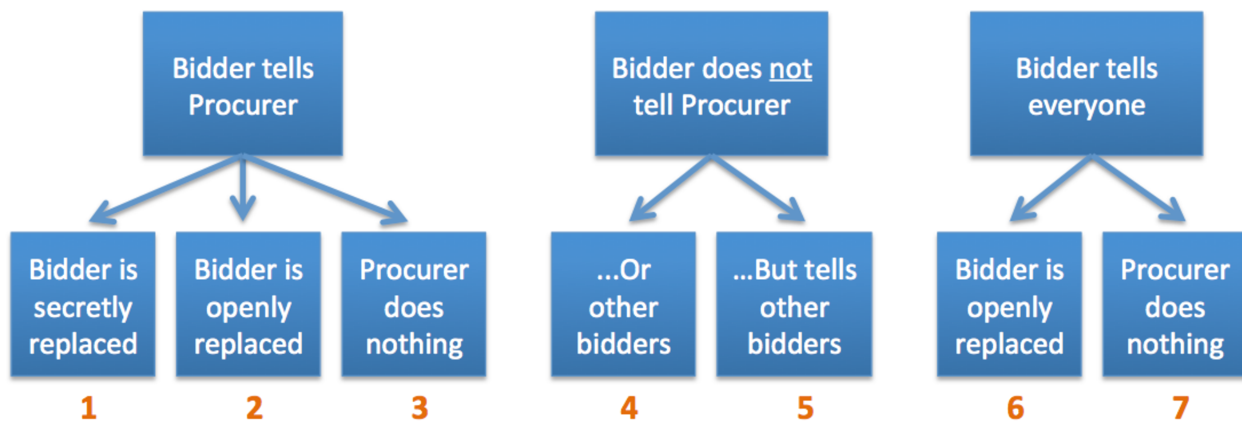
In order to determine the extent to which cover pricing is harmful we must consider some economic theory.[50] We assume that costs are the sole criteria for accepting a bid, meaning that the contract will always go to the lowest bid. For our purposes, the key insight from the game theoretic models of (sealed bid) auctions and tendering[51] is that, where only one or two firms have been invited to bid, adding an additional bidder has a big effect on the magnitude of the winning bid. Where there is a large number (5-6) of bidders, adding an additional bidder has only a small (potentially insignificant) effect on the magnitude of the winning bid. The precise magnitude will depend on how homogenous the bidders are. The intuition is that the more serious bidders there are, the more aggressively each bidder will compete and the closer the

[49] *Kier Group* cited *supra* note 7
[50] We maintain the assumption of the OFT decision that cover pricing were isolated events. Hence we are not considering the case where cover pricing may become reciprocal over time and lead to more sophisticated and harmful forms of collusion.
[51] See for example Klemperer, *Auctions: Theory and Practice* (Princeton University Press, 2004), in particular page 27.

winning bid will get to the absolutely lowest price possible. What matters is therefore the pool of available serious bidders.

A key element to deciding who to invite to tender for a contract, is the belief the procurer has about the lower bound of the bidders' reservation value, i.e. the lowest possible bid a bidder could feasibly make. In drawing up a short-list of who to invite to bid, the procurer will attempt to select those most likely to offer a competitive bid, i.e. those with the lowest reservation values. Imagine that there is one firm among those shortlisted (the insider or non-bidder) who does not want to win the contract. We will consider the following possible scenarios set out in diagram 1 which allow for all possible actions:

Diagram 1



Note immediately that scenario 2 and 6 have an identical outcome because in both cases everyone will know that a specific bidder has been replaced. In the following we disregard scenario 6.

To evaluate the remaining 6 cases, three bits of information are valuable. The first is the marginal value of the 'best' excluded bidder; this measures the benefit of enlarging the set of invited bidders. The second is the effect on the expected winning bid if an insider is replaced by the best outsider, leaving the total number of bidders intact. This essentially measures the

value of an insider if the set of bidders is to be kept fixed. The final element is the expected winning tender price when the insider does not bid and the other bidders know this. This measures the value of keeping the non-bidding of the insider secret.

Consider how these six scenarios compare in terms of the effect on the price the procurer ex-ante expects to pay for the goods or services.[52] The worst outcome for the procurer is where all the other bidders know that the insider firm does not want to win the contract, but the insider is not replaced with another bidder (Scenarios 5 and 7). Knowing that there is one less serious contender and hence less competition, each will adjust their bids upwards. One might intuitively expect that the best outcome is one in which the bidder is replaced (Scenarios 1 and 2). However, this is only so if the replacement bidder is almost as valuable to the process as the insider was expected to be.[53] In that case little to no expected harm arises from the insider dropping out. Consider, however, the other extreme where the replacement offers no competitive pressure at all. In this case the fewer bidders who know that someone has dropped out (and replaced or not since the replacement has no impact on the expected winning bid), the lower the expected winning bid will be. The reason is that those who do not know, bid as if there was one more serious contender and hence continue to bid as aggressively as if that dropout had not occurred. So Scenario 1 becomes preferable to 2. In fact any scenario where the other bidders do not learn of the non-bidder is preferable (1, 3 and 4). The crucial issue is then whether a competitive replacement bidder is available. We can summarise this insight as follows:

- *If the non-bidder can be replaced meaningfully by another bidder, then informing the other bidders about the substitution of the non-bidder is better for the procurer.*
- *If the non-bidder cannot be replaced meaningfully by another bidder, then the fewer bidders know about the existence of the non-bidder, the better it is for the procurer (and therefore for competition)* .[54]

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[52] Note that we do not take the cost of evaluating bids into consideration.

[53] Formally this requires that the effect on the expected winning bid if an insider is replaced by the best outsider, leaving the total number of bidders intact, is small.

[54] We do not consider whether this would constitute a fraud by the procurer or at least a sin of omission.

One implication is that if the non-bidder cannot be replaced with a strong substitute, it is better for the procurer if as many of the other bidders as possible remain unaware of the non-bidder (whether or not a substitution is made), because they will otherwise submit less aggressive bids. The worst case scenario is where the non-bidder makes this public, i.e. scenario 6.

We can take this one step further. Imagine that there is a large pool of more or less equally valuable bidders. While there is no hard-and fast rule about the number of bidders required for competition[55], the cost required for evaluation is such that not all serious bidders would be included in the invitation. Thus where there are a lot of bidders invited, one cannot exclude the possibility that the marginal outsider is a close substitute to anyone of the insiders, in which case there is harm from cover pricing, though paradoxically, this harm is likely to be very small so long as there are still a good number of other bidders who are unaware of the existence of a non-bidder.

Using the same logic, where only a small number of bidders is invited, this must, by revealed preference[56], be because adding the marginal outsider has less effect on the expected price than the cost of evaluating that additional bid. Thus where the number of invitees is small, maybe at most 3 or 4, we can reasonably assume that the expected value of the outsider is modest, so that cover pricing may be the preferred outcome of the procurer and more harm would be done if the approached party publicly denounced that approach.[57] Again, ironically, this is where the harm from cover pricing is likely to be the largest.

In essence, cover pricing has only a very limited anti-competitive effect so long as there is at least one bidder who is unaware that one or more firms will not bid seriously. Only in a small

[55] See the discussion at page 18-19 in Paul Klemperer, Bidding Markets, Competition Commission discussion paper (June 2005) available at: <http://www.nuff.ox.ac.uk/users/klemperer/biddingmarkets.pdf> (last visited 11 May 2015).

[56] Firms and authorities who have to or can meaningfully conduct a tender are typically of such a size that it is reasonable to assume they have thought carefully about the design and process of the ender, including how many and who to invite to tender.

[57] Where there are only two invited bidders this is clearly not true since there are no bidders who do not know about the non-bidder. Where there are only two bidders invited, tendering is unlikely to be the most efficient way to procure goods or services.

minority of the hundreds of instances looked at by the OFT, were there only two firms bidding for a contract. Moreover, the legal alternative to cover pricing – announcing to the world that you do not want to bid – is potentially more harmful to competition, and especially so where cover pricing itself is very harmful. This is because the fact that there will be one less competitive bid becomes known to every firm – not just those contacted for the purposes of obtaining a cover price. Cover pricing could be the best of a bad set of outcomes arising from the pool of serious bidders being too small.

5. Was Cover Pricing correctly treated as an 'Object' restriction?

We have demonstrated that there is only a weak theory of harm in relation to cover pricing and that a discernible anticompetitive effect is only likely in limited circumstances. Despite this, cover-pricing was treated as a restriction by object. As previously stated, the wide net cast by the concept of a 'concerted practice' places great importance on our ability to accurately distinguish arrangements that have as their object the restriction of competition, and are therefore prohibited and punished regardless of whether they actually had any anti competitive effect. In this section we argue that Article 101 may be incapable of distinguishing some horizontal restrictions with ambivalent effects, from the most serious restrictions of competition intended to be captured by the 'object' category.

5.1 Should Analysis as to 'Object' take Effects into account?

One of the key difficulties is drawing a clear distinction between 'object' and 'effect' analysis. In particular, the courts have been very reluctant to require any kind of initial assessment as to the likely anticompetitive effects of a given practice. In *GlaxoSmithKline Services Unlimited v Commission*, the General Court held that before an arrangement could be treated as being

restrictive by object, an abridged analysis of its effects had to be conducted.[58] This was rejected by the ECJ on appeal, stating that:

> ..there is nothing in that provision to indicate that only those agreements which deprive consumers of certain advantages may have an anti-competitive object…. Article 101 aims to protect not only the interests of competitors or consumers, but also the structure of the market, and in doing so, competition as such. Consequently, for a finding that an agreement has an anti-competitive object, it is not necessary that final consumers be deprived of the advantages of effective competition in terms of supply or price.[59]

The General Court's approach in *GlaxoSmithKline* is perfectly understandable given how the courts have arguably never provided a satisfactory explanation of how the two are distinct. For example, in the early case of *LTM*, the court stated:

> '…where an analysis of the said clauses does not reveal the *effect on competition* to be sufficiently deleterious, the *consequences of the agreement* should then be considered, and for it to be caught by the prohibition it is then necessary to find that those factors are present which show that competition has in fact been prevented or restricted…' [60] (emphasis added)

This also goes some way in explaining the diverging approaches in *T-Mobile* and *Cartes Bancaires.* The latter decision reaffirmed the long standing case law on 'object' and 'effect' but did not help clarify what an 'object' analysis should actually involve, other than it should absolutely not engage any analysis of the arrangement's effects. A more helpful evaluation is provided by AG Wahl's opinion in *Cartes Bancaires*, where he acknowledges that it can be 'difficult to distinguish how the examination of the context… which consists in evaluating the risk of competition on the market… being eliminated or seriously weakened… differs from the

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[58] Case T-168/01, *GlaxoSmithKline Services Unlimited v Commission* [2006] ECR II-2969; Discussed in Jones and Sufrin, *supra* note 36, pp.222-225

[59] Case C-501/06, *GlaxoSmithKline Services Unlimited v Commission* para. 63 [2010] 4 CMLR 2

[60] Case 56/65 *LTM* [1966] ECR 337. 359, Discussed in the Opinion of AG Wahl in *Cartes Bancaires* cited *supra* note 8, para. 8

examination of possible anticompetitive effects.[61]

In the absence of an abridged effects analysis of some sort, the sufficient degree of harm necessary for there to be an object restriction hinges on a somewhat loose consideration of the agreement's objective and economic context, as per the *STM* case. The first is fairly straightforward and is not determined by the parties' subjective intentions.[62] In *BIDS*, the ECJ made clear that a restriction without intention to restrict competition or harm consumers, but with the object of reducing a crisis in the sector and increasing competition by making it more competitive after a process of rationalisation, was irrelevant in the application of Article 101(1). They stated that an 'agreement may be regarded as having a restrictive object even if it does not have the restriction of competition as its sole aim but also pursues other legitimate objectives'.[63] The meaning of 'economic and legal context' is a little more puzzling – especially in seeking to distinguish it from any kind of effects analysis. Indeed, the phrase is also used to describe any appraisal of the effects of an agreement (where object is not deemed suitable) and in assessing whether an agreement has an appreciable affect on trade between Member States (necessary for Art 101 TFEU to apply).[64]

AG Whal's opinion in *Carte Bancaires* states that 'anti competitive object' is identified using a formalist approach conceivable in relation to either 'conduct entailing an inherent risk of a particularly serious harmful effect' or 'conduct in respect of which it can be concluded that the unfavourable effects on competition outweigh the pro-competitive effects'. Its harmful nature must be 'proven and easily identifiable, in the light of experience and economics'. He also says that object agreements should '[not] have ambivalent effects on the market' or 'produce ancillary restrictive effects necessary for the pursuit of a main objective which does not restrict

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[61] Opinon of AG Wahl in *Cartes Bancaires* cited *supra* note 8, paras 44-52

[62] Case T-49/02, *Brasserie Nationale NA* v *Commission,* [2005] ECR II-3033 at 85

[63] *BIDS* cited *supra* note 27, para. 21. Discussed in A Jones, 'The Journey toward an effects-based approach under Article 101 TFEU – The case of hardcore restraints' (2010) *The Antitrust Bulletin* 55(4), pp 783-818 p802 and note 81

[64] Joined Cases T-208/08 and T209/08 *Gosselin Group NV* (16 June 2011) at 72; Joined Cases C-215/07, C-133/07, C-135/07 and C-137/07, *Erste Group Bank AG and Others* (24 September 2009); Case C-238/05 *Asnef-Equifax* [2006] ECR I-11125 at 49; Case C-250/92 *DLG* [1994] ECR I-5641 at 31; Case C399/93 *Oude Luttikhuis and Others* [1995] ECR I-4515 at 10 and Case C-306/96 *Javico International* [1998] ECR I-1997 at 22.

competition'.[65]

Yet challenges to object 'in light of experience and economics' appears to occur only in exceptional circumstances. Notable challenges relating to context include: where the restriction came about through the exercise of intellectual property rights[66], was to improve the stability and efficiency of a cross-border credit card transaction system[67], or was to encourage the entry of a second purchaser into the market where there was formerly only one.[68] *Cartes Bancaires* concerned a payment system between French banks aimed at increasing interoperability. In each of these cases the restriction was ancillary to either the exercise of rights or an efficiency enhancing joint venture. Jones points out that this strand of case law (at least prior to *Cartes Bancaires*) is hard to reconcile with a number of other cases where the Commission and European Courts have tended to treat *all horizontal* price or output restraints as restrictions by object, leaving the parties with only the ability to argue the arrangements had some efficiency justifications under Article 101(3).[69] These include: *Reimes II*[70]*, CECED*[71]*, and French Beef*[72]*.*

The limits of 'object' restraints appear to be fluid in the case law and are likely to remain so despite the comparatively restrictive wording of the *Carte Bancaires* ruling. Cover pricing does not have the kind of redeeming qualities found in the exceptions above and is up against a general presumption that direct communication between competitors is harmful. This is summarised in *Dole* as:

> 'Each economic operator must determine independently the policy which he intends to adopt on a common market… While it is correct to say that this requirement of independence does not deprive economic operators of the right to adapt themselves intelligently to the existing or anticipated conduct of their competitors, it does, none

[65] Opinon of AG Wahl in *Cartes Bancaires* cited *supra* note 8, paras 44-52 and 54-56.
[66] Case 27/87, *Erauw-Jacquery Sprl,* [1988] ECR 1919. Discussed in Bailey, *supra* note 27, p582
[67] *Visa International – Multilateral Interchange Fee,* O.J. [2002] L318.17
[68] *Bookmakers' Afternoon Greyhound Services* [2008] EWHC 1978, para. 439.
[69] Jones, 'The journey toward an effects-based approach under Article 101 TFEU – The case of hardcore restraints' (2010) Antitrust Bull. 55(4), pp 783-818, p803
[70] [1999] OJ L 275/17
[71] [2000] OJ L187/47
[72] Case C-101 & 110/97 P, *France Bétail et Viande v Commission* [2008] ECR I-8193

the less, strictly preclude any direct or indirect contact between such operators by which an undertaking may influence the conduct on the market of its actual or potential competitors or disclose to them its decisions or intentions concerning its own conduct on the market,' [73]

The category of 'object' restraints therefore remains very broad in relation to horizontal conduct.[74] It is notable that the ECJ's frustration in *Carte Bancaires* related mainly to the fact the Commission had treated an arrangement within a novel or complex economic setting (a two sided market, no less) as a restriction by object.[75] They reaffirmed that 'certain collusive behaviour, such as that *leading to* horizontal price-fixing by cartels, may be considered so likely to have negative effects… that it may be considered redundant… to prove that they have actual effects on the market.' (emphasis added)[76]. Indeed, even those who criticized the broad approach in *T-Mobile* did not suggest narrowing the meaning of 'object' enough to make the sharing information about future pricing or output intentions capable of being categorised as a restriction by effect.[77]

5.2 Why must 'Object' analysis exclude effects?

A greater effects approach to the enforcement of Article 101 is thought to be undesirable for two main reasons.[78] The first is that it could lead to every case involving a detailed analysis of effects, blurring the distinction between the object and effect categories. Even an abridged effects analysis risks descending into a detailed discussion of economic evidence. Yet the

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[73] Case C-286/13 *Dole Food Company* (19 March 2015) at 119-121; *T-Mobile* cited *supra* note 19, paras 33-5; C-194/99 *Thyssen Stahl v Commission,* EU:C:2003:527 at 86. See also: Cast T-1/89, *Rhone Poulenc SA v Commission,* [1991] ECR II-948

[74] Where an agreement is established as having an anti competitive object, 'the ensuing prohibition has a very broad scope, that is to say it can be imposed as a precautionary measure and thus jeopardize future contacts, irrespective of the evaluation of the effects actually produced. Opinon of AG Wahl in *Cartes Bancaires* cited *supra* note 8, paras 54-55

[75] Calzado and Scordamaglia-Tousis, '*Groupement des Cartes Bancaires v Commission:* Shedding Light on What Is not a 'by object' Restriction of Competition' (2015) J.E.C.L and Prac. Published online on March 18, 2015. p2

[76] *Cartes Bancaires* cited *supra* note 8; citing Case C123/83 *BNIC v Clair,* [1985] ECR 391 para. 22

[77] Jones, 'Left Behind by Modernisation? Restrictions by Object Under Article 101(1) (2010) ECJ 649, pp 657-8

[78] These are set out in Bailey, *supra* note 27, p587

current, principled, application of 'object' arguably goes beyond the small subset of 'hard-core' arrangements it is meant to be reserved for. It therefore risks blurring the distinction by engaging categories of behaviour that may only have an ambivalent effect on competition.

The second is that it would reduce the legal certainty and the 'adiministrability' (as Bailey describes it) of the object category. If we expect markets to comply with competition law and be able to reliably seek on legal advice, it is necessary to have certain hard rules they can adhere to. Never discussing pricing or output intentions with competitors is one such rule. A greater effects approach could unstitch this proxy for the most serious infringements of competition law. This would have negative effects for deterrence, making it more likely that firms engage in cartel like practices where they wrongly calculate their actions will not be caught by the 'object' category,

Jones suggests that while legal systems must rely on 'clear, administrable bright-line rules against obviously anticompetitive conduct', 'any such rule should be drawn on the basis of accepted economic principles so that it yields minimal costs from false positives'. [79] She suggests that Europe should show the kind of flexibility evidenced in the US, where the Supreme Court is willing to review the scope and appropriateness of per se rules over time – most controversially in relation to minimum resale price maintenance in *Leegin*[80]*.* Indeed they are unwilling to treat arrangements as per se illegal when they know 'too little of the actual impact of that restriction'.[81] The greater willingness to review the treatment of individual arrangements under US Antitrust Law is partly due to the absence of any kind of Article 101(3) efficiency defence to Section 1, Sherman Act.

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[79] Ibid.

[80] Leegin Creative Leather Products Inc. v PSKS Inc, 551 U.S. 877 (2007)

[81] *White Motor Co v. United States,* 372 US 261 (1963); *Broadcast Music Inc v Columbia Broadcasting System Inc,* 441 US 1 (1979). Indeed, even under US Antitrust Law (thought to be more flexible and effects based than Article 101 TFEU), Cover Pricing is per se illegal. US cases of *Complementary Bidding* (as it is known there) have frequently been reciprocal or done in return for some form of 'kickback' or compensation, making them more akin to bid-rigging.[81] The experience there is that Cover Pricing can be part of a more sophisticated cartel arrangement or makes the formation of one more likely.

5. Concluding Remarks

The purpose of restrictions by 'object' under Article 101 TFEU is to distinguish the most harmful anticompetitive arrangements between competitors. These are meant to be so serious that the significant degree of harm they cause is assumed without any consideration of whether those arrangements were actually implemented or had any discernable anti-competitive effect. The distinction between object restrictions and those considered as to their effect on competition is particularly important given the deliberately wide meaning of *concerted practice* (and indeed *undertaking*).

The example of cover pricing demonstrates how 'object' analysis is unable to always distinguish between inherently harmful restrictions and those with more ambivalent or neutral effects. As long as there is at least one bidder unaware of the cover price, we have shown how the effect on competition may be negligible. Indeed the lawful alternative to cover pricing (making an announcement to the world of a non-intention to win the tender) can actually be more harmful to competition, as every bidder will then be aware they are competing against one fewer competitive bid. The enforcement of Article 101 against cover pricing actually incentivizes a *more* anticompetitive outcome.

In the absence of any sort of abridged effects analysis, restrictions by 'object' have wide application despite *Cartes Bancaires*. It is enough for the competition authority to present a convincing narrative – in the abstract – that the arrangement results in a sufficient degree of harm.[82] This is very easy to do where there is any sort of direct communication between competitors, as the practice tends to fall under the umbrella of hardcore restrictions like price fixing and bid-rigging, even when it is at best a weak manifestation of such a restriction. We are

[82] See A Italianer, 'The Object of Effects' Speech at CRA Annual Brussels Conference – Economic Developments in Competition Policy. Brussels, 10 December 2014.

told that the significant degree of harm is based on experience, established economics and that consideration is given to the objectives and context of the arrangement. Yet it is difficult to see how this vague ‘we know object arrangements when we see them’ approach can evolve over time to capture experience or any developments in established economics. Indeed, it appears that object can only be effectively challenged where firms demonstrate convincing Article 101(3) type efficiency arguments. It has even been suggested – albeit informally by European Commission officials and some practitioners – that firms can rely on Article 101(3) to distinguish between the ‘object’ and ‘effects’ categories of restriction.[83] This risks blurring both the principle that 101(3) should be available to both object and effect arrangements and the long standing rule that any balancing of pro and anticompetitive effects should not occur within the context of Article 101(1).[84] Article 101(3) is, in any case, an unsatisfactory safety net because it cannot help arrangements with neutral effects and is difficult to rely on practice.[85]

It may very well be that a more effects based approach to Article 101 risks undermining what Jones describes as ‘clear, administrable bright-lines rules against obviously anticompetitive conduct’. [86] A blurring of these could weaken legal certainty, compliance and deterrence.[87] The cost of this design is uncertainty created by the capturing of practices under object that actually lie in the periphery of Article 101. In relation to cover pricing, it also risks placing liability on parties who receive requests for cover prices but have no intention to fulfil that request, as arguably their continued participation in the process could be construed as sufficient parallel behaviour to constitute a concerted practice or even possibly an agreement.

If we accept that a wide variety of practices must be caught by the presumption of sufficient degree of harm to ensure legal certainty, then it is essential that penalties be calculated to

[83] See discussion in Calzado and Scordamaglia-Tousis, *supra* note 75, p3

[84] Case T-112/99 *Metropole Télévision SA v Commission* [2001] ECR II-2459 at 74; Case T-65/98 *Van den Bergh Foods v Commission,* [2003] ECR II-4653 at 107; European Commission, *White Paper on Modernisation of the Rules Implementing Articles 85 and 86 of the EC Treaty*, [1999] OJ C 132/1, paras 56-57

[85] Jones, *supra* note 63, p793

[86] Ibid.

[87] See Bailey, *supra* note 27, pp 565-6; Black, ‘Per se rules and rules of reason: What are they’, (1997) ECLR 18, pp151-152

reflect the variance in seriousness of anti-competitive effects captured by ‘object’. As the CAT made clear in slashing the OFT’s *Construction Bid-Rigging* fines by 90 per cent, it is not proportionate to use the same starting point for every horizontal Article 101 case, simply because it is considered to be an ‘object’ agreement. Any penalty imposed must consider the effects of the conduct in question and should be no higher than is necessary to satisfy the twin objectives of punishment and deterrence. While fining guidelines do make some adjustment for factors such as duration, they do not adequately take into account the extent of any anti-competitive harm achieved by the infringement. This risks unfair and disproportionate fines being imposed on firms engaged in activities that are unlikely to ever achieve significant anticompetitive harm.

Finally, it is worth noting that cover pricing could have been dealt with outside of Article 101 altogether, as the problem was essentially to do with the design of the tender list system. The threat of removal from the list was the primary instigator for cover pricing. The submission of a false bid could in fact have been pursued by the procurer as a fraud. In addition, if those procurers provided the bulk of construction work in a given area, any firms struck off the tender list for not bidding could have challenged them for an abuse of dominance. Unfortunately it is unlikely that tender lists will cease as they save the procurer the cost of identifying a different set of suitable contractors for each individual contract.[88]

[88] *Construction Bid-Rigging* cited *supra* note 5, para. IV.30.