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Parallel Conduct Explained: Unlawful Conspiracy or Rational Economic Behavior

1. Introduction

The Competition Agency's attempt to disrupt anticompetitive behavior among market participants requires proof. That kind of proof may come from different sources, including evidence from economic analysis. Unfortunately, in most cases such economic analysis is inconclusive. The final outcome of the economic analysis is not decisive and leaves room for alternative interpretations. Such is also the nature of parallel conduct. Parallel conduct refers to indirect economic evidence open to contradictory interpretations. In its recent decision[1] to penalize Georgian oil companies, the Competition Agency of Georgia (the "Agency") predominantly relied on the existence of parallel conduct as its primary central evidence of anticompetitive behavior. With that decision, Georgia joined the controversy related to parallel conduct being played out in scholarly discussions as well as international legal practice. This article discusses the issue of parallel conduct in light of theoretical

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1 Order N81 of the Head of the Competition Agency of Georgia dated 14 July 2015.

and legal approaches, explains its nature and provides possible solutions to deal with the issue of parallel conduct in the Georgian case.

Under its own initiative on 12 November 2014, the Agency opened an investigation into the Georgian market for motor fuel products (petrol, diesel).[2] According to the Agency's market analysis, parallel pricing serves as key evidence of violation of Article 7 of the Law of Georgia on Competition[3], which prohibits "any agreement, decision or concerted practice ('the agreement') of undertakings that have as their object or effect the prevention, restriction and/or distortion of competition within the relevant market."

Under order N81 of the Head of the Competition Agency of Georgia issued on 14 July 2015, the Agency penalized the five dominant firms operating in the Georgian market for motor fuel products, treating the practice of parallel pricing as evidence of collusion (defined by concerted practice or agreement). According to the Agency, in spite of the existence of a highly-concentrated (oligopolistic) market characterized by the phenomenon of parallel pricing, the prices set by the five dominant companies were supra-competitive (significantly higher than the market price) and therefore inappropriate. Analysis of the Agency's argumentation indicates that this decision was based primarily on the occurrence of parallel conduct, i.e., indirect evidence of an economic nature.

Parallel conduct typically occurs in oligopolistic industries. It is a strategy of business entities that takes into account the practice of rival firms rather than the interests of consumers. The most obvious manifestation of parallel conduct is the similarity of prices across firms and their rapid fluctuation in a strikingly parallel manner (parallel pricing is usually a tool for setting inappropriately high prices). Such behavior is designated as "tacit collusion" or "conscious parallelism".[4]

There are various interpretations of parallel conduct. The approach of the European Union ("EU") courts is that parallel conduct does not in itself

[2] For more information on the Investigation of the Market of Motor Fuel Published by the Competition Agency of Georgia, refer to the following web link: competition.ge/images/upload/ვრცლად.pdf.

[3] Law of Georgia on Competition N2159 dated 21 March 2014.

[4] Reza Dibadj, Conscious Parallelism Revisited, San Diego Law Review, Vol. 47, No. 3, 2010, pp.593-595.

amount to unlawful action.[5] The same applies to the courts of the United States of America ("USA").[6] In spite of that, some academics believe that parallel conduct in particular circumstances may amount to unlawful action and some countries predominantly use it as key circumstantial economic evidence of unlawful action.[7]

The Agency's reliance on parallel conduct as evidence of unlawful action and the ensuing controversy necessitates comparative research. This paper examines the nature of parallel conduct in light of international practice and provides key policy recommendations for the Government of Georgia.

2. Theoretical Analysis

2.1. Scholarly Debate on the Problems of Parallel Conduct

Scholars have been debating the problems of parallel conduct in oligopolistic markets for more than half a century.[8] The opposing sides of the debate are well represented by two characters: Donald Turner – Professor at Harvard Law School; and Richard Posner – Judge on the United States Court of Appeals for the Seventh Circuit in Chicago.

5 Richard Whish and David Bailey, Competition Law, Oxford, Oxford University Press, 2012, p.567. Also see cases: 48/69 Imperial Chemical Industries v Commission (Dyestuffs) [1972] ECR 619; Züchner v Bayerische Vereinsbank AG (172/80) [1981] ECR 2021, [1982] 1 CMLR 313; and Zinc Producer Group OJ [1984] L 220/27, [1985] 2 CMLR 108.

6 Matthew M. Bunda, Monsanto, Matsushita, and "Conscious Parallelism": Towards a Judicial Resolution of the "Oligopoly Problem", Washington University Law Review, Vol. 84, Issue 1, 2006, pp.189-191. Also see cases: Williamson Oil Co. v Philip Morris USA, 346 F.3d 1287; In re Flat Glass Antitrust Litigation, 385 F 3d 350, 359-60 (3d Cir. 2004); and In re High Fructose Corn Syrup Antitrust Litig., 295 F.3d 651 (7th Cir. 2002).

7 OECD, Policy Roundtables, Prosecuting Cartels without Direct Evidence, 2006, p.11. This approach is shared by prominent Judge Richard Posner; refer to his opinion in: Richard A. Posner, Antitrust Law, Second Edition, 2001, pp.93-94.

8 Gregory J. Werden, Economic Evidence on the Existence of Collusion: Reconciling Antitrust law with oligopoly theory, 71 Antitrust L.J. 719, 735-36, 2004, pp.719-720.

2.2. Professor Turner on Parallel Conduct

According to Professor Turner, prices similar to those prices set as the result of unlawful agreements are unavoidable in oligopolistic markets.[9] Parallel pricing is highly probable in markets where many producers supply identical products. Decline in demand, excess supply or other changes in market conditions do not facilitate price stability in spite of the fact that, as a general rule, such conditions create advantages for producers in the event of price reductions. The maintenance of high prices raises suspicion when market conditions provide the opportunity for firms to obtain increased profit by lowering prices. Moreover, price stability can be maintained in oligopolistic markets even without explicit agreement between firms.[10]

The nature of the oligopolistic market is such that decisions related to the prices or output of one firm affects the sales volume of the others. One may anticipate the behavior of the other and vice versa. Therefore, parallel pricing occurs without overt collusion between firms and may be dependent on "rational calculation." If one firm reduces prices, its sales volume will grow to the detriment of the other, and the competing firm will also cut prices in order to regain the lost clients. Because such a price cut induces the oligopolists to sell their production at a low price, which may be detrimental, firms foresee the negative consequences of price reductions and refrain from cutting prices.[11]

The abovementioned rational calculation may be designated as agreement by conduct, but in Professor Turner's view parallel conduct in an oligopolistic market is not agreement and, even if we call it agreement, does not constitute unlawful conspiracy. Unlawful agreement shall be proved only by the application of additional evidence.[12]

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9 Donald F. Turner, The Definition of Agreement Under the Sherman Act: Conscious Parallelism and Refusals to Deal Harvard Law Review Vol. 75, Issue 4, 1962, p.666.

10 Matthew M. Bunda, Monsanto, Matsushita, and "Conscious Parallelism": Towards a Judicial Resolution of the "Oligopoly Problem", Washington University Law Review, Vol. 84, Issue 1, 2006, p.189.

11 Ibid, p.190.

12 Donald F. Turner, The Definition of Agreement under the Sherman Act: Conscious Parallelism and Refusals to Deal, Harvard Law Review Vol. 75, Issue 4, 1962, p.671.

According to Professor Turner, parallel conduct may result from independent reasoning. Parallel conduct of firms may result in anticompetitive outcomes, but that does not prove the existence of collusion or unlawful conspiracy. Such behavior characterizes the structure of oligopolistic markets making firms interdependent.[13]

2.3. Dissent of Judge Posner

Judge Posner based his approach on "A Theory of Oligopoly" developed by George Stigler[14]. Stigler's analysis of the oligopolistic environment indicates that noncompetitive behavior by firms is not the ultimate outcome of oligopolistic structures. Firms must have a complex understanding of each other's behavior and of the rules they implicitly accept to coordinate parallel conduct.[15] Firms are required to monitor deviation (noncompliance with commonly-accepted rules) and punish it in order to sustain a non-competitive environment. A cartel, however, is not always able to punish deviation. Firms are capable of cheating such a monitoring system, slightly decreasing prices and making more profit while avoiding detection. Stigler's analysis doubts the inevitability of anticompetitive prices in oligopolistic markets.[16]

Judge Posner also argues that anticompetitive outcomes are not unavoidable in oligopolistic markets. Despite their being oligopolists, firms will still encounter many difficulties in attempting to coordinate.[17] Competing firms are not always able to obtain fresh information regarding prices. If the firm has a chance to reduce prices in a short period of time without being detected, it will decrease said prices and resultantly gain profit. The capacity avoid detection is also significant, because firms may be able to increase sales

13 Ibid, p. 681.

14 William H. Page, A Neo-Chicago Approach to Concerted Action, Antitrust Law Journal, Vol. 78, Issue 1, 2012, p. 174.

15 Jonathan B. Baker, Two Sherman Act Section 1 Dilemmas: Parallel Pricing, the Oligopoly Problem, and Contemporary Economic Theory, Antitrust Bulletin, Vol. 38, Issue 1, 1993, pp.156-157.

16 Ibid, pp.149-153.

17 Matthew M. Bunda, Monsanto, Matsushita, and "Conscious Parallelism": Towards a Judicial Resolution of the "Oligopoly Problem", Washington University Law Review, Vol. 84, Issue 1, 2006, p.192.

volume in a short period of time as a result of price decreases, which will not cause reduction of sales volume of their competitors.[18]

Parallel conduct is not the ultimate result of oligopolistic markets. Oligopoly facilitates coordination but does not necessarily cause it.[19] If the economic evidence refers to collusion, then evidence of actual agreement between firms is not necessary. The evidence of such agreement may be deduced from the presence of parallel conduct. Unlike Turner, Judge Posner argues that parallel behavior may be understood as "a literal meeting of the minds" and "a mutual understanding."[20] Judge Posner's ideas support the opinion that parallel conduct may not only be evidence of unlawful conspiracy but may also be its direct expression and a substitute for actual agreement between firms.

2.4. Subsequent Developments

In the current debate, some argue that the problems put forth by the debate between Turner and Posner remain unresolved.[21] However, new methods of economic analysis offer new solutions for detecting unlawful conspiracy. Instead of searching for agreement or intent, these methods observe basic measurements of firm performance – price, output, cost and demand.[22] It is also claimed that research on existing cartels shows that they need to coordinate extensively in order to prevent misunderstandings and detect cheating, and in doing so avoid price reductions and competition.[23]

Despite the above analysis, empirical studies still do not provide sufficient evidence for theorists to solve the problems of parallel behavior endemic to oligopolistic markets.[24] Highly-qualified economic experts reach

18 Ibid, p.193.
19 Ibid, p.194.
20 Richard A. Posner, Antitrust Law, Chicago, Chicago University Press, 2001, p.94.
21 Matthew M. Bunda, Monsanto, Matsushita, and "Conscious Parallelism": Towards a Judicial Resolution of the "Oligopoly Problem", Washington University Law Review, Vol. 84, Issue 1, 2006 p.198.
22 Reza Dibadj, Conscious Parallelism Revisited, San Diego Law Review, Vol. 47, No. 3, 2010, p.624.
23 William H. Page, A Neo-Chicago Approach to Concerted Action, Antitrust Law Journal, Vol. 78, Issue 1, 2012, pp.190-194.
24 Reza Dibadj, Conscious Parallelism Revisited, San Diego Law Review, Vol. 47, No. 3, 2010, pp. 625-629.

different conclusions from the same economic evidence even when they employ widely-accepted modern methods of economic analysis. Some experts believe that parallel conduct occurs without explicit communication, thus rendering circumstantial evidence irrelevant.[25] Other experts focus on Stigler's model and, according to them, parallel conduct rarely occurs without explicit communication.[26]

The above analysis indicates that theoreticians are inconclusive regarding the nature of parallel conduct. This theoretical dichotomy between two main approaches has found expression in international legal practice and induced countries to adopt divergent approaches, which are discussed in detail below.

3. International Legal Practice

3.1. European Union

According to the EU courts, parallel conduct may constitute evidence of concerted practice. However, taken alone it is insufficient and there must be additional evidence.[27] The case of Wood Pulp is exemplary of the kind of inconsistency; parallel conduct can be key evidence of unlawful concerted practice in the absence of a plausible alternative explanation.[28]

3.2. United States of America

The US courts support the opinion of Professor Turner and attempt to adduce additional evidence in order to determine the existence of conspiracy.[29]

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25 Gregory J. Werden, Economic Evidence on the Existence of Collusion: Reconciling Antitrust law with oligopoly theory, 71 Antitrust L.J. 719, 735-36 (2004), pp.798-799.

26 Ibid. p.799.

27 Richard Whish and David Bailey, Competition Law, Oxford, Oxford University Press, 2012, pp.567-568.

28 Ibid, p. 569.

29 Reza Dibadj, Conscious Parallelism Revisited, San Diego Law Review, Vol. 47, No. 3, 2010, p.597. See also the cases: Williamson Oil Co. v. Philip Morris USA, 346 F.3d 1287; In re Flat Glass Antitrust Litigation, 385 F 3d 350, 359-60 (3d Cir. 2004); In re High Fructose Corn Syrup Antitrust Litig., 295 F.3d 651 (7th Cir. 2002).

The courts rely on the plus factors which may constitute behavior contrary to self-interest (i.e., behavior which cannot be explained rationally can be the probable outcome of concerted practice) as well as evidence of communication.[30] The US courts are consistent in ruling that parallel conduct in itself does not amount to unlawful conspiracy; thus something more than parallel conduct is needed in order to exclude the possibility of independent lawful action.[31]

3.3. Chinese Taipei (Taiwan)

The officials and courts of Chinese Taipei equate parallel conduct in pricing to unlawful agreement. The Fair Trade Commission of Chinese Taipei (the "FTC") launched investigation into violation of the Fair Trade Law by two domestic oil suppliers. The FTC acknowledged that simple uniform pricing (parallel conduct) is not necessarily illegal. However, the occurrence of mutual understanding through public price announcements or news releases was followed by the uniform pricing of relevant products on the market, so the public exchange of views constituted more than mere parallel conduct. According to the FTC the two firms did not merely set uniform price levels, but their public exchange of information could be considered a form of mutual understanding and thus concerted action, which is prohibited under the Fair Trade Law.[32]

3.4. Republic of Korea (South Korea)

In South Korea, the issue of parallel conduct is regulated by law. Under Article 19.5 of the Monopoly Regulation and Fair Trade Act (MRFTA), where two or more firms commit any acts (agreements or concerted practice) that practically restrict competition in a particular business area, the firms shall be presumed to have committed an act of unfair collaborative even in the absence of an explicit agreement to engage in such act. On the basis of this

30 Ibid, p.598.
31 Ibid, pp.599-600.
32 OECD, Policy Roundtables, Competition in Road Fuel, 2013, p.307.

article the Korean Fair Trade Commission applies the presumption of a cartel agreement if there is "uniformity of outward conduct", "competition-restrictiveness" and circumstantial evidence.[33]

On the basis of the presumption clause of Article 19.5, the Seoul High court developed a two-step presumption analysis. The first step includes the presumption of concerted action without explicit agreement if it is revealed that the firms engaged in externally-uniform acts which fall under Article 19.1. The second step is presuming unlawfulness when the claimant arguing in favor of concerted practice proves the presence of anti-competitive market outcomes. This presumption may be refuted by defendants if they provide evidence of the absence of concerted action or provide other circumstantial evidence proving that the conscious parallel conduct does not amount to concerted action.[34]

4. Recommendations for the Government of Georgia

According to OECD roundtables, "The country just beginning to enforce its competition law may face obstacles in obtaining direct evidence of a cartel agreement. It probably will not have in place an effective leniency programme, which is a primary source of direct evidence. There may be lacking in the country a strong competition culture, which could make it more difficult for the competition agency to generate co-operation with its anti-cartel programme. In short, the competition agency could have relatively greater difficulty in generating direct evidence in its cartel cases, which would imply that it will have to rely more heavily on circumstantial evidence."[35]

On the other hand, cases of parallel conduct may force the Agency to devote significant financial and human resources to investigation. Quantitative analysis, expert testimonies and the collection of economic evidence may create difficulties even in experienced jurisdictions such as the USA. The

33 OECD, Policy Roundtables, Prosecuting Cartels without Direct Evidence, 2006, p.137.

34 Chung-Su Choe, Korean Antitrust for proof of price Fixing: Comparative Analysis with the U.S. Antitrust, Journal of Korean Law, Vol. 9, Issue 2, 2010, pp.365-366.

35 OECD, Policy Roundtables, Prosecuting Cartels without Direct Evidence, 2006, p.11.

varying approaches of economic experts and adjudicators and the unavailability of necessary information may increase the costs and enforcement errors. The inherent complexity of possible violations expressed in instances of parallel conduct poses important challenges to the Agency.[36]

Georgia is inexperienced in competition policy enforcement issues and must adopt the approach best suited to its conditions, modeled on either the EU or USA approach. The punishment of companies for parallel conduct will be a precondition for endless litigation and ambiguity, incurring related burdensome expenses for the state. It is recommended not to view parallel conduct as the agreement or concerted practice in itself or the key evidence of an unlawful conspiracy. It may become the ground of suspicion or the complementary evidence.

5. Conclusion

It is apparent that judges and theoreticians disagree on the nature of parallel conduct. Parallel conduct may constitute agreement, key evidence of agreement, complementary proof or rational economic behavior, all simultaneously.

Indeed, it is not possible to apply different meanings to the same phenomenon. Parallel conduct cannot constitute agreement. There is strong evidence that business entities are able to adapt to market conditions quickly and take the most advantageous decisions. In some cases, firms opt for parallel conduct because it is the best choice for the firm. It is not recommended to equate independent, calculated and rational decision making with agreement or concerted action. It is not possible to say that every instance of parallel conduct constitutes agreement. In some cases, parallel conduct may be considered evidence of agreement rather than agreement in itself.

Parallel conduct may serve as key evidence of agreement in very rare occasions. In most cases, economic analysis is not sufficient to detect con-

[36] Juan David Gutiérrez Rodríguez, Tacit Collusion: Theory and Case Law in Argentina, Brazil, Chile, Colombia and Panama (1985-2008), Latin American Competition Law and Policy, 2009, p.324.

spiracy and there is instead an alternative explanation for parallel conduct. In some cases, it is possible to provide very convincing economic evidence asserting that the engagement of firms in parallel conduct is not in their best interest and supposedly not the result of independent decision making. This is exceedingly difficult to prove, however. Parallel conduct may amount to complementary evidence which can form the basis of suspicion and, subsequently, proof of unlawful action when presented in conjunction with other evidence. It, of course, can be the rational economic behavior, as it provides much gain for the members of oligopoly and in the most cases is in their best interest.