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EVOLUTION OF CARTEL PRACTICE IN CROATIA

ABSTRACT

This paper analyses the development of cartel enforcement practice in Croatia since the first Competition Act was adopted in 1995, i.e. since the Competition Agency was established in 1997. Until 2009 only five decisions have been adopted which deal with the issue of cartel arrangements between competitors. The facts of these cases are presented and main legal issues discussed. The authors point out to three underlying characteristics of the ten-year enforcement practice: (a) all cartel cases concerned explicit collusion; (b) in all cartel cases there was an association of undertakings that promoted collusion and/or helped to enforce the cartel; (c) undertakings gave self-incriminating statements in the proceedings before the Competition Agency. On the basis of these characteristics the authors conclude that the fight against cartels in Croatia is still in its infancy. Some awaited legislation changes (introduction of leniency, competence of the Competition Agency to decide on fines) should make cartel enforcement more viable in the future.

Key words: cartels, collusion, competition law, enforcement, Croatia

JEL classification: K21, L41

1. INTRODUCTION

Prosecution of cartels is nowadays on the top of the list of priorities of enforcement agencies throughout the world. These hard-core infringements of competition law are non-controversial from the point of economic theory. As a rule cartels are known to cause harm with very rare exceptions and this is translated into the law with the "per se" standard. This means that there is no need to investigate their possible pro-competitive and anti-competitive effects – cartels are "per se" illegal and no analysis of their effects on the market is needed.

Two main elements of an effective enforcement policy are recognised today: an active *ex offo* enforcement (accompanied with the possibility of severe punishment) and a leniency policy. These are two sides of a coin – undertakings need to be aware that their illegal behaviour, if unearthed, will result in strict punishment. On the other hand, cartel participants are given an incentive to help prosecuting a cartel – in return for

their cooperation they get to be treated more leniently. It is common ground that no leniency policy would function effectively unless there is a credible threat of being fined by an active enforcement agency.

It is the intention of both leniency and severe fines to undermine the stability of cartels. The cartel enforcement policy has been fine-tuned several times in the US and in the European Union during the last decade or so. The trend was to offer more attractive incentives for leniency applicants to inform of cartel existence, its inner functioning and involvement of particular cartel members. But in Croatia, which first introduced relevant competition rules in 1995, leniency programme as such has never been part of its competition legislation. However, a possibility of a more lenient treatment of undertakings is extensively used by the Croatian misdemeanour courts when deciding on the fine (since the Competition Agency under current legislation has no competence on pronouncing fines and can only adopt a decision on the existence of a breach of competition rules). Misdemeanour courts are for this purpose lavishly applying the general rule of criminal law on immunity from fines and reduction of fines, and thereby perversely distorting the efficient prosecution of undertakings that breach competition rules. Evidently, this is no alternative to having a US or EU-style leniency programme.

This paper is devoted to analysing the cartel enforcement practice in Croatia since the introduction of competition legislation in 1995, i.e. since the Competition Agency was established in 1997. In spite of having a flourishing merger control practice the enforcement agency has a lot less convincing track record when it comes to cartel enforcement. We will try to look into the underlying reasons. In presenting the past practice of the enforcement agency in the area of cartels we will try to point out to some weaknesses in its substantive competition analysis as well as to identify some signs, albeit weak, of maturing cartel enforcement in Croatia.

2. CARTELS AS AN EXPLICIT FORM OF COLLUSION

Not every form of collusion between undertakings is punished by competition laws. Coordinated behaviour of competitors on the market may not only be result of their illegal interaction but it may also be the case that their parallelism, e.g. as regards prices, is due to the phenomenon of oligopolistic interdependence (Viscusi et al., 2005:87, 106). In this case starting legal action against these undertakings would mean prosecuting rational behaviour of market players. The line between explicit and tacit collusion may therefore be quite thin. The prevailing yardstick in US and EC competition law has been the existence of anti-competitive contact between parties. If contact can be proven, the parallelism in conduct may not be excused as rational economic behaviour (Woodpulp II:1993).

Cartels are a form of explicit collusion whereby competitors explicitly fix prices or output, divide markets or customers. It is an explicit form of cooperation because there is communication between undertakings on variables crucial for their competitive relationship. The proof of their anti-competitive communication serves as a proof that an “agreement” has been concluded between them which in consequence puts this behaviour within bounds of application of competition rules.

3. ECONOMIC ANALYSIS OF CARTELS

Modern economic analysis of cartel behaviour has its roots in an influential article of George J. Stigler. He was the first to identify two pre-conditions for successful functioning of cartels: first, reaching an agreement between undertakings on conditions of their cooperation, and second, maintaining cartel stability (Stigler, 1964). Even if competitors have initially agreed on the terms of cooperation, e.g. increase in price, decrease of quantity, it may be difficult to prevent some of them from "cheating" on the agreed terms. This is because, once a cartel equilibrium has been reached, there is an incentive to breach the agreement to increase profits (Motta, 2004:139). This is why a control mechanism needs to be established to check on cartel members and their adherence to cartel agreement.

Moreover, in order to secure cartel stability it has been observed that some kind of punishing mechanism is used if cheating is detected. Hence, there are three crucial elements in the life-cycle of a cartel that are identified by modern economic theory of collusion: first, reaching agreement on the terms of cooperation, second, ability to oversee the implementation of cartel terms (cartel stability), and third, punishment for departure from cartel terms (Motta, 2004; Carlton et.al 2005; Bishop et.al 2002). Cartel stability depends on the benefit that can be obtained from cheating, on the likelihood of detection of cheating and on the possibility of cartel members to punish the cheater (Bishop et.al 2002:143).

Certain economic factors have been identified which influence the sustainability of collusion. Although none of these factors is conclusive to the determination of breach of competition rules their presence serves as an indication of the existence of illegal conduct. These are structural factors (number of competitors, barriers to entry, frequency of interaction between competitors, transparency of the market), demand-side factors (whether the market is rising, stagnating or falling, whether there are significant market fluctuations), and supply-side factors (innovations market or mature market, symmetry of competitors, i.e. similar cost structure or production capacity) (Ivaldi et.al 2003:11).

4. NORMATIVE LEGAL FRAMEWORK

In Croatian competition law cartel agreements are prohibited and are considered as null and void: "agreements between undertakings..., explicit or tacit agreements, coordinated practice... which have as their object or effect distortion of competition are prohibited, in particular those by which undertakings determine directly or indirectly purchase or sale prices, or other commercial terms" (Competition Act, 2003:Article 9). Although this provision is modelled on Article 81 EC, there is a significant departure from the Community *acquis* in part of the provision of Article 9 which mentions "tacit agreements". It is a widely accepted view that tacit collusion should not be prohibited – unless there is an explicit contact between competitors conscious parallel behaviour should not be prohibited. This view is strongly promoted by antitrust economists

(Motta, 2004:137-138; Alese, 1999:381) and was also accepted by the European Court of Justice (Woodpulp II, 1993).

Although already the first Croatian Competition Act (1995) was drafted under influence of Community competition law, it was the Stabilisation and Association Agreement (SAA) signed between Croatia and European Union (2001) that introduced into the Croatian legal system, by its Article 69, an obligation for Croatia to harmonise its domestic legislation with the *acquis*. The more thorough harmonisation with the *acquis* was conducted when the second Competition Act (2003) was adopted. In addition, the SAA by its Article 70 obliged Croatian authorities to apply, to restrictive agreements and abuse of dominant position (and state aid), criteria arising from the application of Community competition rules provided there is an effect on trade between Croatia and Community.

5. CARTEL ENFORCEMENT PRACTICE IN CROATIA

5.1. Early enforcement practice

5.1.1. Orthopaedic Equipment Dealers cartel

One of the first decisions of the newly established Competition Agency was dealing with an explicit price agreement between undertakings selling orthopaedic equipment (Otto Bock Adria d.o.o. et al.:1997). Some twenty undertakings, all members of the association of undertakings (Croatian Chamber of Economy – Orthopaedic Equipment Group), adopted a decision to give a joint bid to the Croatian Health Insurance Institute which was inviting a tender for procurement of orthopaedic equipment. They also adopted a decision on a joint price list for orthopaedic equipment. After they submitted their decision for a joint bid and the joint price list to the Health Insurance Institute, the Institute immediately informed the Competition Agency of their collusive actions.

The Competition Agency adopted a decision declaring the price agreement null and void. It held that price agreements may not be excluded from the prohibition because "prices are one of the main elements of competition" and that price agreements are liable to distort competition significantly. However, it also held that arrangements between members of the association of undertakings which contribute to "promoting this field from organisational, technological, scientific, educational and other aspect is not only permitted, but also something to be whished for".

5.1.2. Split Driving Schools cartel

Another classic price cartel was prosecuted by the Competition Agency when seventeen driving schools from Split concluded an agreement on joint price for B-class driving lessons (Biserka-ST d.o.o. et al.:2001). This was done under the auspices of their association, Croatian Community of Driving Schools – Regional Committee Split. They have agreed that parties to this agreement may not publicly advertise a lower price, and they stipulated a pecuniary fine for breach of this obligation. It was the associations' role to make the calculation of an "objective and real" price, under which

it was not possible to operate. In the course of proceedings the association of undertakings stated that the implementation of agreement has not been successful in practice since "some driving schools are trying to secure work by competing with lower price".

The Competition Agency adopted a decision declaring this agreement to be prohibited and thus null and void. It found justification provided by the association on the necessity to calculate "an objective and real price" not acceptable and stated that the agreement was "significantly restricting free competition".

5.1.3. Uniform Calculation Elements case

In another driving schools case the Competition Agency had to scrutinise a cooperation agreement concluded between driving schools which agreed not on the uniform price but on "uniform calculation elements for price of one teaching hour" (Semafor d.o.o. et al.:2002). Once again this was done under the auspices of the association – Croatian Community of Driving Schools. The peculiarity of this case is that the participating undertakings submitted their agreement for approval to the Competition Agency. Even more odd was that the Agency satisfied itself that the parties made no agreement on "price". It held that the agreement on calculation elements was not illegal since it was able to ascertain from the price lists submitted by the parties that they charged different prices for an hour of driving lessons.

5.2. Recent enforcement practice

5.2.1. Demining Operators cartel

As a response to falling prices on the market for demining services, seventeen demining companies in Croatia signed an explicit agreement whereby they determined a price per square meter which particular undertaking may charge (HCR v AKD-Mungos et al.:2005). They also divided the market geographically by determining in which locations each undertaking may provide its services. This was done for the purpose of a public tender that was about to be announced by the Croatian Demining Centre (HCR), an undertaking granted to perform some public authority tasks but also a competitor on the market.

The agreement concluded by the demining undertakings contained elaborated provisions intended for maintaining cartel discipline and included means for punishing "cheaters". As in all other cases mentioned above, the agreement was signed under the auspices of an association to which each and every one of these undertakings belonged (Croatian Association of Employers – Demining Association). In this case an active role was envisaged for the association in the implementation of the cartel agreement: an executive committee of the association was due to appoint a commission which was due to carry out proceedings in case there is deviation from agreed provisions, with the final goal to compensate damages an undertaking suffered after being exposed to "illegitimate" competition by a cheater. For this purpose each party to the agreement deposited a promissory note for the amount of 1 million HRK (approx. €135,000) which were to be deposited in a bank safe opened specially for this purpose. If a

competitor, also party to this agreement, was to apply to tender for location previously granted by agreement to another undertaking, and successfully offered to provide demining services for a lower price, the "damaged" undertaking was due to be compensated from the deposited promissory note.

The Competition Agency adopted a decision declaring this to be an illegal cartel agreement, which is "always prohibited" since it has no positive effects on the market. The Agency rejected the argument of the accused undertakings that the agreement has not been applied by the undertakings, i.e. that it was not consumed. On the contrary, the Agency established in the proceedings that thirteen contracts for provision of demining services were concluded exactly "for the price" and "with the undertaking" as previously agreed by competitors. Even if the agreement was not consumed, the Agency held, it would still be deemed prohibited by the Competition Act on the basis of its aim to distort competition.

5.2.2. Bus Operators cartel

The most recent cartel case dealt by the Competition Agency involved coordinated price increase by providers of bus services on two routes in Croatia: Zagreb-Split and Zagreb-Šibenik (Autobusni promet d.d. et al.:2007). As of July 1, 2006 all seventeen competitors started charging the same price for its service although before this date price levels were different. It was within a period of only six days that they all informed the relevant bus stations of the price increase, and with no exception they all started with new prices from the above mentioned date. This was indicia enough for the start of proceedings.

Once the proceedings started the Competition Agency succeeded in securing some written proof of competitors' previous explicit coordination on price increase, which made clear that this was no tacit collusion scenario. This was a fax, sent by one of the bus operators to one of the bus stations informing them of the new prices as of July 1, 2006, with the following content: "pursuant to a written coordination (*usuglašavanje*) of price lists of June 27, 2006, as verified by bus operators-signatories of the Promemoria, the price for route Zagreb-Split shall amount to 150 HRK". It also said that "in case signatories of the Promemoria should not comply with the common price list... it shall be automatically cancelled". In addition, it was established that competitors have communicated between themselves regarding the prices and that they found that it was a necessity to "determine the price in the amount of 150 HRK as a lower level of profitability".

As in previous cases, discussed above, there was a role for the association of undertakings to be played in this case as well. The Agency was able to establish that competitors had frequent exchange of information and opinion within the Croatian Chamber of Commerce-Road Carriers Group to which all of them belonged. It was actually the Chambers' services themselves that prepared a calculation of the most suitable price.

The decision adopted by the Competition Agency rightfully determined that a severe breach of competition rules has been committed.[1] It was held that, "in spite of the absence of a written agreement" this constituted coordinated practice since "the existence of identical prices and declarations by parties... point undoubtedly to the existence of a joint intention of the parties involved". Curiously, no breach of competition rules has been established as regards the association of undertakings which in this case played an active role in coordinating the competitors' behaviour, and this is not different from the previous Competition Agency practice.

5.3. Underlying characteristics of the Croatian cartel enforcement practice

We have identified three underlying characteristics of the Croatian cartel enforcement practice: (a) all cartel cases deal with explicit collusion; (b) in all cartel cases there is an association of undertakings that promotes collusion and/or helps to enforce the cartel; and (c) undertakings give self-incriminating statements in the proceedings before the Competition Agency.

5.3.1. All cases deal with explicit collusion

In all but the last case (Bus Operators cartel) a formal, written cartel agreement on prices was concluded between competitors and this agreement was unearthed by the Competition Agency. Generally, decisions to join their market power by concluding a cartel agreement were motivated by the need to "stabilise the market", to stop their falling profits, and to counter the rising costs of doing business. It is clearly visible that undertakings were aware of the possibility of deviation from the agreed terms and they were ready to deal with this issue in a manner consistent with the modern economic cartel theory: they devised a mechanism for providing cartel discipline which included means to punish cheaters. A good example of enforcing discipline in a cartel is the Demining Operators case where special procedures were provided in case a cartel member decided to bid a lower price and thereby break the terms of cartel agreement.

Although in the Bus Operators case the Competition Agency was not able to discover a written cartel agreement between undertakings, this is without doubt also a case in which the conduct of competitors can be described as "explicit collusion". In this case, the Competition Agency was able to conclude that there has been a breach of competition rules from "fragmentary evidence": statements of some of the parties which confirmed their involvement in a cartel agreement, and some telling written evidence of illegal parallel behaviour (identical memoranda sent individually by all cartel members to bus stations). Indeed, it was possible to prove that anticompetitive contact has taken place between competitors and this trumped any arguments of innocent parallel behaviour (although this kind of argument was not entertained by the accused parties).

[1] Proceedings against the decision of the Competition Agency have been initiated by the bus operators before the Administrative Court of the Republic of Croatia. The judgement is still pending.

5.3.2. Active role of trade associations

Among the analysed cases there is not one case in which participating undertakings were not assisted by their trade association in their cartel behaviour. Admittedly, in some cases it is difficult to ascertain from the text of the decision exactly what kind of involvement was taking place. The reason for this probably lies in the fact that the liability of association of undertakings was not being scrutinised by the Agency in any of the cases and that the Agency was not interested in determining the exact role of the trade association. However, in two cases (Demining Operators case, Bus Operators case) the active role of associations in the cartel was so obvious that the lack of reaction of the Agency in this regard must be seen as incorrect application of substantive law.

In the Demining Operators case, as can be seen from the facts of the case as described above, it was the trade association that provided for a mechanism to punish undertakings which deviated from the collusive agreement. The promissory notes that undertakings were supposed to issue as collateral in case of breaching the cartel agreement were to be deposited in the associations' bank. Also, the executive committee of the association was to establish a three member board which had to adopt a decision in favour of undertakings that suffered damage from the "cheating" behaviour of other competitors and a decision to collect compensation on the basis of the deposited promissory notes.

In the Bus Operators case, as can be seen from the facts of the case as described above, the role of the trade association was to calculate the most appropriate price which can then be charged by undertakings, which took into account rising costs and other negative trends on the market. In addition, regular meetings of competitors were organised by the association in which associations' employees were given the task of making minutes of the meetings.

5.3.3. Self-incriminating statements

In the above described cases it was not infrequent during the proceedings before the Competition Agency that undertakings themselves gave self-incriminating statements. For example, in the Bus Operators case one of the accused undertakings voluntarily explained that they (i.e. competitors) had regular meetings in the trade association where they discussed and "coordinated their behaviour as regards issues of transport security, terms of provision of services, the issue of fuel, and of course ... the price of services". He reasoned that since the road transport of passengers was a "sensitive" and "specific" industry this kind of communication between competitors was surely necessary. Furthermore he pointed out to the fact that there existed between the service providers in this industry a "long-term practice of business communication, exchange of information and experience, commercial analysis etc.".

In the Demining Operators case the undertakings accused of concluding a cartel agreement argued to their defence that the circumstances on the market were quite unfavourable and that their goal was to secure "survival on the market and evenly

distributed utilisation of capacity", as well as to stop "the prices of demining services from falling".

From these typical examples we can not only observe that collusion is seen by competitors as a remedy for negative market trends but what is striking is the complete ignorance of the existing competition rules. It seems that appropriate legal advice has not been given to the undertakings against which the Competition Agency started proceedings. On a more cynical note we may question the very need of the undertakings for some legal advice – taking into account the toothless nature of the cartel enforcement in Croatia under the current competition legislation.

6. CONCLUSION

Cartels between competitors in Croatia are no different from the cartels in any part of the world. However, there are parts of the world where fight against cartels is more efficient than in Croatia. On a more soothing note we might say that to achieve effective cartel enforcement takes time and resources, and that the efforts invested so far by the Competition Agency are not insignificant. It is true that the current competition rules prevent to a certain extent the war against cartels to be waged in full. It is true that the Competition Agency has no competence to decide on fines and that there are no legal rules that provide for leniency. This contributes to the image of the cartel enforcement being toothless.

This is still an early phase of enforcement of competition rules in Croatia. It has been a bit more than ten years now since the Competition Agency has been established and some crucial legal instruments are still missing from the competition legislation (e.g. leniency). But once the new, improved legislation is passed the list of excuses will be shorter and shorter. We believe that weak competition culture may only be remedied by vigorous enforcement: this means "big" cases and significant fines. Unfortunately, as we are well aware, this will lead to the more or less abrupt disappearance of the remarkable self-incriminating statements.

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