Syndicated financial instruments and antitrust: the recent price-fixing investigation related to derivative products in project-finance transactions in Spain

Pedro Callol*

Banks; Derivatives; National competition authorities; Price fixing; Project finance; Spain; Syndicated loans

Context of the case. Competitor collaboration as a device to enable competition.

Co-operation between competing financial entities is an important feature of the banking sector. In large-volume financial transactions, co-operation is perceived as being of the essence to achieve the goal of spreading risk amongst various market participants. Co-operation in the framework of syndicated products has been naturally accepted traditionally, as has been the case, for instance, in the insurance and reinsurance markets. Like any other type of firm collaboration, however, co-operation in the banking sector invariably leads to contact between competitors with the risks such contact implies in terms of scope for sensitive information sharing or concertation.

In recent times there seems to be a still shy, but increasing antitrust agency focus around the area of financial transactions involving co-operation between competing banks. In its 2017 Management Plan, the European Commission signalled its concern with close co-operation in the credit derivatives market following action against the International Swaps and Derivatives Association (ISDA). The European Commission also announced at the time that it would commission an independent study on potential competition issues of loan syndication.[1]

Earlier in 2016, the British Financial Conduct Authority disclosed that it had found out about conduct in the framework of syndicated lending potentially infringing competition law, as a result of which it issued formal "on notice" letters resulting in *firms undertaking several initiatives to strengthen their competition law compliance, including more robust training for market facing staff.*[2]

As in any other form of competitor co-operation, financial transactions in which banks get together to confirm a single offer should satisfy certain conditions ensuring that any co-operation does not go beyond what is required to achieve a legitimate competitive purpose. The broad principle as set out by the European Commission in its Horizontal Cooperation Guidelines is that a joint commercialisation agreement amongst competitors *is normally not likely to give rise to competition concerns if it is objectively necessary to allow one party to enter a market it could not have entered individually or with a more limited number of parties than are effectively taking part in the co-operation, for example, because of the costs involved.*[3]

The above rationale is applicable to any competitor collaboration, including in financial markets. The world of finance is a competitive one, and there is no reason in principle for banks not to compete amongst each other, unless such co-operation is necessary to enable the existence of a given market. The justification for competitor collaboration in the finance sector is based, for instance, on the fact that the dimension or risk of a given transaction justifies various competitors getting together as a device to create a market that would otherwise not exist or (perhaps) it would only exist in objectively comparably worse financial conditions for borrowers.

The purpose of this short article is not to dwell on the details of the syndicated loans and syndicated financial products and competition at the different stages of the credit formation/syndication[4]; but, rather, to provide a brief comment on the recent antitrust decision (Decision) of the National Competition and Markets Commission of Spain (CNMC) of 13 February 2018, fining the accused banks (Santander, Sabadell, Caixa, BBVA) €91 million. The Decision has been issued in application of art.101 TFEU (and the equivalent national law provision) making it a relevant precedent EU-wide. Indeed, if confirmed by the courts (the accused banks have already announced that they will apply for judicial review of the Decision) the Decision has potential to disrupt the way banks have traditionally done business in various areas.

* Callol, Coca & Asociados, Madrid.

[1] Tender issued in November 2017: *http://ted.europa.eu/udl?uri=TED:NOTICE:133880-2017:TEXT:EN:HTML* [Accessed 28 March 2018].

[2] *https://www.fca.org.uk/publication/documents/rru-february-2017.pdf* [Accessed 28 March 2018]. In the US, the issue has been scrutinised in the context of litigation (*CompuCredit Holdings Corp. v Akanthos Capital Management, LLC* 677 F.3d 1042 (2012)).

[3] Point 237 of the Communication from the Commission—Guidelines on the applicability of Article 101 of the Treaty on the Functioning of the European Union to horizontal co-operation agreements.

[4] For some detail on these topics, see O. Bretz, "Competition law and syndicated loans: identifying the regulatory risks" [2015] Comp. Law 231, available at: *https://www.jordanpublishing.co.uk/system/froala_assets/documents/1553/CLJ_article_-_Comp_Law_and_Syndicated_Loans.pdf* [Accessed 28 March 2018].

The antitrust case against a syndicate of banks allegedly fixing prices of underlying derivatives

The Decision refers specifically to the derivative products ancillary to syndicated loans, the goal of which is to insure borrowers against fluctuations of the interest rate to which the cost of the syndicated loan is indexed. The Decision considers that the accused banks have fixed the cost of the derivative products in a manner and at a level that breaches art.101 of the TFEU and the national competition law equivalent (art.1 Competition Act).

The factual part of the Decision sets out the context by making various explanatory considerations around credit syndication. It is perhaps worthwhile noting that the Decision seems to tactfully avoid getting into any critical analysis of credit syndication as a form of collaboration. There is no analysis of why or to what extent competitor collaboration is or could be justified on the facts.

The Decision indicates that at least one of the four accused banks has participated, individually, in the majority of the syndicated loans in Spain in the last few years (depending on the year considered), signalling that the accused banks are very important players, although no bank individually appears to have anything coming close to dominance (as could be expected). The Decision also explains in a rather didactic fashion the workings of the caps and collars and derivative products entered into to insure syndicated loan related interest rate risks.

An interesting part of the facts refers to the moment of entering into the derivative agreement to cover the interest rate fluctuation risk. Immediately before entering into the derivative agreement to cover the mentioned risk, the banks talk to each other with a view to fixing the price or rate applicable as floor. The Decision relies on evidence of conversations between bankers. Unfortunately, the non-confidential version of the Decision does not provide many details on the specifics of those communications, which surely would be juicy for the reader.

The Decision also refers to the existence of an arbitral award between the complainant in the administrative proceeding and one of the accused banks (Caixabank), regarding the derivative product entered into between the borrower and the bank to insure against the rate fluctuation risk. Again, the non-confidential Decision completely censors the contents of the award; however, the presence of arbitral awards seemingly adjudicating controversies between banks and borrowers in this context is, or may be, of some significance, as will be seen.

The legal grounds of the Decision analyse two types of conduct. First, the conduct of the accused banks regarding the co-ordination to fix the economic conditions of the derivative used as hedge against the risk of fluctuation of the interest rate; secondly, the existence of illegal tying of the credit product with the derivative product.

Starting with the second conduct, the Decision finds that the accused banks force borrowers in project finance transactions to contract with the same syndicate of banks the derivative product covering against the rate fluctuation risk. On that point, the Decision concludes that the investigation does not enable a conclusion that the banks have acted illegally in connection with this specific conduct. However, the Decision also states that the fact that banks force the borrower to contract with them the derivative product is an element that facilitates the collusion point which forms the backbone of the accusation, and which is discussed below.

Regarding the possible co-ordination to fix the economic conditions of the derivative product used to protect against fluctuations of the interest rate:

1) As already pointed out, the Decision does not question the rationale of the syndicated lending (it does not question the need for competing banks getting together to offer a loan). Nor does it question the fact that pricing of the derivative product insuring against fluctuations in the interest rates must be a single, common price. Assuming that a common price is necessary, the Decision scrutinises the fairness of the pricing level. We come back to that below.
2) The Decision acknowledges that the methodology of calculation of the derivative "market" price varies from bank to bank and is not easily identifiable. The price cannot be known by the customer, who may (if the customer had specialised advice) estimate it, although not with absolute accuracy.

The assessment of the CNMC seems somewhat unusual from an antitrust standpoint. The Decision, as indicated, does not contain any analysis of the merits of the joint selling. Failing that, the Decision scrutinises the manner in which the joint selling is taking place and, particularly, the pricing level at which the joint selling is taking place. The analysis process might have been the reverse: focus on the legality of the joint selling as such (in this case, the legality of the joint offering of the derivative product by the members of the syndicate of banks); if the joint selling is legal (see initial consideration above resorting to the European Commission Horizontal Guidelines—the typical rationale under antitrust law would be because without joint selling the banks would not be able to offer the product at all), then price-fixing would be justified; conversely, price-fixing would be illegal if joint selling is not justified. It seems the CNMC wished to avoid the "hot potato" of having to decide on whether syndicated loans and their ancillary derivative products are justified as a form of joint selling. The point was raised by one of the banks in the proceedings (stating that because credit syndication—and joint pricing of the ancillary derivative product—is legitimate, the pricing level is not an antitrust issue). However, the Decision does not really tackle the

argument, ignoring any analysis of whether or not the joint selling should be allowed and focusing instead, as already indicated, on the *manner* of the joint selling, which according to the Decision takes place in an illicit way, by exploiting an information asymmetry which results in a price for the customer above the market price.

The Decision relies on a recent judgment of the European Court of Justice of 23 January 2018, *Hoffmann la Roche v Autorità Garante della Concorrenza*,[5] which refers to deceptive conduct infringing art.101 TFEU in the context of pharmaceutical marketing authorisations. In that matter, Roche and Novartis agreed to disseminate deceptive information that the therapeutical use of Avastin for eye care would not be entirely safe. Roche and Novartis were, respectively, licensees for Avastin and the competing product—Lucentis—(the licensor of both products being another company—Genentech), so that by virtue of the licensing system both Roche and Novartis could have bound themselves not to compete in Italy. The CNMC Decision relies on [71] of the ECJ judgment, which states that the focus of restraints ancillary to a main restraint must be whether the main restraint (in that precedent, the licence) would be *possible* without the ancillary restraint (the joint dissemination of the information). If the response to that question is that the main restraint would be possible (even if less profitable or less convenient), then the ancillary restraint would not be justified. On that basis, the CNMC reaches the conclusion that although the joint selling and pricing by the banks of the derivatives is not questioned, pricing above the market price is not an allowed ancillary restraint, as it is not strictly necessary for the main restraint, but merely makes it more profitable:

> "even accepting that a single price for the derivative product were required, it would be required that the price offered is the best of the possible prices, i.e., the price in market conditions that ensures fulfilment of the condition that no cost for the client is implied and to achieve that the process of determination of the price must be clear, and transparent for the client".[6]

The Decision quotes [71] of the commented *Roche* judgment, cited. However, the Decision does not quote [72] and [73] of that judgment, which state that the dissemination of deceiving information had effects beyond the parties to the main restraint, i.e. it sought to influence third parties, particularly medics; and that the dissemination of deceptive information could not be considered as objectively necessary for the licence. It may be questioned whether borrowers in syndicated loans (the same entities that purchase the derivative at stake in the Decision) are third parties; and it appears debatable that the joint pricing system chosen is not objectively justified (at least from a purely antitrust standpoint).

No doubt the CNMC considers it appropriate to intervene in a bargaining process that takes place between buyer and seller (lender and borrower, even if in this case the lender is a syndicate of banks, the validity of whose syndication, as previously discussed, has not been scrutinised). To achieve that end, the Decision appears to dissociate the price calculation mechanism as something distinct from the joint selling. In that context, the CNMC seeks to ensure that the pricing level is fair or oriented to market price. This seems novel, as antitrust (assuming that there is no illegal joint pricing mechanism, which the Decision does not question) would generally not be expected to intervene in the price level (other than in situations of predatory, discriminatory, exclusionary, excessive pricing by dominant companies, which is not the case here as the Decision is a purely art.101 TFEU and national law equivalent, case). Furthermore, when setting prices, any seller plays with the information available to that seller with the goal of pricing optimally. Naturally, the (civil, consumer protection, financial markets) laws require that some key information is disclosed in the framework of a transaction (on matters such as known product defects, legal or economic charges, etc.). Indeed, as pointed out above, it seems that the financial entities' conduct is being contested under contract law (see mention pointed out above to arbitral awards between the complainant and some banks). But, generally speaking, the internal information on price elaboration, costs, etc. is not required to be disclosed under antitrust law (save perhaps in exceptional circumstances of dominance and in regulated markets), which is generally accepted as a natural part of the bargaining process. Indeed, forcing the disclosure of that kind of information amounting to strategic business secrets may threaten key aspects of product differentiation and profit maximisation, which is the quintessential ultimate goal of companies in free markets).

One potential policy risk behind the Decision is that competition authorities may start to question pricing levels as "unfair" in instances of agreements, rather than restricting this possibility to rather exceptional cases of abuse of dominance.

The Decision relies on the fact that an information asymmetry has been (illicitly) exploited, though the doubt arises as to whether civil law or financial regulation would not be better suited to address the concerns.

Unsurprisingly, the matter has received ample coverage from the press nationally and internationally. Beyond the immediate repercussions of the case on syndicated loans in the project finance transactions investigated, the legal principles relied upon by the Decision could arguably be applied to other project finance transactions in Spain, to the same banks as those accused, but also to other banks operating similarly (in practice, most banks). Likewise, those legal principles may apply to transactions relying on comparable mechanisms beyond Spain. The Decision

[5] *Hoffmann la Roche v Autorità Garante della Concorrenza* (C-179/16) EU:C:2018:25.
[6] Free translation from the Spanish original.

itself states that the conduct has had economic effects (as the price of the derivatives is above the "market" price), seemingly seeking to pave the way for antitrust damages claims. Under Spanish law arguably the starting point for statute of limitations period accounting is the Decision (moment when the harmed party knows the basic factors causing harm), which means that syndicated loans subject to this type of ancillary derivative transaction may potentially be at the core of damages claims even if the transactions go well back in time for years or decades.