Too much information! Recent competition law cases in the banking sector

This article highlights the need for financial institutions to control the exchange of competitively sensitive commercial information, as well as the potential challenges raised by amendments to the UK Cartel Offence.

INTRODUCTION

Infringements of competition law can lead to significant fines and in certain jurisdictions (including the UK) may even lead to imprisonment and/or fines for the individuals involved in the most serious forms of infringement such as price-fixing. Agreements that infringe competition law will be void and unenforceable, even in the absence of enforcement action.

After an extended period when the banking sector was relatively free of competition law scrutiny, the financial crisis led to heightened enforcement on a global scale. The range of enforcement activity, coupled with the tendency for companies under investigation to settle rather than contest actions, has led to greater legal uncertainty over the extent to which common commercial practices may in fact be unlawful.

This situation has been aggravated further in the UK by a recent rather disjointed extension of criminal cartel law. Although the crisis is finally abating, banks should therefore continue to be vigilant to ensure that common commercial practices, such as loan syndication, do not infringe competition law.

BACKGROUND

Historically, European competition law enforcement tended to avoid intervention in financial markets, preferring to focus instead on combating cartels in traditional manufacturing industries such as cement, chemicals, glass, graphite electrodes and power cables. While the UK competition authorities, in particular, have undertaken a number of retail financial services market investigations in recent years (covering, for example, store cards, small business banking and home credit), wholesale financial markets were largely immune from scrutiny, presumably on the grounds that they were viewed as functioning well for their (primarily highly sophisticated) customers. The Austrian banks cartel decision of 2002, in which the Commission fined eight Austrian banks €124m for systematically fixing interest rates for deposits and loans, was an exception to this rule. It should be seen as an outlier case, however, that reflected a failure by the participating banks to adapt long-standing and entrenched business practices that became subject to EU competition law following the entry of Austria into the EU in 1995. The onset of the financial crisis in 2008 changed this, as the political pressure on competition authorities and other regulators to “do something”, combined with internal measures within banks to review long-standing practices with a more sceptical eye and where appropriate report them to the authorities, resulted in new and wide-ranging competition inquiries.

Although the acute phase of the financial crisis has now passed and signs of economic recovery are emerging, the rather slow pace of competition law enforcement means that the results of this heightened activity are only now emerging. The heightened level of scrutiny shows little sign of abating, making it as important as ever for banks to be aware of the continued competition law risks associated with carrying on certain forms of business within the competition regulators’ spotlight.

Although it is not possible to cover all recent developments in one relatively short article, we hope to highlight the need to control the exchange of competitively sensitive commercial information, as well as the potential challenges raised by the UK cartel offence amendments.

PROHIBITION OF ANTI-COMPETITIVE AGREEMENTS

Article 101(1) of the Treaty on the Functioning of the European Union (TFEU) prohibits agreements and concerted practices which have as their object or effect the prevention, restriction or distortion of competition in the EU, and which affect trade between EU member states, unless they can
be shown to deliver countervailing efficiencies (in which case they are viewed as exempt from the prohibition, under Art 101(3)).

The European Commission (Commission) is responsible for the enforcement of this prohibition at the EU level, with national competition authorities (NCAs) having the power to enforce it at the member state level. NCAs also retain the power to enforce their own national competition laws, which generally contain equivalent prohibitions to Art 101(1).

Any agreement or concerted practice caught by Art 101(1) TFEU is void and unenforceable and, depending on the seriousness of the infringement, may attract enforcement action by the Commission or an NCA, which can lead to the imposition of substantial fines. In the absence of enforcement action, the legality of an agreement may be challenged by private parties before the courts of a member state, potentially resulting in the award of damages or other relief, in addition to preventing enforcement of the underlying agreement.

Certain types of agreement and concerted practice are viewed as infringing Art 101(1) TFEU “by object” and therefore presumptively unlawful. These include price-fixing, market or customer allocation, limitation of supplies or output and bid-rigging. This list is not exhaustive, however, and the Commission and NCAs have tended to take an expansive approach to “object infringements”, given the fact that there is no need for them to prove any adverse market impact in such cases. This tendency has been evident in cases in the banking and financial services sectors, particularly in cases involving information exchange.

The exchange of competitively sensitive information has long been considered a potential infringement of Art 101(1), but until relatively recently, information exchange was generally viewed as an “ancillary” aspect of a wider infringement, rather than an infringement in and of itself. Regulators’ stance on the position has hardened, however, as confirmed in the Commission’s 2011 guidelines on the applicability of Art 101 TFEU to horizontal cooperation agreements, OJ 2011/C 11/01 (Horizontal Guidelines). These made it clear that the Commission viewed the mere “communication of information among competitors” as capable of constituting an infringement, in circumstances where it reduced strategic uncertainty in a market.

Furthermore, the Commission made it clear that such communication would be viewed as an infringement of Art 101(1) by object if the information exchanged was individualised and related to future prices or quantities.

The case law makes it clear that the threshold for an infringement of Art 101(1), through the exchange of information, can be easily met: simply attending a single meeting where a company discloses its pricing plans to its competitors may be caught by Art 101(1), even absent an explicit agreement to raise prices. When a company receives strategic data from a competitor it will be presumed to have accepted the information and adapted its market conduct accordingly, unless it responds with a clear statement that it does not wish to receive such data.

While some forms of information exchange remain permissible, as a general rule of thumb, any information that a company would not in the normal course of business want its competitors to know is likely to be competitively sensitive information; its exchange therefore, is likely to raise competition concerns. Care should therefore be taken over any disclosure of such information.

**THE OFT’S RBS/BARCLAYS CASE**

It is important to recognise that competition law concerns do not arise only from the systematic exchange of sensitive market information between a large number of competitors. In fact, isolated communications between individuals within competing companies may also give rise to competition law liability.

This was clearly illustrated by a 2011 infringement decision by the UK Office of Fair Trading (OFT) against Royal Bank of Scotland Group plc (RBS) and Barclays plc. In its decision, the OFT found that, between October 2007 and February or March 2008, individuals in RBS’s professional practices coverage team disclosed generic, as well as specific, confidential and commercially sensitive future pricing information to their counterparts at Barclays, with the object of facilitating the coordination of the banks’ respective pricing for loans supplied to large professional services firms. Although the pricing information flowed only one way, i.e., from RBS to Barclays, the OFT viewed the disclosure by the individuals at RBS as an attempt to influence Barclays’ pricing and, in turn, to reduce price competition between the two banks. The OFT held that it was entitled to presume that the information received from RBS was taken into account by Barclays when pricing future deals and that RBS could reasonably have expected such an outcome.

As a result, the necessary elements for an infringement of Art 101(1) TFEU and its domestic law equivalent were present.

In reaching its decision, the OFT echoed the Commission’s general approach to information exchange noted above, in stating that sharing amongst competitors of pricing or other information of commercial or strategic significance, which they would otherwise keep secret as confidential business information, is likely to amount to an infringement as it increases transparency in the market about the undertakings’ competitive behaviour and thereby substitutes practical cooperation for the risks of competition. The OFT went on to state that the mere disclosure and receipt of pricing information to competitors would almost certainly be anti-competitive where it is capable of influencing their future conduct on the market.

Despite the short duration of the infringement, and its limited scope, RBS was fined £28.59m for its conduct. Barclays escaped a fine on the grounds that it had voluntarily informed the OFT of the conduct.

**THE COMMISSION’S INTEREST RATE DERIVATIVES CASES**

While the OFT fine in the RBS/Barclays case was large by UK standards, it is dwarfed by the fines that have been levied by the Commission in recent cases involving financial companies. Most notably, in December 2013, the Commission announced that it had imposed fines totalling €1.7bn earned by the banks’ counterparts at Barclays, with the object of facilitating the coordination of the banks’ respective pricing for loans supplied to large professional services firms. Although the pricing information flowed only one way, i.e., from RBS to Barclays, the OFT viewed the disclosure by the individuals at RBS as an attempt to influence Barclays’ pricing and, in turn, to reduce price competition between the two banks. The OFT held that it was entitled to presume that the information received from RBS was taken into account by Barclays when pricing future deals and that RBS could reasonably have expected such an outcome.

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on eight financial institutions (Barclays, Citigroup, JPMorgan Chase, Deutsche Bank, RBS, Société Générale, UBS and the broker RP Martin) for participating in “cartels in the interest rate derivatives industry”. Specifically, the Commission found that four of these banks participated in a cartel to distort the pricing of Euro interest rate derivatives between September 2005 and May 2008 and that five of the banks and RP Martin participated in, or in the case of RP Martin facilitated, a cartel in Yen interest rate derivatives at various times between 2007 and 2010. In each case, notwithstanding the Commission’s liberal use of the word “cartel” to describe the parties’ conduct, it based its infringement finding on the fact that traders of participating banks had frequently exchanged commercially sensitive information, including their submissions for the calculation of EURIBOR and Yen LIBOR (respectively) and trading positions.

It is important to note that the Commission’s decision of December 2013 arose from a settlement, under which parties admit their infringement in return for reductions in their fines of 10%. Crédit Agricole, HSBC and (as far as the case related to Euro interest rate derivatives) JPMorgan Chase declined to settle with the Commission, as a result of which the Commission issued statements of objection to those three banks on 20 May 2014. The Commission also issued a statement of objections to broker-dealer ICAP on 10 June 2014. These companies will now have the opportunity to respond to the Commission’s charges before any final infringement decision can be issued.

**IMPLICATIONS**

While the full details of the infringing conduct in the interest rate derivatives cases are not yet in the public domain, it is clear that both of the cases described above arose from individuals within banks acting in a manner that went beyond the proper performance of their functions. As a result, it seems reasonably uncontroversial that the nature of the information exchange that arose in these cases was inherently likely to raise competition concerns, on the grounds that the exchanges had a clear object of restricting competition and that this was distinct from the underlying legitimate business of, respectively, providing loans or trading derivatives.

The situation may be less clear cut where information exchange is an ancillary aspect of a legitimate commercial practice. For example, while the procedure provided for by a “market disruption” clause in a LIBOR (or EURIBOR) denominated loan agreement clearly has a legitimate underlying purpose, the fact that it involves lenders notifying a new rate to the lenders’ agent that reflects the lender’s actual (and commercially confidential) cost of funds means that care needs to be taken to avoid such information being disseminated more widely. (Since information on a lender’s costs may be viewed as “strategic” in competition law terms, on the basis that a company’s costs are a key factor in its pricing decisions and sharing it with competitors may therefore reduce strategic market uncertainty. As a result, depending on the circumstances, the exchange of such information between competitors may still infringe Art 101 on the grounds that it has the effect of restricting competition.)

While Art 101(1) will not be infringed by the mere fact of a lender sharing such information with the agent and in their capacity as such, concerns would arise from onward dissemination of the information to other lenders, or indeed to the agent’s own lending arm, given its strategic nature. Fortunately, there is no obligation on an agent to communicate one lender’s cost of funds to other lenders and, indeed, agents are likely to be under an implied duty of confidentiality not to do so. In addition, borrowers are unlikely to act as a conduit for such problematic information exchange between lenders, since they will tend to have access only to the aggregated “blended” rate offered by all lenders, rather than a specific lender’s rates. It is nevertheless advisable for lenders to guard against improper use of information disclosed under a market disruption clause, including by explicitly prohibiting onward dissemination by agents and by maintaining appropriate information barriers to prevent the use of such information by individuals within the agent institution’s lending arm. It follows from this, that the agent should refuse any request from a lender to pass on such information to other syndicate members.

**THE UK CARTEL OFFENCE**

As well as providing for the imposition of civil penalties on companies that enter into anti-competitive agreements, some countries’ national regimes make participation in certain forms of anti-competitive practices a criminal offence. While successful prosecutions of individuals remain rare in the EU, the potential for the parallel application of criminal and civil law to restrictive agreements can cause complications, even in the absence of prosecution.

Since 2003, it has been a criminal offence in the UK for an individual to agree with one or more other individuals to make or implement arrangements between at least two undertakings which, if operating as the parties intend: (i) directly or indirectly fix the price of a product or service by those undertakings; (ii) limit supply or production of goods or services by those undertakings; (iii) divide the supply of products or services between those undertakings; (iv) divide customers between those undertakings; or (v) constitute bid-rigging arrangements. On conviction, an individual guilty of this offence (the Cartel Offence) may be imprisoned for up to five years and/or face an unlimited fine.

Since 1 April this year, a prosecutor need no longer demonstrate that an individual acted dishonestly for the offence to be committed. This significantly broadens the scope of the offence and, due to the deliberately formalistic nature of the offence, potentially catches participation in agreements that would not raise concerns under civil competition law, due to a lack of effect on competition or the presence of overriding efficiencies.

There are a number of exclusions and defences to the Cartel Offence. Under the exclusions, an individual will not commit the offence if:
- customers are given “relevant information” about the arrangements entered into between those for the supply of the product or service, either directly or broad publication in the London, Belfast or Edinburgh Gazettes. “Relevant information” is defined as: (i) the names of the undertakings to which the arrangements relate; (ii) a description of the nature of the arrangements which is sufficient to

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show why the Cartel Offence may apply; and (iii) the products or services to which they relate. This exclusion applies if relevant information is provided to customers;

- bid-rigging arrangements are made known to the person requesting the bids;
- details of the arrangements are published in the specified manner before they are implemented; or
- the agreement is made to comply with a legal requirement.

If no exclusions apply, an individual will have a defence where one of the following applies:

- at the time of making the agreement, it was the intention of the individual entering into it that it would not be concealed from customers at all times before they enter into agreements for the supply to them of the product or service;
- at the time of making the agreement, the individual entering into it did not intend for it to be concealed from the UK’s new competition authority, the Competition and Markets Authority (CMA); or
- prior to making the agreement, the individual entering into it took reasonable steps to ensure that its nature would be disclosed to legal advisers for the purpose of obtaining legal advice about doing so before its making or implementation.

While it is clear that the intention behind the Cartel Offence is (as its name suggests) to enable the prosecution and conviction of individual participants in hard-core cartel activity, it is conceivable that the removal of the dishonesty requirement could lead to an unwittingly catching common commercial practices that are benign and in many cases pro-competitive.

For example, arrangements that involve the pooling of risks or supplies between a number of providers, such as syndicated loan agreements and underwriting agreements, could be viewed as arrangements that "divide between [undertakings] A and B the supply in the UK of a service". In addition, a syndicated loan agreement could be viewed as an arrangement to "directly or indirectly fix a price for the supply...of a...service", given that the members of the syndicate agree a single interest rate and repayment schedule for the borrower, and share the provision of a loan accordingly. On this analysis, any agreement between two or more individuals (for example, an employee of a facility agent and of a lender) to make or implement such an arrangement could be an offence. The fact that syndication agreements are very common in the market, and are an efficient and generally pro-competitive means by which a borrower can obtain a single price to access a pool of lenders, unfortunately has no bearing on this analysis, given the deliberate exclusion of such considerations from the offence.

Fortunately, it is likely that, in most cases, syndicated loan agreements will be excluded from the offence on the grounds that the borrower will be provided with the required "relevant information" before entering into the loan agreement. While the position may be less clear cut if any lender assigns or transfers its portion of the loan to another lender without the knowledge of the borrower, since in such circumstances the borrower would no longer know "the names of all undertakings to which the arrangements relate", syndicated loans based on LMA standard forms provide for a procedure for assignment which necessarily ensures that the borrower is aware of the identity of the new lender in the event of an assignment or transfer. Although execution of a sub-participation agreement may not trigger this procedure, the underlying loan arrangement would not be materially altered in such a scenario and so no new relevant "arrangement" within the meaning of the Cartel Offence would arise.

In May 2014, the LMA issued a notice on the application of competition law to syndicated loan arrangements, in which it noted the importance of seeking and keeping a record of the prior consent of the borrower to any proposed contact between competitors to protect lenders from criminal prosecution. More generally, the LMA noted the importance of seeking legal input into appropriate compliance measures to avoid competition law infringements.

Of course, any syndicated loan agreement that is not on standard LMA terms may not have the same safeguards and other forms of financing agreement that involve elements of risk sharing or allocation could in principle give rise to issues under the Cartel Offence. While it is highly unlikely that the CMA would actually pursue a prosecution against individuals for facilitating the execution of such agreements, provided that there is a clear underlying legitimate purpose, there remains some risk that agreements which on their face may fall within the scope of the Cartel Offence could be tainted by illegality and hence unenforceable as a matter of public policy. This could potentially lead to lenders being unable to recover loans or enforce key terms of such agreements. While this may seem far-fetched, and courts are likely to be reluctant to entertain claims where a loan agreement was entered into on standard terms in the normal course of business, the potential sums involved may mean that a debtor or insolvency practitioner wishing to avoid payment may have a significant incentive to run such an argument in future litigation.

CONCLUSION

Financial markets run on information. Market participants should be familiar with the concept that some information may not be shared, whether because it is "inside" information or commercially sensitive "strategic" information. As noted above, the extensive interpretation given to Art 101(1) TFEU and domestic law equivalents by the Commission and NCAs means that any exchange of information falling into the latter category, even if it does not relate to pricing, risks infringing competition law, unless the exchange can be shown to be a necessary element of a lawful arrangement. The good news is that the steps needed to ensure that the use of such information does not give rise to competition law liability should generally be consistent with, and support, wider compliance procedures designed to prevent the unlawful dissemination and use of sensitive commercial information.