COMPETITION POLICY INTERNATIONAL

CPI Antitrust Chronicle

August 2011 (2)

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I. INTRODUCTION

It will have taken policy makers an extra financial crisis to realize that financial markets should not be hostage of the predictions of the "big three" credit rating agencies (the "CRAs"), i.e. Moody's Investors Services, Standard & Poor's, and Fitch ratings. Pluralism in ratings is the new mantra of regulatory proposals in the European Union ("EU") and the United States.[2] And controversial proposals abound, with calls to dismantle the existing CRAs or to set-up public, State-sponsored rating agencies.[3]

Interestingly, while all the evidence points to the existence of a competition problem in the rating industry, almost nothing has been written on whether the CRAs could be amenable to antitrust scrutiny. This is all the more surprising. From an economic standpoint, the credit rating industry exhibits structural—*i.e.*, a tight oligopoly—and behavioral—*i.e.*, ratings parallelism—features that routinely give rise to antitrust concerns. And from a legal standpoint, the competition rules are a very elastic instrument, which can: (i) be triggered *ex officio* under flexible conditions and at little costs; and (ii) lead to the adoption of remedies that often come close to standard regulatory obligations.

In this context, this paper seeks to assess the possibility of competition intervention in the credit ratings industry. Given that competition law does not prohibit oligopolistic market structures as such, a necessary trigger for antitrust enforcement is the existence of a course of conduct that either constitutes unlawful collusion under Article 101 the Treaty on the functioning of the EU ("TFEU"), or abuse of dominance under Article 102 TFEU. In the following sections we formulate hypothesis of infringements under Articles 101 and 102 TFEU, gauge their factual plausibility, and assess their legal vulnerability to competition proceedings.

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[2] *See* European Commission, *Public Consultation on Credit Rating Agencies*, p. 14 (5 November 2010): (http://ec.europa.eu/internal_market/consultations/docs/2010/cra/cpaper_en.pdf).

[3] *Merkel pour une agence de notation européenne* LESOIR (17 July 2011): http://www.lesoir.be/actualite/economie/2011-07-17/merkel-pour-une-agence-de-notation-europeenne-851567.php.

Obviously, it would be beyond the scope of this paper to screen the various activities of CRAs that may give rise to a competition infringement.[4] We thus focus only on whether CRAs' recent downgrading of sovereign ratings can trigger antitrust liability.[5]

On this, some background information is in order. Back in 2007, the CRAs were lambasted for: (i) their blind optimism in relation to Subprime securities; and (ii) for the length it took them to warn investors of the dangers associated with such securities. In the aftermath of the Subprime crisis, the pendulum swung. CRAs became extremely pessimistic and anticipative in their ratings.[6] This change towards a more *ex ante* approach of ratings magnified the possibility of errors.

With this new paradigm, CRAs are now suspected of devising flawed predictions (some talk of "self-fulfilling prophecies"). Within the space of a few weeks, the big three CRAs have successively downgraded the sovereign ratings of five European countries (Greece, Ireland, Portugal, Italy, and Spain), and plunged the financial markets in a state of profound distress. Those decisions, and more generally the rating of sovereign countries, are the activities subject to review in this paper.

II. COLLUSION

Almost inevitably, the similar timing and content of CRAs' downgrading decisions raises suspicions of collusion. EU Commissioner Reding explicitly alluded to this with the following words: "It cannot be that a cartel of three U.S. firms decides the fate of whole economies and their citizens."[7]

On closer examination, the credit rating industry exhibits several patterns of parallel behavior. This is first true in relation to the timing of rating publications. Notwithstanding that the CRAs are free to adjust their ratings when they see fit,[8] the number of sovereign ratings adjustments issued by the three agencies has increased exponentially these last few months. Figure 1 below depicts the quasi-simultaneous acceleration of rating adjustments in relation to the five EU countries that have been the most severely hit during the sovereign debt crisis.

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[4] Most agreements, including cooperation agreements, participation in industry associations, etc. may raise competition issues. The same is true of other types of conduct, such as pricing, investment, marketing, and R&D policies, etc., on which we barely have any information.

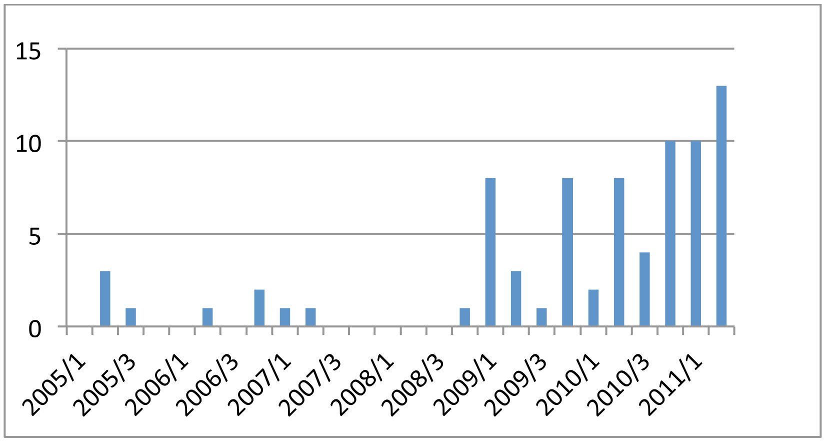
[5] Our paper will therefore not deal with S&P's alleged excessive pricing practices in relation to U.S. International Securities Identification Numbers (ISINs) in Europe, which triggered the opening of an investigation by the EU Commission in 2009 and which may be solved by the offer of commitments. *See* Press Release, *Antitrust: Commission market tests Standard & Poor's commitments on international securities identification numbers*, IP/11/571 (16 May 2011).

[6] R. BAGHAI, H. SERVAES & A. TAMAYO, HAVE RATING AGENCIES BECOME MORE CONSERVATIVE? IMPLICATIONS FOR CAPITAL STRUCTURE AND DEBT PRICING, p. 2 (June 2011).

[7] *EU's Reding: Need To Smash Cartel Of Three US Rating Agencies,* FOREXLIVE, (11 July 2011): http://www.forexlive.com/blog/2011/07/11/eus-reding-need-to-smash-cartel-of-three-us-rating-agencies/.

[8] "A change in rating may thus occur at any time in the case of an individual issue. Such rating change should serve notice that Moody's observes some alteration in creditworthiness, or that the previous rating did not fully reflect the quality of the bond as now seen." Moody's, *Ratings definitions*, http://www.moodys.com/ratings-process/Ratings-Definitions/002002.

Figure 1 – Number of rating announcements made by the three main CRAs for Greece, Ireland, Italy, Spain, and Portugal.



Second, the CRAs seem also to follow parallel courses of action in relation to the intensity of rating adjustments. Despite the high level of subjectivity that characterizes the assessment of sovereign credit, CRAs indeed never disagree on more than three notches.[9] Figure 2 shows this in relation to Greece (Annex I provides information on four other EU countries). Besides, it is exceptional when a downgrading leader (*i.e.* a CRA that is the first to issue a negative outlook) decides to actually downgrade a specific target without having previously obtained assurances from other CRAs (*i.e.*, through the publication of negative outlooks) that they will follow suit. The red points on the Figure 2 tend to demonstrate this.

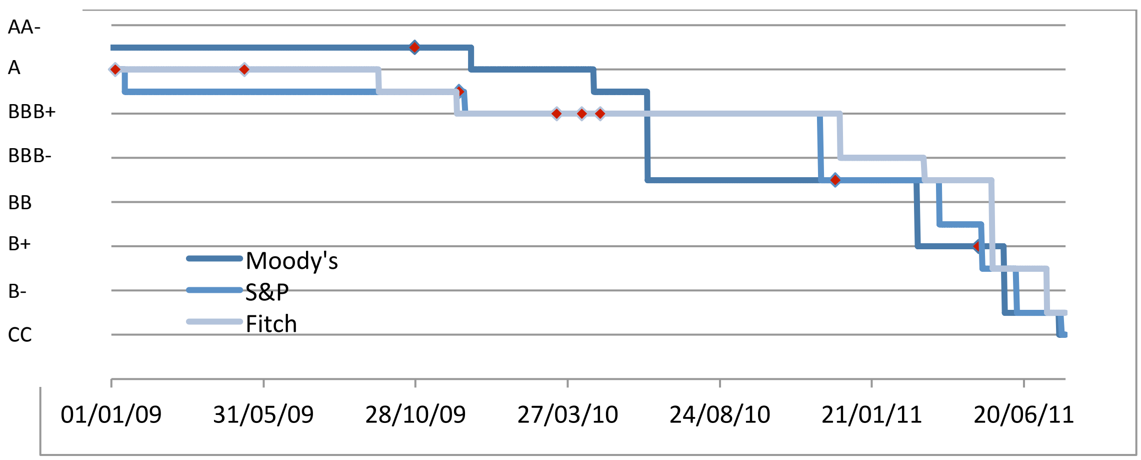


Figure 2 – Evolution of the rating of Greece[10]

[9] *See* Annex 1.

[10] In red, the negative outlook announcements.

Should such courses of parallel conduct stem from a collusive agreement, the CRAs would likely be found guilty of infringement to Article 101 TFEU.[11] However, the strategic motives that could prompt CRAs to conspire along those lines remain unclear. After all, collusion on downgrading is unlikely to improve CRAs' profitability.[12]

A first possible explanation draws on conspiracy theory. It suspects the CRAs, who are primarily US-based (and possibly with the complicity of other US-based players) of trying to harm the interests of EU countries and their financial establishments. But this theory has been proven wrong by the recent downgrading of the United States and other non-European countries (*e.g.*, Japan). In addition, Fitch is controlled by a French financial holding company. This mere fact cast doubts on the overall validity of the U.S. *v*. EU theory.

A second possible explanation involves larger-scale collusive activities between CRAs and financial establishments active in other markets (*e.g.* banks, hedge funds, insurance companies). The CRAs, together with several financial establishments, may have downgraded specific sovereign bonds in order to harm rival financial establishments that are excessively exposed to sovereign debt, *i.e.* those that purchased sovereign bonds from fiscally exposed countries or that sold Credit Default Swaps on those bonds.[13] The CRAs and the colluding banks may also be trying to inflate interest rates on sovereign bonds, with a view to increasing banks' revenues and, in turn, CRAs' ability to extract higher fees from giving ratings.[14]

Again, both variants could trigger the applicability of Article 101 TFEU subject to proof of concerted conduct. There is, however, a missing piece in the puzzle: Why would CRAs favor certain financial establishments over others? Besides the particular situation of Moody's, which is controlled by two investment firms active on the sovereign debt market,[15] industry data says nothing of this.[16]

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[11] There are several ways in which the big three CRAs may have colluded. First, CRAs may have directly conspired to slash sovereign ratings. In the alternative, CRAs may have indirectly colluded, through contacts with common customers or in the context of joint organizations (*e.g.* trade associations, joint ventures, etc.).

[12] And may even reduce profits, if rated States decide to remove business from them.

[13] C. Gatinois, *Pour les hedge funds, spéculer sur la dette souveraine peut rapporter très gros*, LE MONDE (13 July 2011). This strategy would benefit banks that anticipated the actual crisis and bought Credit Default Swaps as a guarantee against the possible failure of EU States.

[14] Contrary to other debt issuers (*e.g.* firms, etc.), banks and financial groups that would be interested in increased interest rates have the power to obtain favors from CRAs: "Structured finance accounts for a major share of some rating agencies' total revenues; equally important, these amounts are paid by a small number of investment banks that know how to exploit their leverage." J. Coffee, *The Role and Impact of Credit Rating Agencies on the Subprime Credit Markets*, Testimony Before the Senate Banking Committee, p. 1 (September 26, 2007).

[15] The principal institutional owners of Moody's are Berkshire Hathaway and Davis Selected Advisers. Berkshire Hathaway is very active on the sovereign debt market. As of 2010, Berkshire owned $29 billion in fixed income securities, and held $2 billion of US government bonds and more than $10 billion of foreign government bonds (*see* Berkshire Hathaway Inc., Annual Report, p. 74, (2010): http://www.berkshirehathaway.com/2010ar/2010ar.pdf). Davis Selected Advisers is an investment management firm that manages several funds. Among those funds, Davis manages a Government Bond Fund. The Fund's strategy is to diversify among different types of government securities, maturity lengths, call provisions, and interest rate coupons (*see* http://davisfunds.com/funds/government_fund/).

[16] Beyond the fact that the CRAs have developed symbiotic relationships with banks and other financial institutions that are used to commission credit rating agencies to assess the value of their products.

This silence by no means entails that the collusion hypothesis should be ruled out. History suggests that the financial sector is not sheltered from collusion. Economic studies have, for instance, alluded to collusive conduct between issuers and CRAs.[17] Furthermore, antitrust agencies have themselves uncovered unlawful conspiracies in the financial sector.[18] Should competition authorities ("CAs") be ready to investigate risks of collusion in relation to sovereign bonds, they enjoy sufficient powers to bring the truth to light.

III. ABUSE OF DOMINANCE

In this section, we attempt to delineate the relevant market (A); examine whether the CRAs occupy, individually or jointly, a dominant position (B); and assess if their rating policies constitute unlawful abuses under Article 102 TFEU (C).

A. Market Definition

Credit rating agencies provide information on the creditworthiness of debt issuers. In its widest application, the relevant market could cover all those instruments that disclose information allowing investors to assess credit risk:[19] financial journals, analyst reports, internal risk-assessment procedures, capital/solvency ratios, any appropriate combination of accounting indicators, etc.[20]

Such a market definition is, however, overly broad. Ratings issued by CRAs exhibit several features that distinguish them from other information channels. First, investors favor CRA ratings because they enshrine information on the creditworthiness of the debt issuer in the present and in the future, by contrast to static accounting indicators.[21] Second, portfolio governance and prudential regulation obligations require investors to hold financial products rated by CRAs.[22] As a result, debt issuers have little choice but to request ratings from the CRAs in exchange for a fee.[23] Alternative risk-assessment instruments are thus no substitutes for CRA ratings, and should thus be excluded from the relevant market.

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[17] M. Pagano & P. Volpin, *Credit Ratings Failures and Policy Options*, mimeo, p. 10 (October 2009), who allude to collusion between issuers and agencies to reveal only coarse information despite product complexity.

[18] For instance, *see* EU Commission, Press Release, *Commission fines five German banks for fixing the price for the exchange of euro-zone currencies*, IP/01/1796 (11 December 2001).

[19] It is worth recalling that the relevant market "comprises all those products and/or services which are regarded as interchangeable or substitutable by the consumer." Neither the inaccuracy of the ratings, nor the irrationality of investors who stick with CRAs' opinions whatever the cost, should alter the market definition. Commission Notice on the definition of relevant market for the purposes of Community competition law, OJ, C 372/5, ¶7 (9 December 1997).

[20] European Commission, Public Consultation on Credit Rating Agencies, *supra* note 2 at 8: http://ec.europa.eu/internal_market/consultations/docs/2010/cra/cpaper_en.pdf.

[21] S. Schaefer, *Stocks Plunge After S&P Downgrade of U.S. Rating*, FORBES (August 8, 2011): http://www.forbes.com/sites/steveschaefer/2011/08/08/market-mauled-after-sp-downgrades-u-s-credit-rating/.

[22] OECD, *Competition and Credit Rating Agencies*, DAF/COMP(2010)29, 5 p. 57 (October 2010).

[23] Whatever the accuracy of these predictions—and despite ratings agencies' recent track record of errors—market reactions to the announcements made by rating agencies evidence that most investors simply cannot do without CRAs prescriptions. J. Hunt, *Credit rating agencies and the worldwide credit crisis: the limits of reputation, the insufficiency of reform, and a proposal for improvement*, 1 COLUMBIA BUS. L. REV, pp. 109-209 (2009).

Within the market for rating services, a further distinction may be drawn between sovereign and corporate ratings.[24] First, the customers of corporate and sovereign ratings are different, with, on the one hand, private sector organizations and, on the other hand, sovereign States able to raise taxes to fulfill their contractual obligations.[25] Second, ratings of corporate and sovereign bonds involve distinct methodologies. While corporate ratings hinge primarily on the analysis of economic and accounting data—and to a lesser extent on the political context surrounding business activities—sovereign rating necessitates a thorough political assessment of a country's willingness to repay its debts. This implies additional working staff with specific expertise on social and political issues.[26] In turn, this limits supply-side substitution,[27] given that many CRAs other than the "big three" do not have the brainpower to rate sovereign bonds.

Finally, sovereign ratings are information goods, which can be easily traded across borders. Hence, the market for sovereign ratings is global in scope.

B. Dominance

1. Single Firm Dominance

The credit ratings industry exhibits high levels of concentration. The "big three" are often reported to control together 94 percent of the rating industry.[28] In addition, the market is characterized by high barriers to entry/expansion (*e.g.*, reputation, information on debt issuers, proprietary rating methodologies, economies of scale, etc.).

At first glance, however, it seems doubtful that any of the three CRAs individually holds a dominant position. This is because, as a matter of principle, there is only one dominant player in a relevant market and this dominant player is necessarily the market leader.[29] In the present case, the quasi-symmetrical market position of Moody's and S&P rules out any finding of individual dominance.

That said, from both a legal and economic standpoint each of the "big three" CRAs—or perhaps only Moody's and S&P—could exceptionally be deemed to enjoy an individual

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[24] That said, it must be acknowledged that the corporate and sovereign markets share a special relationship. Because of the reputation effects that characterize the rating industry, the market position the three big CRAs were able to achieve on the corporate rating market was leveraged into the market for sovereign ratings. The appetite of investors for ratings from well-known agencies allowed the main CRAs to duplicate their market share in the neighboring market for sovereign ratings. This makes the market for corporate rating a unique entry gate to the market for sovereign rating.

[25] Commission Notice on the definition of relevant market, *supra* note 2., ¶43.

[26] "The rating of sovereigns depends more on the art of political economy than on the science of econometrics. It depends on the careful judgement of experienced analysts about the durability of policy and the values of policy-makers as much as on a hard-nosed assessment of the prospects for a nation's export potential". FITCH, SOVEREIGN RATINGS. RATING METHODOLOGY, p. 4: http://www.fitchratings.com.bo/UpLoad/methodology.pdf.

[27] Commission Notice on the definition of relevant market, *supra* note 2, ¶20.

[28] While one can count approximately 74 CRAs throughout the world, the three major CRAs, namely Moody's, S&P, and Fitch, account for 94 percent of the global market. *See* International Monetary Fund ("IMF"), *The uses and abuses of sovereign credit ratings*, IMF Global Financial Stability Report, Annex 3.1, p.118 (October 2010).

[29] The market leader must outrank its rivals by some significant margin. *See*, *Communication from the Commission, Guidance on the Commission's enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings*, OJ, , C 45/7, ¶20, (24 February 2009).

dominant position. To start with the economics, it is well documented that issuers seek to obtain at least two ratings, and sometimes three.[30] This means that issuers do not view the ratings of the CRAs as substitutes for one another, but rather as complements to one another. Pushing our market definition a little further, it could be argued that each CRA operates in a stand-alone, captive market. In turn, this means that each of the three CRAs—or at least Moody's and S&P—is an "unavoidable trading partner" for issuers.[31] Put differently, Moody's, S&P, and Fitch would each enjoy a monopoly position, in their own market.

Turning to the law, CAs and courts could possibly delineate distinct relevant markets for the various CRAs, and find that each of them occupies a dominant position under Article 102 TFEU. Alternatively, and more controversially, CAs could draw inspiration from the Commission's decision in *ABG/Oil Companies operating in the Netherlands* in which several rival companies operating in the same market were found to enjoy a dominant position relative to their respective customers.[32] This line of reasoning has, however, never been used in subsequent Article 102 TFEU cases. That said, there is some precedential authority in the case law to find single firm dominant positions in the credit ratings industry.

2. Collective Dominance

Article 102 TFEU applies to tight oligopolies via the doctrine of "collective dominance." In practice, the Commission has seemed reluctant (if not allergic) to using this doctrine in oligopolistic markets.[33] However, despite the Commission's reticence, the EU Courts have repeatedly stated that a dominant position may be "held by two or more economic entities legally independent of each other, provided that from an economic point of view they *present themselves or act together on a particular market as a collective entity* (emphasis added)."[34] Besides, at the national level, some CAs have built a solid track record in this field. Given the tight oligopolistic structure of the credit ratings industry, it is thus legitimate to examine whether the CRAs hold a collective dominant position.

At its core, the notion of collective dominance covers those oligopolistic markets in which rivals can coordinate their conduct (*e.g.* price, output, investments, etc.) without entering into an explicit collusive arrangement. Economists refer to this phenomenon with the oxymoron "tacit collusion."

Under Article 102 TFEU, a finding of collective dominance requires: (i) a certain degree of parallel behavior among oligopolists (the notion of "collective entity"); and (ii) the satisfaction of the three conditions articulated by the General Court in *Laurent Piau v. Commission*, *i.e.*:

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[30] *The Role of Credit Rating Agencies ESME's report to the European Commission*, European Securities Markets Expert Group (ESME), p.3 (June 2008): http://ec.europa.eu/internal_market/securities/docs/esme/report_040608_en.pdf.

[31] The concept of "unavoidable trading partner" comes from the seminal judgment of the ECJ of 13 February 1979, *Hoffmann-La Roche & Co. AG v Commission*, Case 85/76, *ECR,* 1979, p. 461.

[32] Commission Decision, 19 April 1977, IV/28.841 – *ABG/Oil companies operating in the Netherlands*, OJ, L 117, pp. 1-16 (9 May 1977).

[33] Except in very specific circumstances. On this, *see* N. Petit, *Oligopoles, collusion tacite et droit communautaire de la concurrence*, BRUYLANT-LGDJ, Chapitre II (2007).

[34] ECJ, *Compagnie Maritime Belge Transports SA and others v. Commission*, ("*Cewal*"), joined cases C-395 and C-396/96P, *ECR,* 2000, p. I-1365 (16 March 2000).

> Three cumulative conditions must be met for a finding of collective dominance: first, each member of the dominant oligopoly must have the ability to know how the other members are behaving in order to monitor whether or not they are adopting the common policy; second, the situation of tacit coordination must be sustainable over time, that is to say, there must be an incentive not to depart from the common policy on the market; thirdly, the foreseeable reaction of current and future competitors, as well as of consumers, must not jeopardise the results expected from the common policy.[35]

Unfortunately, subsequent case law provides no guidance on the interpretation of those conditions. In previous cases, the Commission and the EU Courts have established collective dominance on the basis of a less sophisticated assessment, which involved the review of a "checklist" of pro-collusive market characteristics or through the proof of "structural links" among oligopolists (*e.g.* agreements, shareholdings, etc.). Moreover, in *Impala v. Commission*, the Court stressed that:

> in the context of the assessment of the existence of a collective dominant position, although the three conditions [...] which were inferred from a theoretical analysis of the concept of a collective dominant position, are indeed also necessary, they may, however, in the appropriate circumstances, be established indirectly on the basis of what may be a very mixed series of indicia and items of evidence relating to the signs, manifestations and phenomena inherent in the presence of a collective dominant position.

Now, on the facts, the two components of collective dominance are *prima facie* present. First, parallel behavior is a salient feature of the credit ratings industry.[36] The sovereign debt crisis offers daily illustrations of this, with CRAs repeatedly adjusting their ratings on their competitors' actions. In the same vein, several scholarly studies record systematic patterns of "mimetism," "inertia," "herd behavior,"[37] and "piggybacking effect"[38] in the credit ratings industry:[39] successive credit ratings tend to converge after publication;[40] upgrade probabilities are

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[35] CFI (now General Court), *Laurent Piau v Commission*, T-193/02, *E.C.R.,* 2005, p. II-209*,* ¶111*,* (26 January 2005).

[36] R. Cantor & F. Packer, *The Credit Rating Industry*, FRBNY Q. REV., p. 3 (Summer-Fall 1994). As early as 1994, the parallel behavior of the two main agencies was perceivable. In the wake of the financial crisis in Mexico, S&P had rated Mexico with a positive outlook for upgrade before downgrading its assessment to align it with that of Moody's.

[37] Herd behavior can be compounded by managers' incentives (reputational issues and sharing the blame in case of errors). D. Scharfstein & J. Stein, *Herd Behavior and Investments*, 80(3) AMER. ECON. REV., p. 465 (1990).

[38] P. Gomas, *Do credit rating agencies piggyback? Evidence from sovereign debt ratings*, p. 19 (19 June 2011) (Preliminary draft). What has been described as a "piggybacking effect" has numerous, crucial implications: "First, errors of one agency contaminate the rating of other agencies. Second, if ratings are reported in a categorical scale, piggybacking leads to inertia and herd behaviour. Even if one agency perceives a deterioration of the creditworthiness, it might be reluctant to act if the rivals do not. It will only downgrade if it receives a strong negative signal. On the other hand, once one agency acts, it might generate waves of subsequent adjustments. Third, if agencies are themselves averaging their ratings, investors can get wrong idea about the variance of the signals.

[39] Of course, the CRAs occasionally disagree on ratings, but this is often confined to one or two notches on the finer scale. P. Hill, R. Brooks, & R. Faff, *Variations in sovereign credit quality assessments across rating agencies*, (34) J. BANKING & FINANCE, p. 1327 (2010). Moreover, divergences seem more frequent for sovereign ratings than for corporate ratings: "The disagreements across agencies represent more than half of all observations, except in the case of the S&P/Fitch pair. (…) The high frequency of disagreements across agencies can be explained by rating agencies using varying methodologies, different quantitative/qualitative factors and different weights on these factors in

much higher, and downgrade probabilities are much lower, for a sovereign issuer with a recent upgrade by another agency;[41] and rating changes by a rating agency are also significantly more likely after downgrades than after upgrades by a first rating agency.[42]

Second, the features of the credit ratings sector support a tacit collusion hypothesis. To name only a few of them, the industry exhibits:

- a small number of oligopolists;
- similar activities in range, nature and variety;[43]
- identical business models, with the big three CRAs operating under the "issuer pays" model;
- similar fees[44] and similar "list prices;"[45]
- similar cost structures and similar human resources (in size);[46]
- close rating methodologies;[47] and

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assigning sovereign ratings. Rating agencies may also disagree to a greater extent about speculative grade rated issuers (more opaque issuers with a high degree of instability and poor information quality), which represent 46.4% of the total number of observations. In addition, agencies may have better knowledge about countries in their 'home region,' and thus assign favourable ratings for issuers located there." R. Al-Sakka & O. ap Gwilym, *Split sovereign ratings and rating migrations in emerging economies*, (11) EMERGING MKTS. REV., p.95 (2010).

[40] R. Al-Sakka & O. ap Gwilym, *id*. at 95.

[41] And vice-versa. R. Al-Sakka & O. ap Gwilym, *Leads and lags in sovereign credit* ratings, (34) J. BANKING & FINANCE, pp. 2614–2626 (2010): "S&P tends to demonstrate the least dependence on other agencies, and Moody's tends to be the first mover in upgrades. Rating actions by Japanese agencies tend to lag those of the larger agencies, although there is some evidence that they lead Moody's downgrades."

[42] A. Guttler & M. Wahrenburg, *The adjustment of credit ratings in advance of defaults*, (31) J. BANKING & FINANCE, p. 751 (2007).

[43] "As of September 2005, S&P had credit rating opinions outstanding on approximately $30 trillion of debt, including 745,000 securities issued by roughly 42,000 obligors in more than 100 countries. Moody's numbers were roughly the same." F. Partnoy, *How and Why Credit Rating Agencies Are Not Like Other Gatekeepers*, Legal Studies Research Paper Series, Research Paper No. 07-46, p. 66 (May 2006).

[44] *Id* at 66.

[45] Moody's and S&P are said to charge similar fees and to have adopted similar "list prices." The structure of Fitch issuers' fee schedules is similar to that of Moody's and S&P. "Both Moody's and S&P have the following 'list prices' for the requested ratings: 3.25 basis points on issues up to $500 million, with a minimum fee of $25,000 and a maximum of $125,000 (S&P) or $130,000 (Moody's); both charge an additional 2 basis points on amounts above $500 million (S&P caps the amount at $200,000; it also has a one-time fee of $25,000 for first-time issuers). Both offer negotiated rates for frequent issuers and offer quarterly charges on amounts outstanding for issuers of commercial paper. (…) The structure of [Fitch and Duff & Phelps] issuers' fee schedule is similar to that of Moody's and S&P; but, as would be expected from firms that are perceived to be more peripheral, their fee levels are lower (2.5 basis points for Fitch IBCA; 2.75 basis points for Duff & Phelps)." L. White, *The credit rating industry: an industrial organization analysis*, prepared for the Conference on "Rating Agencies in the Global Financial System" p. 14, to be presented at the Stern School of Business, 1 June 2001, 20 April 2011: http://www.antitrustinstitute.org/node/10356).

[46] S&Ps ratings operations are roughly of the same size as Moody's, while Fitch is somewhat smaller. All three companies employ about the same numbers of analysts. L. White, *The Credit Rating Agencies*, 24(2) J. ECON. PERSPECTIVES, p. 216 (Spring 2010).

- high market transparency, with the publication of credit ratings, contacts with common customers, and through the participation to several professional associations;[48]

Last but not least, the three conditions of *Laurent Piau v. Commission* may well be satisfied. First, in light of the high degree of transparency that prevails on the market, CRAs can easily monitor each other's ratings. Second, CRAs' incentives to follow each other's behavior may be sustained through the threat of price wars or other retaliation mechanisms (poaching of key personnel, *e.g.* internal analysts), etc. Finally, the likelihood of entry/expansion is presumably low, given the high obstacles that potential/actual rivals must overcome to penetrate the market.[49] The persistence of large profit margins in the credit ratings industry corroborates this last proposition.[50] Overall, and subject to confirmation through an in-depth economic analysis, a collective dominance/tacit collusion hypothesis cannot be ruled out.

C. Abuse

1. Theoretical Background

The scope of the concept of abuse is open-ended. In essence, however, Article 102 TFEU outlaws dominant firms' conduct which harms the competitive structure of markets through the foreclosure of other firms, be they competitors—first line injury abuses—or economic partners (customers or suppliers active on neighboring markets)—secondary line injury abuses. Those abuses are often labeled "exclusionary abuses."

Besides exclusionary abuses, Article 102 TFEU also prohibits so-called "exploitative abuses": conduct whereby a dominant firm exploits its market power and directly harms its customers through excessive prices, output reductions, poor product/service quality, etc. In brief, such abuses cover the several inefficiencies traditionally ascribed by economic theory to monopoly power.

2. Rating Errors

Ever since their inception, CRAs' have been criticized for misguided decisions, as if errors were an endemic feature of the industry.[51] In recent times, observers have lambasted CRAs for

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[47] The three main CRAs have similar methodologies for corporate rating. There are more divergences on sovereign rating, though.

[48] For instance, the CRAs cooperate within the context of the International Organization of Securities Commissions ("IOSCO"), an association of organizations that regulates the world's securities and futures markets. For more, *see* http://www.iosco.org/.

[49] Without wading into too much detail, there are five types of barrier to entry/expansion that protect the big three from competition: (i) informational expertise, including the incumbent CRAs' control over a wealth of strategic information on issuers, and the time needed for prospective entrants to acquire such information; (ii) brand loyalty towards incumbent CRAs in a market where experience matters; (iii) transaction costs savings achieved by issuers in dealing only with a few CRAs; (iv) investors' cognitive limits, including their unwillingness to spend large resources to understand, interpret, and compare many different rating standards; and (v) regulatory obstacles in the United States, Europe, and Japan where only a limited number of CRAs (respectively 10, 4, and 5) are officially recognized as credit assessment institutions.

[50] This despite repeated criticism of stakeholders from all sides.

[51] To reverse this argument, CRAs often claim that pursuing them is like blaming the thermometer for the temperature. Some observers have also described CRAs as mere "messengers," and argued that it would make no sense to shoot the messenger. But this is wholly unpersuasive. CRAs ratings do not convey crude information. They

repeated type I errors (erroneous downgrading or under-rating).[52] Likewise, up until the fall-out of the Subprime crisis, CRAs have been criticized for repeated type II errors (erroneous upgrading or over-rating). In this context, one may legitimately question whether such errors are likely to fall foul of Article 102 TFEU.

There are several senses in which CRAs' ratings errors may be akin to unlawful abuses under Article 102 TFEU. First, and to focus only on type I errors, with the mistaken downgrading of selected sovereign ratings, CRAs risk injuring the structure of related financial markets, by pushing sovereign-exposed financial establishments (banks, insurance companies, etc.) towards bankruptcy.[53] As in secondary line injury cases, this is likely to increase concentration in neighboring markets, weaken competition, and harm consumer welfare. Beyond this, the harm caused to competition with the disappearance of specific market players may trigger increased financial instability.[54]

Second, the downgrading of certain countries—despite the drastic economic reforms and austerity measures undertaken in those countries—and the relative immunity of other countries—despite dire economic situations—may be a form of subjective discriminatory conduct,[55] which inflicts a competitive disadvantage on holders of downgraded bonds.

Finally, rating errors can also be akin to exploitative abuse to the extent that they reflect the structural failure of dominant firms to supply efficient services. Given the absence of competitors, rating errors do not translate into market share losses that could discipline the CRAs. Moreover, dominant CRAs, insulated from competition, need not improve, let alone correct, flawed rating methodologies.

Not unlike our analysis of dominance, we acknowledge that our assessment of abuse is unconventional, and departs from mainstream Article 102 TFEU analysis.

This notwithstanding, our interpretation of Article 102 TFEU is based on established competition policy principles. It is wholly consistent with the Court's case-law (i) in price discrimination cases, which seeks primarily to avoid distortions of competition in markets where

embody analysis, value judgment, and interpretation, just as a doctor's diagnosis does after taking a patient's temperature. Seen as a diagnosis, credit ratings may thus be flawed.

[52] For instance, S&P's recent downgrading of the U.S. rating was fraught with a daft mathematical mistake of approximately $2 trillion. *See* http://www.treasury.gov/connect/blog/Pages/Just-the-Facts-SPs-2-Trillion-Mistake.aspx.

[53] Note that type II errors generate similar concerns, as they induce investors to take excessive risks, and thus weaken their competitive position. The explanation for the rating agencies' conduct can perfectly be framed in the words used by (i) behavioral economists to describe irrational conduct—why hammer Greece and Portugal, and meanwhile maintain the U.S.' AAA rating?—in markets where players are excessively risk averse; or (ii) conventional economists to describe information imperfections and reputation dynamics (to stay credible, agencies need to be tough on ratings).

[54] The contagion dynamics on financial markets are abundantly documented in the scholarship and official reports.

[55] At the end of the day, the rating implies a subjective assessment of the creditworthiness of the issuer. It leaves an important margin of appreciation left to the analyst. This is all the more so when it comes to the rating of sovereign debt, where an assessment of the "political willingness to pay" must be undertaken.

the dominant firm is not active (secondary-line injury);[56] and (ii) in other types of cases (refusal to deal), where dominant firms have been condemned for eliminating trading parties in markets where they were not active.[57] For instance, in *British Airways* ("BA"), the General Court (previously, the Court of First Instance) objected to the fact that the various travel agents that purchased tickets to BA received different rebates. The Court held that such a discriminatory rebate scheme[58] could distort competition in the downstream market for air travel agency services and was thus abusive.[59] Albeit implicitly, the Commission confirmed this in its Discussion Paper on Article 102 TFEU. It suggested that abuse concerns could arise if the elimination of a market player led to collusion in the secondary market, or if the eliminated market player was a key source of rivalry (*e.g.* a maverick player).[60]

Moreover, our proposed interpretation of Article 102 TFEU tallies with the Commission's goals under the State aid rules, where bailouts to failing firms are (i) generally authorized out of concerns of increased oligopolistic concentration;[61] and (ii) specifically cleared in the banking industry, for fear of increased financial instability and risks of contagion.[62]

3. Extortionate Ratings

CRAs occasionally issue unsolicited ratings.[63] Unsolicited ratings are credit ratings not initiated at the request (and with the cooperation) of the relevant issuer.[64] In the aftermath of the Subprime crisis, regulators have encouraged unsolicited ratings in order to mitigate the nefarious conflict of interest that can stem from the "issuer pays" model.[65] In addition, regulators have

[56] D. Geradin & N. Petit, *Price Discrimination under EC Competition Law—Another Doctrine in Search of Limiting Principles?* 2(3) J. COMPETITION LAW & ECON, p. 479 (2006).

[57] *See*, for instance, ECJ, 14 February 1978, *United Brands Company and United Brands Continentaal BV v. Commission*, Case 27/76, *ECR*, 1978, p. 207.

[58] GC (previously CFI), 17 December 2003, *British Airways plc v Commission*, T-219/99, *ECR,* 2003, p. II-05917, para. 233-240.

[59] *Id.* By remunerating at different levels services that were nevertheless identical the rebates schemes distorted the level of remuneration which the travel agents received. "Being dependent on the financial resources of each agent, that ability of agents to compete in supplying air travel agency services to travellers and to stimulate the demand of airlines for such services was naturally affected by the discriminatory conditions of remuneration inherent in BA's performance reward schemes." Hence, BA's rebates schemes were held to be an abuse of a dominant position, "in that they produced discriminatory effects within the network of travel agents established in the United Kingdom, thereby inflicting on some of them a competitive disadvantage."

[60] *See* DG Competition discussion paper on the application of Article 82 of the Treaty to exclusionary abuse, Brussels, December 2005, ¶¶ 222-223.

[61] Communication from the Commission, *Community guidelines on State aid for rescuing and restructuring firms in difficulty*, OJ 244, pp.2-17, ¶ 31 (01.10.2004).

[62] T. Beck, D. Coyle, M. Dewatripont, X. Freixas, & P. Seabright, *Bailing out the Banks: Reconciling Stability and Competition – An analysis of state-supported schemes for financial institutions*, CEPR (2010).

[63] T. Alloway, *The unpredictability of the unsolicited rating*, FT ALPHAVILLE, (28 July 2011): http://ftalphaville.ft.com/blog/2010/07/28/300116/the-unpredictability-of-the-unsolicited-rating/.

[64] Regulation No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies, OJ L 302, p. 1–31, recital (21 17.11.2009): "An unsolicited credit rating, namely a credit rating not initiated at the request of the issuer or rated entity, should be clearly identified as such and should be distinguished from solicited credit ratings by appropriate means."

[65] Since the 1970s, entities that issue debt pay CRAs to rate their credit-worthiness, therefore creating strong incentives to CRAs to provide positive ratings.

entitled non-officially recognized CRAs to issue such ratings, in a bid to foster transparency, information availability, and differentiation on the market.

In so far as sovereign ratings are concerned, countries receive a general rating grade, which is normally unsolicited. In contrast, countries do solicit specific ratings for the various bonds they issue.[66] Unsolicited ratings may also affect corporate organizations and bonds.

In practice, unsolicited ratings are often below solicited ratings. Observers have thus voiced concerns that CRAs may deliberately issue negative unsolicited ratings in order to push issuers to solicit ratings.[67] As explained by Partnoy "the agency threatens the issuer with unfavorable ratings to obtain fees now."[68] The problem here is that someone is forced to purchase a service he does not want, and has to divert resources away from alternative, more valuable, uses.[69] We refer to these as extortionate ratings.

When practiced by dominant CRAs, extortionate ratings may have two types of anticompetitive effects. First, the influx of new customers caused by negative unsolicited ratings increases the size of the CRAs' (individual/collective) dominant position and, in turn, the magnitude of the various inefficiencies arising from its (their) market power.[70] Second, dominant CRAs reduce the contestable share of the market that can be served by prospective new entrants, by locking-in customers that were not previously tied in by contractual commitments. In so doing, the dominant CRAs protect their (individual/collective) dominant position.[71]

On close examination, the case law of the EU courts to date provides no precedent in relation to these types of abuse. Forced purchasing has only been prohibited to the extent that it is the result of a tying strategy under Article 102 (d) TFEU (where the sale of good X is conditioned on the purchase of good Y). That said, extortionate ratings may be sanctioned for its exploitative effects, in the spirit of the prohibition of "unfair purchase conditions" under Article 102 (a) TFEU. In addition, extortionate ratings may also constitute a new breed of exclusionary abuse under Article 102 (b) TFEU. If dominant firms can be condemned when they attract new customers through low prices (in abusive rebates and predatory pricing cases), it seems justified to sanction them when they reach the same result through mischievous practices.[72]

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[66] J. Cotterill, *Gratuitous Sovereign AAA*, FT ALPHAVILLE (17 February 2011): http://ftalphaville.ft.com/blog/2011/02/17/491736/gratuitous-sovereign-aaa/.

[67] W. Poon, *Are unsolicited credit ratings biased downward?*, 27(4) J. BANKING & FIN., pp. 593-614 (April 2003); W. Poon & M. Firth, *Are Unsolicited Credit Ratings Lower? International Evidence From Bank Ratings*, 32(9-10) J. BUSINESS FINANCE & ACCOUNTING, pp.1741–1771 (November 2005).

[68] F. Partnoy, *supra* note 43 at 72.

[69] This is a source of allocative inefficiency.

[70] One could however argue that this is likely to generate productive efficiency. With an increased customer base, CRAs could achieve economies of scale and reduce their production costs.

[71] Interestingly, CRAs often claim that unsolicited ratings mainly serve as a signaling device, to prove that they even have expertise in markets in which they have no significant presence. The publication of unsolicited ratings is thus used as a marketing instrument. C. Bannier, P. Behr, & A. Gäuttler, *Why are unsolicited ratings lower than solicited ratings? A theoretical and empirical assessment*, p. 2 (28 April 2007): http://www.finance.uni-frankfurt.de/master/brown/181.pdf.

[72] The case law on abusive sham action (*Astra Zeneca*) and on other deceptive practices (*Rambus*) seems to support this contention. In *AstraZeneca,* the General Court upheld the Commission's decision according to which AstraZeneca had abused its dominant decision. The Commission criticized the misleading representations AZ made

4. Other Possible Abuses

In addition to the ratings-related abuses discussed above, a wide array of other CRA commercial practices may fall within the purview of Article 102 TFEU: exclusivity obligations, long-term contracts, tying/bundling of services, unfair contract terms, loyalty discounts, etc. Absent further information on CRAs' commercial practices, it is beyond the scope of this paper to explore their compatibility with Article 102 TFEU. But an antitrust investigation could possibly shed light on a number of abusive practices which, to date, have not yet surfaced on the radar screen of competition authorities.

IV. CONCLUSION

If policy makers are serious about their commitment to reform the credit rating industry, they should certainly take a look at the competition rules. As seen above, the credit ratings oligopoly has the stigmata of antitrust concerns: (i) high degree of market concentration; (ii) parallel behavior; and (iii) conduct with exclusionary effects on related markets. And on pain of sounding heretical, with a little ingenuity, the antitrust rules may be enforced to regulate the CRAs. Indeed, competition agencies can impose on—or negotiate with—infringing firms very significant behavioral and structural remedies, ranging from trademark licenses, to contractual modifications, divestitures, and so on.[73]

Moreover, besides competition enforcement, it would still be perfectly legitimate for competition agencies to undertake a competitive assessment of the credit rating sector.[74] Indeed, competition agencies are well placed to ascertain the causes, consequences, and solutions to "competition problems" in specific industries.[75] They should in turn use—they actually often do—their expertise to advocate regulatory reforms that foster competition before policy makers. The former Director General of DG COMP, Philip Lowe, summarized this in saying: "One thing the crisis has served to highlight is the importance of good regulation and the need to expand our sphere of influence from beyond the narrow confines of our specialist field."[76] In the EU, Article

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before the patent offices or courts of several Member States to induce the offices or courts to deliver supplementary protection certificates to which AZ was not entitled. GC, 1 July 2010, *AstraZeneca AB v. Commission*, T-321/05. *ECR,* 2010. In *Rambus,* the Commission held the preliminary finding that Rambus had abused its dominant position by not disclosing the patents it owned in the course of standard-setting negotiations. *See* Final report of the Hearing Officer, COMP/38.636 — Rambus, *OJ,* 2010, C 30/08.

[73] *See* Articles 7 and 9 of Council Regulation No 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty, OJ, L 1/1 (4 January 2003). As suggested previously, those remedies are often regulatory obligations in disguise.

[74] *See*, in the same sense, House of Lords, European Union Committee, 21st Report of Session 2010–12, *Sovereign Credit Ratings: Shooting the Messenger?,* &100 (21 July 2011): "There is a compelling argument for a thorough competition inquiry into the structure and regulation of the credit rating industry. This inquiry should consider the full range of ideas proposed to increase competition in the sector."

[75] They boast expert staff and, in contrast to industry regulators, are less prone to capture. The concept of "competition problem," as opposed to competition infringement, was used by DG Competition Director P. Lowe, *Competition policy as it has and as it should develop*, Georgetown University Law Center, Global Antitrust Enforcement Symposium, Washington, (22 September 2009): http://ec.europa.eu/competition/speeches/text/sp2009_15_en.pdf.

[76] *Id.* at 9.

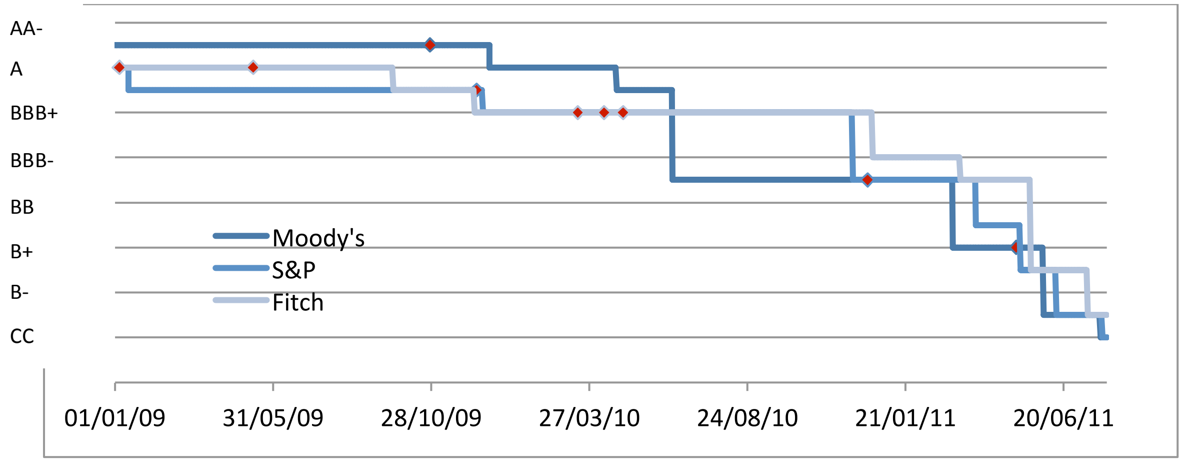
17 of Regulation 1/2003 offers a legal basis to this end.[77] In the past, DG COMP relied on this provision to make proposals for regulatory reforms in a number of areas (telecommunications, electricity, gas, pharmaceuticals, etc.).[78] Time may now be ripe to use it in the credit rating industry.

[77] Article 17 of Regulation 1/2003, *op. cit.*. "The Commission may publish a report on the results of its inquiry into *particular sectors of the economy or particular types of agreements across various sectors and invite comments from interested parties*."

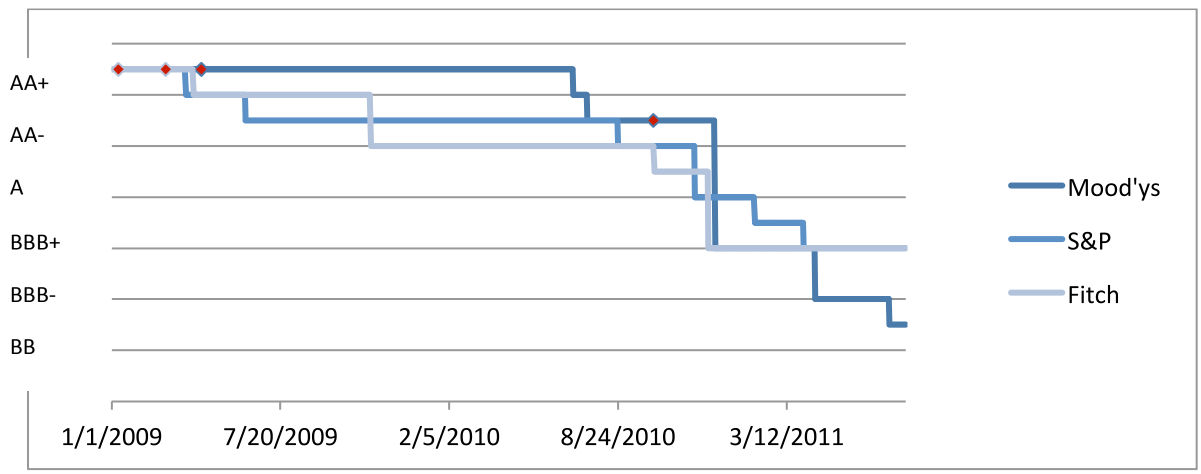
[78] *See* Nicolas Petit & C. Lousberg, *Enquêtes sectorielles: Complément ou substitut de l'action des autorités de concurrence?*, (2) CONCURRENCES (2010).

V. ANNEX I: EVOLUTION OF THE RATINGS OF THE BIG THREE CRAS

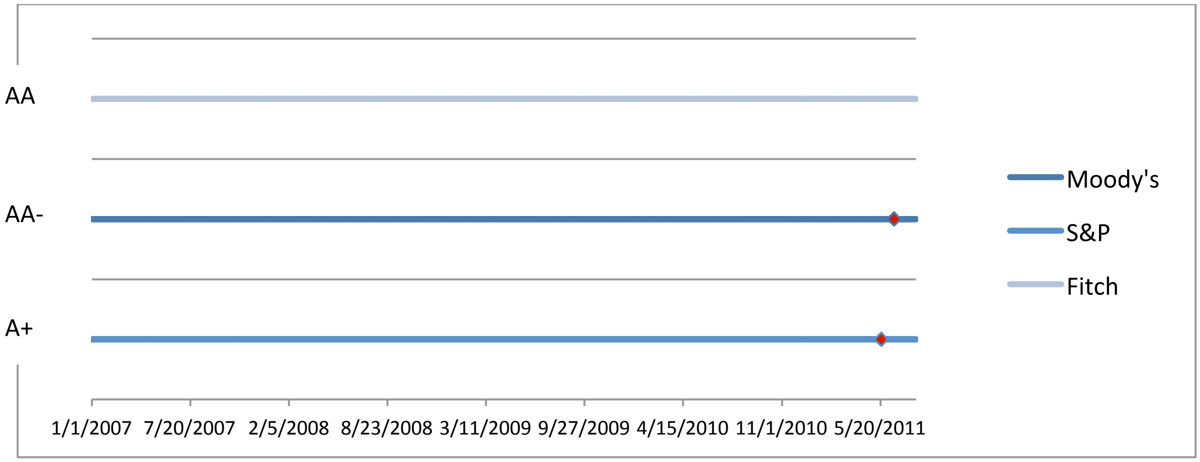
Evolution of the Foreign Long Term ratings from January 1, 2007 to July 31, 2011 (where the rates have not earlier been modified, the graphs start on September 1, 2008 or September 1, 2009 for better readibility). Moody's grades are converted to correspond to match the S&P/Fitch grade scales. In red, the "negative outlook" announcements.



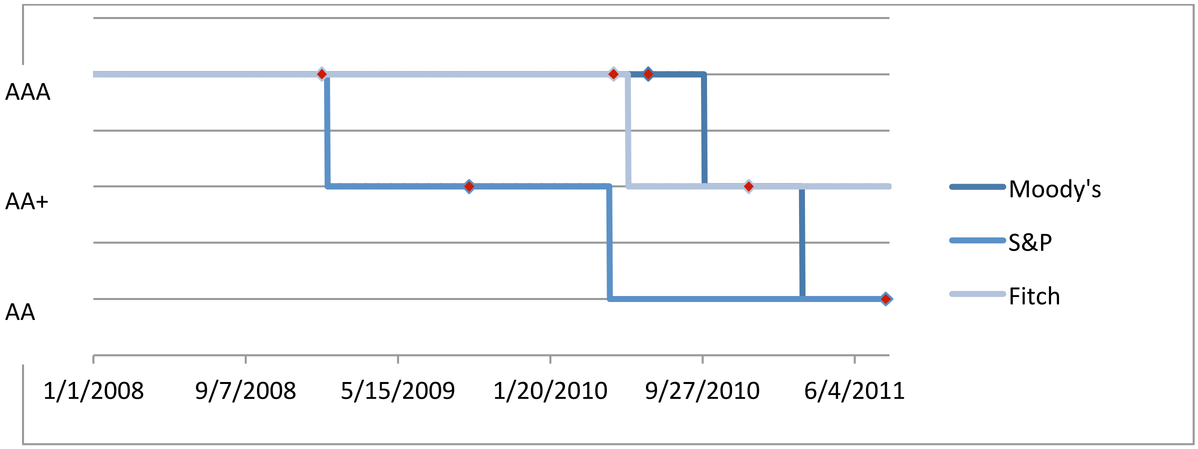
Evolution of the rating of Greece



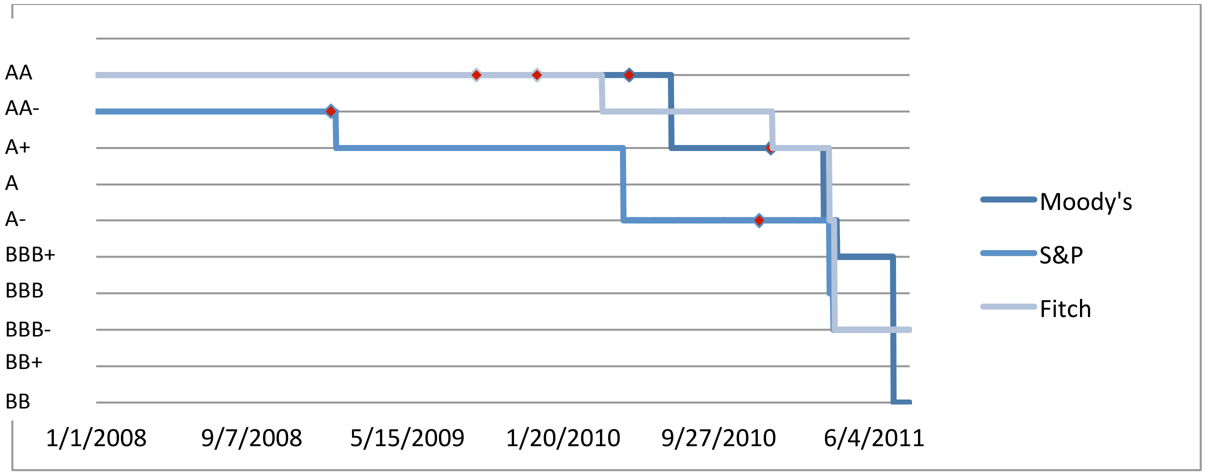
Evolution of the rating of Ireland



Evolution of the rating of Italy



Evolution of the rating of Spain



Evolution of the rating of Portugal