

CRA Competition Memo



The importance of a theory of harm

A recent trial in Ireland has highlighted the importance of a coherent theory of harm in any competition law case. As a result of not having a coherent theory of harm, the Irish competition authority saw a jury dismiss three and a half years of work in little more than 15 minutes.

The background to the case

Ireland is unique in Europe in the way that domestic waste is collected.¹ The standard model in Europe is that local authorities collect domestic waste or that they tender the service for private sector operators to collect the waste. Either way, there is only one waste collection operator collecting in any given area. Ireland is different in that there is competition in the market, with competing operators collecting within the same area. Thus consumers have a choice of operator in most parts of Ireland.

In 2005 the County Council in County Mayo, in the west of Ireland, decided that it wanted to withdraw from domestic waste collection. The Council was losing money on its collection service and so decided to allow the private sector to tender for the council's service. The tender would have involved a private sector company buying the council's refuse trucks, wheelie bins and customer list and then committing to continue to serve these customers for at least a year. It was generally agreed that the value in the tender lay almost entirely in the customer list. The council had 14,000 customers. This was compared to the largest private sector operator in Mayo who had about 2,000 customers.

Three private sector collectors decided to get together to put in a joint bid: Bourke Waste Removal, Wheeley Environmental Refuse Services and McGrath Industrial Waste. This was because they felt that none of them could have handled the council's 14,000 customers on their own. They formed a new company to this end (BGM Ltd) and confirmed with the council that it was acceptable for these three firms to put in a joint bid. In addition, the three firms put in a bid in the name of only one of the companies, for €1 less than the joint bid. This bid was motivated by the fact that, under the terms of the tender, only firms that had put in an expression of interest for the tender and that already had a waste collection licence could bid. BGM Ltd did not satisfy either criterion as it was only set up relatively late in the tender process. As it happened, the council was not concerned about BGM not satisfying these criteria as the three constituent firms did satisfy them. Importantly, BGM (and the associated €1-less bid) were the only bids made for the 14,000 customers. The council duly awarded the tender to BGM.

The Competition Authority investigation

In January 2006, before BGM had been able to take over the council's service, the Competition Authority began to investigate the tender process and BGM on the basis that they suspected bid rigging and market sharing. Three and a half years later, in June 2009, the case came to trial in the Central Criminal Court in Galway. The defendants were accused of seeking to prevent, restrict or distort competition by the sharing of customers and markets. The trial lasted eight days and involved 20 counts of anti-competitive behaviour against the various defendants.² The jury took a little over 15 minutes to acquit the defendants on all counts. How could a three and a half year investigation be given such short shrift by the jury? The answer lies in the competition authority's complete failure to articulate a coherent theory of harm or to gather the facts necessary to support a theory of harm.

The need for a coherent theory of harm

The key to understanding whether an agreement can potentially prevent, restrict or distort competition is to understand what would have happened if the agreement did not exist. It is not possible to say that an agreement is anti-competitive without knowing what the alternative to the agreement was and what effect this would have had on the market. This is the approach advocated by the European Commission. In its Article 81(3) Guidelines³ the Commission states that a "useful framework for making this assessment" is to ask the following question: "Does the agreement restrict actual or potential competition that would have existed without the agreement? If so, the agreement may be caught by Article 81(1)."⁴

So in order to understand whether an agreement is potentially anti-competitive, it is necessary to know what would have happened if the agreement did not exist – the counterfactual – and to develop a theory of harm based on the counterfactual.

Furthermore, it is not enough to show that a practice which might often cause consumer harm has occurred. A coherent theory of harm must explain how competition is or could be prevented, restricted, or distorted in this particular case, and this will require a consideration of the nature of competition and of the mechanism through which the practice negatively affects consumers in this particular case. Without a proper analysis of the counterfactual, there can be no coherent theory of harm, and without the latter, no convincing case can be made that an agreement

¹ With the exception of some parts of Finland.

² Mike Walker of CRA acted as economic expert to the defence.

³ "Guidelines on the application of Article 81(3) of the Treaty" (2004/C 101/08).

⁴ Paragraph 18.

or other practice is anticompetitive. This is where the Irish competition authority's case fundamentally failed.

Possible theories of harm

Bid rigging

As late as February 2009 the competition authority was referring to this case as a bid rigging case. Thus the authority's 2008 Annual Report stated that

"In November 2008, the DPP charged eight individuals in connection with alleged bid rigging offences under the Competition Act 2002."⁵

However, this charge did not make it to the actual trial, which referred only to the defendants sharing markets. So what happened to the bid rigging charge? The answer is that it was not a coherent charge, as quickly becomes apparent when any thought is given to the counterfactual.

Standard bid rigging behaviour involves potential bidders agreeing amongst themselves who is going to win which tenders with the aim of lowering the price that they have to offer in order to win the tender. So the correct counterfactual question in this case was: would the winning bid have been higher if the three firms had not bid as one? The answer to this question was clear: no, since there would have been no bids at all if the firms had been forced to bid separately. So there is no sense in which it can be argued that the agreement reduced the winning bid. Nonetheless, it is concerning that even three years after starting their investigation, the competition authority appeared not to have thought through this issue properly.

Sharing markets and customers

The indictments stated that the defendants had sought to prevent, restrict or distort competition by the sharing of markets and customers. On the face of it, this seems like a coherent allegation of anti-competitive behaviour. But again it quickly becomes apparent that the competition authority had not thought through their theory of harm, or counterfactual, or gathered the necessary evidence.

There are two distinct groups of customers that BGM might have shared. The first is the customers that were previously serviced by the council. The second is the customers that the three firms already serviced. It matters greatly which set is being referred to in the allegation of customer sharing. There was clear evidence that there was an agreement to share the first set of customers, but equally it is clear that this was not anti-competitive. There was no evidence of an agreement to share the second set of customers.

One of the requirements of the tender was that the winning firm had to continue to offer service to the council's customers for at least a year after taking them over. In order for BGM to comply with this requirement it was necessary for the three operators to decide amongst themselves which operator would take over which of the council's "runs". It is very hard to understand how the joint venture could operate otherwise. It was predicated on the need to handle the council's business collectively because each firm was too small to handle it on its own, so this required that the ex-council customers were divided

amongst the three operators. It also makes sense that this division should occur on geographic lines. Thus, for instance, it made sense for Bourke, which operated in the Westport area, to take on the council's Westport customers. Neither of the other two firms operated in Westport.

So whilst there was evidence that the parties aimed to share the ex-council customers if they won the tender, this was not anti-competitive since it was a necessary corollary to putting in a joint bid. It would not have been possible to comply with the terms of the tender without deciding who would service the various ex-council customers.

The only coherent theory of harm that the competition authority ran was that the firms had agreed to share existing customers and that this was anti-competitive. However, whilst this theory of harm was potentially coherent, the competition authority was able to provide no evidence in favour of it. Since the defendants were accused of seeking to prevent, restrict or distort competition, a necessary condition of any theory of harm was that the three firms actually competed against each other. However, the competition authority was unable to provide any evidence that they did and there was plenty of evidence that they did not. Principally, domestic waste collection is an essentially local business and the three parties operated in geographically distinct areas. The competition authority accepted during the trial that it had not carried out any market analysis or involved any of its economists in the investigation.

Domestic waste collection is subject to economies of density, meaning that it is less costly to pick up the waste of ten customers who are located close to each other (e.g. in the same street) than of those who are not close to each other. The existence of economies of density was accepted by the competition authority, but they made no attempt to analyse whether, even if there had been an attempt to share existing customers, this might have been economically efficient. So there was no theory of harm that prices would rise, or quality fall, and, tellingly, the competition authority did not claim in court that either would have happened.

It is ironic that at the time of the original tender, the competition authority was arguing in the *Greenstar*⁶ case that competition in local waste collection markets was economically inefficient.

Conclusions

Failing to think through your theory of harm, or your counterfactual, can lead to a substantial waste of time and money, not to say loss of credibility. The competition authority spent three and a half years on this case and involved more than 20 staff. The trial lasted eight days and involved five senior counsel, five juniors, four instructing solicitors and a myriad of other personnel. That constitutes a considerable amount of resources expended on a case that the jury was evidently, and correctly, entirely unconvinced by.

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⁵ Irish Competition Authority 2008 Annual Report, page 6.

⁶ Enforcement decision series (no. E/05/002) 30/8/2005).