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Competition Issues Regarding Procurements for Large Companies and Suppliers: The *Gazprom* Case

A.E. Shastitko
(M.V. Lomonosov Moscow State University)
&
S.V. Golovanova
(National Research University, Higher School of Economics)

Competition Issues Regarding Procurement for Large Companies and Suppliers—The *Gazprom* Case

A.E. Shastitko & S.V. Golovanova[1]

I. INTRODUCTION

This article demonstrates that even established and verified facts of agreements among producers are not sufficient conditions for either cartel identification and, as a consequence, prosecution of agreement participants. Qualifying sellers' interactions on a market as collusion is not a simple task, although it might seem so if using an oversimplified world vision. It doesn't mean there is no ground to fight against cartels. It simply means this battle is not so straightforward.[2]

To establish a cartel requires looking at institutional details and the wider context of related documents, actions, appearances, and occurrences. To illustrate, we looked at the recent antitrust case against Russian producers of large diameter pipes ("LDPs") which sold to one large buyer—OJSC Gazprom. This case illustrates that avoiding wasteful outcomes from a so-called traditional hostile view in antitrust is an important and possible task, although a hard one.

This article explains the Russian LDPs antitrust case within the framework of the New Institutional Economics and, more precisely, the research tradition rooted in Oliver Williamson works.[3] Overall, however, there is lack of academic interest regarding competition issues in procurement of LDPs for one large buyer. One restriction to exploring this subject matter, and in developing the discussion, is the availability of information concerning both the materials of the antimonopoly proceedings (as the materials may contain information which constitutes a commercial secret of a particular market participant) and the research conducted (which is true not only for Russia).

This article is based on analysis including information posted on the Web page of the Russian Federal Antimonopoly Service ("FAS"), and has the following structure. Section II discusses the economics of collusion looking at the initial position of the antimonopoly authority in the case against the pipe-manufacturing companies. Section III presents the circumstances to

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[1] A.E. Shastitko is a Doctor of Economics, Professor & Head of the Chair of Competition and Industrial Policy, at the School of Economics, M.V. Lomonosov Moscow State University. He is also Director of the Competition and Economic Regulation Research Center for the Russian Presidential Academy of National Economy and Public Administration. S.V. Golovanova is a Doctor of Economics, Professor & Chair of Economic Theory and Econometrics, National Research University, Higher School of Economics, Nizhny Novgorod. Expert discussion of the LDP case is supported by Basic Research Program of NRU HSE (2013). Authors are grateful to Anastasia Astashkevich for assistance . The paper has benefited from discussions at the 15th International Conference "Public Sector Transition", St. Petersburg, November 2013

[2] The support for this idea might be received from the following studies: [Harrington, 2006], [Marshall, R. and Marx, L. 2012], [Hyytinen et al, 2012].

[3] See [Williamson, 1985].

be considered when testing a collusion hypothesis. Section IV proposes a theoretical interpretation of the actions by pipe-manufacturing companies in light of the economics of contractual relations. Conclusions are provided at the end.

II. HOSTILITY TRADITION VIEW AS APPLIED TO THE LDPS WORLD

The hostility tradition in antitrust is based on a presumption of monopolization for business practices which don't meet known and well-explained patterns of economic organization. This problem was clearly articulated more than 30 years ago. However, the syndrome of hostility lives on. A recent example is the case initiated by FAS in 2011 after an initial inspection of the wholesale suppliers of LDPs used to build cross-country gas pipelines. They saw signs of violation of Article 11 of the law "On Protection of Competition" (which relates to the ban on market division by area, product range, and output of products)[4] and instituted legal proceedings against all major Russian manufacturers of LDPs. Subsequently, several companies engaged in the wholesale trade of pipes were also added.

FAS' main concern was the established fact that the Russian LDP producers had signed long-term and day-to-day schedules to supply large-diameter pipes for OJSC Gazprom's projects for the period 2008-2011. Russian FAS closed the case in Murch of 2013 without sanctions as they requalified the LDP producers' behavior in a way to make it eligible to use the provisions of Article 13 of the law "On Protection of Competition." These provisions related to socio-economic benefits that were derived the market participants' behavior, namely: (1) creation of a sub-industry (localized production of LDPs), (2) creation of more than 6,000 jobs, and (3) positive effects for budget receipts.[5]

However, a set of issues remain that require explanation to understand both FAS' position and what this position means not only in a specific area, i.e. the wholesale trade in LDP, but in general. This is all the more important because, after closing one antitrust case regarding LDPs, FAS has opened another, but with different list of participants.

The economic background (justification) of the collusion ban (which is consistent with the provisions of clause 1, Article 11 of the law "On Protection of Competition" and analogous to Article 1 of Sherman Act and Article 101 of the Treaty on Functioning of European Union) is that, if supply-side market participants agree among themselves on who to supply and the volume of goods to be supplied (i.e. market division), this may result in a smaller output and a higher price as compared with a competitive market. In some cases, this participation leads to a lower quality of products and a lower rate of updating products and modernizing production, especially since such modernization may prevent both the entry into such agreement and its sustainability. As a result, this kind of agreement would have a negative effect on the public welfare and, specifically, on profits by LDP consumers as well as those further down the process chain.

[4] FAS News Line: http://www.fas.gov.ru/fas-news/fas-news_32369.html?ct[1]=1&ct[2]=1&ct[3]=1&ct[4]=1&ct[5]=1&ct[6]=1&ord=1&curPos=10

[5] The judgment in the case against CJSC "TD TMK", OJSC "OMK-Stal", CJSC "ChTPZ Group", CJSC "ITZ", OJSC "ChTPS", CJSC "TD Uraltrubostal", CJSC "OMK", and OJSC "VMZ" was posted on the FAS' site; http://www.fas.gov.ru/netcat_files/234/186/h_33ea145a7ee18a88134e6a73619769eb

In the LDP case, large-scale (mainly, private) investments carried out by the pipe manufacturers had effectively resulted in a new sub-industry in Russia, i.e. a present-day production operation for LDPs. Without this new development, OJSC Gazprom would have had to meet its needs for pipes of that category (roughly 50 percent of the product range[6]) through imports. However, it is difficult to talk about a literal collusion among LDP manufacturers. Furthermore, the appearance of new market participants does not conform well with a collusion hypothesis aimed at limiting or excluding competition, as new participants can dramatically damage the stability of such an agreement.[7]

According to the information provided by the Association of Pipe Manufacturers to the Russian FAS in Letter No.121-11/APT, before 2010 the major pipe-manufacturing companies had invested a total of ca.10 billion dollars in the establishment and upgrading of pipe production facilities.[8] In turn, according to the information provided by the Federal State Statistics Service ("Rosstat"), approximately 200 billion rubles were invested in a specific type of economic activity—"Manufacturing of Cast-Iron and Steel Pipes"—in the period from 2005 to 2011 alone, or about 0.4 percent of 2011 GDP. This information refers to the successful implementation of a retooling program by a number of major pipe manufacturers within a relatively short period of time (5 to 7 years). However, these figures require further clarification, especially if used to test hypotheses unrelated to the one for a collusion between market participants within the product market definition set by the Russian FAS. In this connection, it should also be mentioned that the method to create a new sub-industry implemented in Russia has a number of specific features, one of which, ironically, is minimum direct participation by the state (see Appendix 1).

In addition, an important aspect of a successful collusion is not only its subject matter, but also the ways to enforce it. The result of collective actions by the participants is normally inconsistent with conditions of maximizing individual results. A maximum individual result (profits realized by an individual business entity) is ensured just when all the participants to an agreement comply with it, except for one individual company (which thereby earns the maximum result). Therefore, an enforcement mechanism is needed to discipline any violators. If it is illegal, the participants to such agreement cannot count on any protection by the state, so any enforcement tools created by the participants themselves are even more relevant.

Since any agreement—legal or illegal, formal or informal—is a tool limiting the freedom of individual choice of one of the participants, it must contemplate using diverse enforcement means. These would include a matching response in the event that it is established that: (i) any quotas have been exceeded, (ii) sales were made of the wrong assortment, (iii) sales were made to others than "one's own" consumers, or (iv) the company engaged in (covert) price cutting. Also

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[7] See [Vasconcelos, 2008]

[8] The text of that letter is unavailable from any open sources. However, similar information can be found at http://www.kommersant.ru/doc/1903821 (The Kommersant. "Oil and Gas". Supplement, No. 59 (4843), April 4, 2012), containing information on that in the period "from 2005 to 2011, the metal-makers invested about 7 billion dollars in the modernization of production of broad sheets and large-diameter pipes." Another source, http://www.metalinfo.ru/ru/news/49798, mentions the amount of 10 billion dollars, although the period is not clear ("over the last 7 years").

possible are such "asymmetric" response variants as threatened physical action against the company's decision makers. The less stable the situation, and the higher the degree of diversity (differentiation) of the product, the higher the requirements for the effectiveness of the enforcement mechanisms.[9]

Therefore, regarding the FAS investigation, it should have been expected that the investigation would have identified the elements of an enforcement mechanism. However, there was no evidence that the supply-side LDP market participants had created any such mechanisms. In this context, one of the principles at stake is whether it is possible to charge companies with any unlawful acts without any evidence containing information concerning the economic nature of an agreement (but not its effects).[10]

The arguments of the Russian FAS concerning the LDP markets and any competition-limiting actions was reduced to the following:

1. The electric-welded LDP market had a small number of market participants (one to three depending on a particular market within the product boundaries: single-joint longitudinally welded pipes, double-seam longitudinally welded pipes, or spiral-welded pipes).
2. Entry barriers were considerable, driven both by the need for large-scale initial investments and significant payback periods.
3. Customs duties, which are essentially protective, were important[11] (15 to 20 percent as compared to 5 percent in other, related industries).
4. Installed capacity significantly exceeded consumption by Russian consumers (yet, no explanation was provided as to whether or not consumption needs extended beyond the three-year period under study).
5. Access to the transport infrastructure and the sources of blanks (particularly for large-format sheets) were limited.

It is on these grounds that the antimonopoly authority declared the market to have weak competition.

Essentially, the listed circumstances could be interpreted in favor of the hypothesis that the market structure appears to be conducive to anticompetitive practices by participants.

[9] It is to change the balance between the economic effects of the two strategies—compliance and violation of a cartel agreement—in favor of the latter that the punishment abatement program aims to do [Aubert et. all, 2006]. The conditions of the effectiveness of a punishment abatement program introduced in 2007 into the Russian Code of Administrative Offenses are explored in [Avdasheva, Simankova, 2009].

[10] That issue is considered in greater detail in the context of the discussion of regular amendments to Article 178 of the Criminal Code of the Russian Federation containing the conditions of instituting criminal proceedings for the violation of the requirements of the antimonopoly laws in [Shastitko, 2013b].

[11] In light of Russia's accession to WTO, any attempts to preserve that level of customs duties in the long run will fail. This aspect takes on a special resonance for the industries in which the import customs duties for their products will be reduced and, as a consequence, competition with imports, all other conditions being equal, will increase.

However, a number of circumstances need to be taken into account when testing the collusion hypothesis.

III. COLLUSION HYPOTHESIS IN LDP CASE VERIFICATION

How market participants relate to each other is defined by a number of factors which should be taken into account not only when assessing the behavior of business entities, but also when the antimonopoly authority develops an approach looking to reduce the risks of type I errors (i.e. those errors which hinder beneficial cooperation between and among economic entities for public welfare).[12]

A. Factor 1

For several decades, LDPs had been importing goods for the USSR and then for Russia. Meeting the needs of major gas and oil transportation companies for Russian-made pipes was not accomplished until the early 21st century. As of 2012, the production capacity for LDPs was about 5 million tons,[13] with such capacity having been created either as a result of new construction or rehabilitation (Table 1).

Table 1. Main investment projects in the LDP segment in 2005 to 2010

Project	Operator	Implementation (year)	Investments (in $ million)	Annual capacity
Two LDP lines	OMK	2005	310	1,600,000 t
LDP workshop	Severstal	2006	300	600,000 t
VMZ capacity addition	OMK	2008	190	+380,000 t
VTZ capacity addition	TMK	2008	214	+650,000 t
Vysota 239	ChTPZ	2010	900	900,000 t

Source: http://www.kommersant.ru/doc/1903821, according to company data.

If, for example, the utilization of the production capacity in 2002 was 45.2 percent (just about 723,000 tons, respectively), then in subsequent years, even amid a crisis, it never went down below 60 percent (2008), reaching far higher levels in other years, as, for example, in 2010 (84.2 percent, totaling in absolute terms ca. 3.2 million tons, i.e. 4.4 times more than in 2002).[14]

[12] For more details concerning type I and II errors, see [Shastitko, 2011].

[13] http://www.metalinfo.ru/ru/news/49798

[14] A proviso should be made that the information provided by the Federal State Statistics Service deals with LDPs having a diameter of 480 mm and more, while the Analytical Report of the Russian FAS with LDPs having a diameter ranging from 530 mm to 1,420 mm. In this connection, an assumption is made whereby the share of LDPs having a diameter ranging from 480 mm to 530 mm is insignificant and has no effect on the order of the quantitative estimates obtained. A more accurate assessment of the share of the products of the said diameter by using the data available to experts does not appear possible.

B. Factor 2:

The FAS Analytical Case Report pointed out that the lion's share of LDPs made by Russian companies were used to build a gas transportation infrastructure (this refers, first and foremost, to single-joint longitudinally welded LDPs and spiral-welded LDPs). This means that the procurement process was ultimately (and largely) controlled by the OJSC Gazprom group (according to the estimates by the Russian FAS, more that 50 percent of electric-welded LDPs sold in Russia are used by the group.[15]) Overall, after making a tentative estimate of the aggregate purchases by the OJSC Gazprom group and OJSC Transneft, it would appear that those two entities consume the bulk of the LDPs both produced in and imported to Russia, although the situations differ rather dramatically in terms of the selected markets within the product boundaries. In this context, the following two interrelated circumstances are noteworthy:

1. To explain the economic content of any agreements, it is initially assumed that, because of buyers' self interest, any agreement to which they are a party can not be viewed as a collusion if there are several sellers acting on the other side. Indeed, a collusion in any market, according to the economic nature of that phenomenon, should exclude the participation of a buyer since a collusion goes against its interests.

   In addition, the provisions of the Russian antimonopoly laws produce an additional confirmation: The appearance of the term "cartel" in the wording of Article 11 of the law "On Protection of Competition" unambiguously indicates an agreement participated in solely by supply-side market participants (or, sometimes, demand-side market participants), but by no means suppliers *together* with consumers. Where a buyer is included in an agreement, that circumstance fundamentally changes the economic nature of the said agreement. It is in connection with this circumstance that grounds arise to raise a supersession (non-application de facto) of the price as a mechanism of governance which, under ordinary conditions, drives the interaction between buyers and sellers. If that is the case, then wrongly interpreting the matter may result in the substitution of (i) the notion of restricted competition with the preserved market mechanism with (ii) the supercession of the market mechanism (with an atomistic adaptation of each of the market sides to changing circumstances of goods circulation in the market).

2. The existence of a countervailing force[16] essentially creates obstacles to qualifying sellers in the market (markets) as being dominant. In this connection, what stands out is the judgment of the court in the *Russian FAS vs. OJSC Megafon* case[17] where, although the fact that the mobile communication operator had a high share in the market of traffic transfer services (including call termination) into its own network was admitted, the Court nevertheless took into account the circumstance that, as a buyer of the service in other similar services markets, OJSC Megafon could not afford to unilaterally determine the economic exchanges conditions in the market where it had a high share. Moreover, it

[15] http://fas.gov.ru/fas-in-press/fas-in-press_32311.html

[16] See [Chen, 2007]

[17] Judgment of the Arbitration Court of Moscow in case No. A40-14118110-17-942 dd. February 14, 2012. See also [Shastitko, 2013a]

is for this reason that the previously considered mechanism of governance when forming LDP delivery schedules (1b) appears to be most likely.

C. Factor 3:

Any business activity is risky. At the same time, it is not customary in economic theory to deem that entrepreneurs are a special category of risk-loving people; this is all the more so if we are talking about corporations. The fact that the best results often come from an environment of uncertainty (risk) is not a reason to believe that any entities achieving such results are risk-loving. Risk attitude is a personal (psychological) quality that says nothing about the capability of people to cope with or manage risks, just as the fact of participation in a lottery says nothing about the capability to win. In this connection, an important circumstance for explaining the form of a particular economic organization (business practice) is the high level of uncertainty and the related risk of substantial losses, particularly as driven particularly by the following factors:

a) significant durations of the production cycle (order cycles, as, for example, in case of sheet delivery from Germany, Japan, or South Korea to manufacture LDPs);

b) high costs of manufacturing as well as significant switch-over costs preventing LDP manufacturers from fully utilizing existing capacity to manufacture other goods for the same and/or other consumers; and

c) volatilities of both the supply conditions for the materials required for LDP output (first and foremost, the strip material or blanks for the manufacturing of pipes) and the demand from the main consumers. It is especially important to take this into account for the period after the year 2008 which is characterized not only by the significant deterioration in the global economic situation, but also by the upset of expectations formed as a result of almost two decades of no major crisis developments in the key economies of the world.

However, the stated circumstances would not be so important if Russia had not created, virtually "from scratch," a modern sub-industry to manufacturer LDPs. Without information concerning the future needs of the LDP market, producers would hardly have been able to decide to make multi-billion investments in the development and set-up of a production operation for LDPs. Correspondingly, the exchange of information between OJSC Gazprom and the production factories concerning future development forecasts (projected requirements and projected production capabilities) became an important factor facilitating the entry of the Russian manufacturers of LDPs into new commodity markets, offering competitive products.

D. Factor 4:

Russia is not the only country with a multi-branch network of cross-country pipelines. In this connection, the analysis, generalization, and evaluation of prevailing practices of relations between the pipe manufacturers and the companies controlling the pipeline network can be of fundamental importance. Do these said groups of companies really have long-term contractual relations? Are tender procedures used in this area? If yes, how are they organized? Does the Russian practice of organizing of LDP supplies show any fundamental differences, for example, from the European practice? If yes, what are the effects of such differences?

These questions present two aspects which seem to be important and need to be discussed in detail: (1) a time-based "sweep" of pipe supplies with an allowance for tender procedures, and (2) variants of pipeline construction organization.

1. Time-Based "Sweep" of Pipe Supplies with an Allowance for Tender Procedures

According to available internet resources, the world practice of awarding of contracts for LDPs involves organizing tender procedures. However, a more detailed analysis shows that there were no such announcements for LDPs among current competitive tenders (other than Russian tenders). In fact, we failed to discover any tender conditions or even any official announcements concerning competitive tenders for the supply of LDPs. But non-official reports provided information concerning a tender procedure for the supply of LDPs under the international project to install the "Nord Stream" gas pipeline. In this case, the sequence of negotiations was as follows:[18]

Prior to holding the tender, Nord Stream AG (shareholders: OJSC Gazprom–51 percent; Wintershall Holding (a subsidiary of BASF SE) and E.ON Ruhrgas-15.5 percent each; Gasunie and GDF Suez-9 percent each), in cooperation with its shareholders, undertook a study of the world market and chose six potential suppliers—manufacturers from Germany, Russia, and Japan. Only those companies were invited to participate in the November 2006 tender. A year later (in November 2007), contracts were signed with the successful tenderers (Europipe and OJSC Vyksunsky Metallurgichesky Zavod (Vyksa Steel Works)) stipulating the delivery terms and ensuring the timely implementation of the project to build the first line of the "Nord Stream" offshore oil pipeline. The delivery period for the Russian company was from May 2008 to the end of 2010.

However, no available information allows us to assess the extent to which such a procedure is typical for procurement of LDPs.

2. Variants of Pipeline Construction Organization

The construction of a pipeline following the completion of the design and engineering stages depends on whether there is an infrastructure existing which allows accumulating LDPs in significant quantities before the construction of the pipeline begins. Specifically, there needs to be: (a) special storage facilities to safeguard the LDPs' and (b) sufficient transport infrastructure development to provide for uninterrupted supplies of LDPs from the storage facility in accordance with the approved schedule.

If the required infrastructure is in place, the interrelation between the tender terms and the physical start of pipeline construction is of the essence, while the connection between the construction and the actual delivery under the lot won by a particular LDP supplier after the construction is launched may be weaker. This requires a sufficient amount of time between the completion of the engineering design of the pipeline (development of all required engineering and technical specifications) and the physical start of construction. Let's imagine a situation where two years are provided for the construction of a pipeline and the construction should

[18] http://www.niann.ru/?id=345824

commence within a year following the approval of the project. This period of time is quite sufficient to build up a stock of LDPs to ensure uninterrupted supplies for the major portion of the project.

If there is no such infrastructure, then the "zero warehouse" variant should actually be implemented, i.e. the just-in-time system. This has a number of specific features reflected in other related issues dealing with the organization of the production and delivery of LDPs. First, just-in-time requires a far higher level of dealing with logistics issues pertaining to the use of the limited throughput capacity and the need for precautions in case of any interruptions in the LDP delivery chain link. In other words, to ensure that the project begins on time, it is required to identify and offset the risks associated with diverse asset specificity dimensions, including temporal specificity,[19] with mechanisms allowing quick adaptation to any contingencies.

Therefore, the specific features differentiating the Russian practice of preparing for a project to build cross-country pipelines from European or North American practices need to be identified, along with the consequences from those specific features. It is also important to consider when using the elements of the "comparable markets in a competitive environment" concept in the event that the antimonopoly authorities may make any claims.

IV. CREDIBLE COMMITMENTS IN LDP PROCUREMENT AND CONTRACTING

To both ascertain the nature of contractual relations (using the LDP case as an example), and to form norms for antimonopoly enforcement, it is highly important to explain the methods used by the companies (first and foremost, by the manufacturers of LDPs) to offset their production and competitive (especially from importers) risks.

The absence of internal LDP production in Russia for a long period of time (several decades) despite, it would seem, a natural need (transportation of gas and oil over large distances) and capabilities (developed metallurgical base) may indirectly indicate that the problem of credible commitments was unsolved and that there were no incentives for investments, nor that there were any other circumstances making internal production of LDPs urgent. The feasibility of a production chain involving vertical integration (most likely, of the OJSC Gazprom group for the pipe manufacturing sector) was low as well, and not only because of inefficiency. Also relevant explanations were the economic reforms in the 1990s and in the early 2000s, not to mention the antimonopoly control costs.

That is why an important question is how the Russian companies resolved the problem of commitment credibility in connection with using highly specific capital (in economic terms, high switching costs to alternative consumers).

The materials in the Gazprom case contain the factory shipping schedule for LDPs under OJSC Gazprom's projects from 2008 to 2010. The schedule presents the total scope of supplies by for three years, by quarter; as well as by pipe size, strength class, and manufacturer. It is evident

[19] As one of the forms of the specificity of assets, the temporal specificity is described first in [Masten et al, 1991]. Its importance in determining the form of organization is confirmed on the basis of empirical materials, for example, in [Hwang, 2006]

from the schedule that supplies from different companies for one project were most likely interrelated.

This implies that there are also issues related to risks, first and foremost, of negative externalities. The negative externalities are due to the fact that the pipeline has value for the consumer (in this case, the OJSC Gazprom group) as a component of a larger project. Accordingly, any failure to implement one part of a project may, all other conditions being equal, negatively affect the possibility of implementing another part, not only regarding physical capital specificity, but also regarding the temporal specificity.

Supposing that the shipping schedule is to be fulfilled rigorously, then all the subsequent tender procedures are a formality since they are held without regard to the specific features of the pipeline construction projects, including ensuring the supplies of the strip material for the manufacturing of LDPs within a much shorter time frame. From this perspective, the behavior of the LDP manufacturing companies could draw objections, indeed.

Indeed, introducing such procedures, and strictly complying with them, could make such procedures from the outset either impossible or insufficient because there would inevitably be no adequate supply (by term, structure, or any other conditions). This would eventually mean either reliance on imports (as demonstrated by the history of the previous decades) or frustrated investment programs to develop and maintain the gas transportation and oil transportation systems. This would have negative consequences for the Russian hydrocarbon manufacturers in regards to external markets and, correspondingly, have consequences for budgets which are already burdened with commitments, and any dismissal of those commitments could prove also prove costly.

The practical solution of the problem of credible commitment depends, in the first place, on any alternatives that are available to the contract participants—subject to the national statutory requirements—and, in the second place, on any alternatives that the contract participants are ready to consider as real rather than fictitious. Such alternatives include:

1. Using indicative medium-term and long-term planning. In fact, it appears from the materials in the case that an attempt was made to use this particular variant. Unlike in a collusion, an indicative planning system necessarily implies participation of two parties having opposing interests from the outset. Moreover, the applied delivery organization scheme, i.e. using services provided by trading companies and without direct contractual relations with OJSC Gazprom, makes this method of interaction crucially important to create and provide incentives for LDP manufacturers to continue supplies to OJSC Gazprom.
2. Procurement and supply procedures for LDPs with an allowance for the strip material order and delivery cycle and the production of LDPs from such strip material. In effect, this alternative implies that LDP manufacturing companies may participate in tenders without assuming any risks related to significant sunk costs, i.e. costs incurred to create any products having no or very limited alternative application. Once a company has been awarded a contract for the supply of LDPs, it has time to make production arrangements (naturally, by using its existing production facilities). Yet, there is another important

condition that needs to be met—the lot size must reflect the supply capacity of an individual manufacturing company.

According to available information, the time elapsing from the date on which the successful tenderer was determined to begin shipping was several months. The least gap (3 months) was identified for Europipe (the lot size was not monitored as part of the analysis), while for the other projects it was 6 to 9 months.

Table 2. LDP Delivery Terms for Diverse Projects

LDP supplier	Project	Date of tender or project announcement	Contract award date	Commencement date of supplies
OJSC Vyksunsky Metallurgichesky Zavod (Vyksa Steel Works)[20]	Nord Stream	tender: November 2006	November 2007	May 2008
Salzgitter Mannesmann International GmbH[21]	Taweelah to Fujairah Gas Pipeline	tender: November 2007	December 2007	40% of supplies made in July 2008
EUROPIPE GmbH[22]	Ichthys LNG Project	tender: December 2010	February 2012	April 2012
Nippon Steel[23]	Australia Pacific LNG	project: January 2010 decision: July 2011	August 2011	January 2012
Mitsui & Co., LTD. Nippon Steel[24]	Gas Pipeline in Mediterranean Sea	project: January 2006 decision: December 2006	February 2007	October 2007

3. Long-term negotiated contracts between the respective entities of OJSC Gazprom and LDP manufacturers. This variant has a number of sub-variants, including long-term contracts with automatic extensions or extensions based on negotiations, but, in effect, none of these had been used because the contracting practice was focused on short-term relations relative to the planning horizon for LDP production and supplies. The case materials contain information explaining why this variant between the OJSC Gazprom group and LDP manufacturers was never put in place. This was due to the decision made by OJSC Gazprom concerning the pipe procurement procedure.
4. Utilization by LDP manufacturers of financial instruments to insure their risks. However, no references were found in the case materials that some stakeholder or other entity had

[20] http://www.niann.ru/?id=345824; http://odrag.ru/prim/399-vyksunskij-metallurgicheskij-zavod-oao-vmz-2

[21] http://www.dolphinenergy.com/press-releases-detail.aspx?id=52; http://www.dolphinenergy.com/press-releases-detail.aspx?id=50; http://www.gulfoilandgas.com/webpro1/MAIN/Mainnews.asp?id=6232

[22] http://www.inpex.co.jp/english/news/pdf/2010/e20101101.pdf; http://www.europipe.com/107-1-News.html

[23] http://www.aplng.com.au/sites/default/files/APLNG_signsKeyUpstreamContracts.pdf ; http://www.hydrocarbons-technology.com/projects/australia-pacific-lng-queensland/; http://www.aplng.com.au/sites/default/files/Nippon_WASCO_contract.pdf

[24] http://www.medgaz.com/medgaz/pages/nota_prensa_7-eng.htm; http://www.medgaz.com/medgaz/pages/nota_prensa_10-eng.htm

ever raised or discussed this idea.[25] Apparently, this is due to the fact that Russian trading sites are not ready yet to organize trading in such complex financial instruments, while the entry into any foreign sites involves additional costs. Apparently, this is also due to the fact that supplies under the same OJSC Gazprom project are made by different manufacturers, even within one quarter.

5. Direct state regulation of this area. In effect, this would mean that the right to make decisions concerning the material elements of contracts should be delegated to a dedicated regulator, with pipe manufacturers preserving their formal status as private companies. The problem of using this scheme is closely linked to issues relating both to an efficient use of information and full costs of regulation (including in connection with distorted incentives) that are deemed to be last resort measures to offset market behavior risks. In this context, attention should also be drawn to the risks related to the expansion of insider trading along with the non-transparent effect on the decisions made by the regulator.

6. Establishing a joint venture with other pipe manufacturers and consumers; in particular, to develop and commercialize new products (as, for example, between Exxon, as one partner, and Nippon Steel and Mitsui, as the other[26]). However, the establishment of a JV with the participation of one of the LDP manufacturers would invariably put it at an advantage, while a JV with the participation of all manufacturers is not only risky in terms of preserving a competitive environment, but also is extremely difficult to set up (if it is to be more than just a mere formality).

The actual result of an effective ban on long-term contracts with LDP manufacturers is the use of the variant defined by two key elements:

- indicative planning by developing supply schedules with strong mutual dependence between the buyers (consumers) of LDPs and the manufacturers of LDPs in a situation when the consumer, nonetheless, can still rely on imports; and
- insurance of pipe manufacturers' risks in circumstances where there is a mismatch between the tender procedures, on the one hand, and the specific features of the production and supply of LDPs and the strip material to produce LDPs, on the other hand. This insurance can be achieved by including trading companies having a required minimum level of assets and experience in dealing with logistics challenges so that compensation can be obtained in case of their failure to fulfill their obligations.

Ultimately, the FAS took into account the fact that a major buyer turned out to be a party to the agreement, which allowed requalifying the actions observed from collusion (Clause 1 of Article 11 of the law "On Protection of Competition") to agreements limiting competition (Clause 4 of the same Article). The said clause concerns offenses that can be excused in accordance with the balanced approach rule.

[25] It should be noted that the use of credit resources in this case cannot be viewed as an insurance technique since the loan would still have to be repaid should the project fail. For this purpose, reference is made to such forms as guarantees (including by the state) and reduced risk of switching over to imported products.

[26] http://www.skladmetalla.ru/news/1708

V. CONCLUSIONS

The conditions prevailing in the LDP markets and the actions by LDP manufacturing companies can be explained without using a collusion concept. This conclusion is based on a thesis where the identified institutional details and context are important for qualifying the actions and agreements between the market participants, as well as for assessing their consequences. Among the key points and lessons learned from the antitrust LDP case are:

1. The leading role of the OJSC Gazprom group, a major buyer in the LDP markets along with OJSC Transneft, contradicts the idea that manufacturers' collusive behavior, which aggravates the position of a buyer, can be organized with the active participation by that buyer without some additional and special assumptions.
2. For the period 2005-2011, the strategic task to create a modern Russian industrial base for LDP production has been fulfilled. Previously, substantial risks of large-scale private investments in assets with a high degree of specificity had constituted a major entry barrier. The feasability of organizing a collusion among the market participants, i.e. the national manufacturers of LDPs—given the existence of historically dominant imports—is difficult to substantiate and prove under conditions of positive transaction costs and when based only on the assumption of collective actions by sellers. It is important to take into account external factors relative to LDPs manufacturers.
3. The establishment of collusion, by itself, although requiring no indepth market research to answer all the questions—from determining the time interval to the competitive situation characteristics—still requires an answer to the question of whether any enforcement mechanisms exist that ensure that each of the individual market participants (in this case, LDP manufacturers) adhere to the agreement.

The "picture of the world" in the LDP antitrust case, as presented in terms of the LDP supplies organization used in 2008-2010, can be seen as a need to reduce manufacturers' contract risks in a situation where it was necessary to ensure that the conditions of LDP production, including purchases of the strip material from independent producers (including imports), be compatible with the conditions of supplies determined by OJSC Gazprom. In effect, such an organization of the production and supplies of LDPs, i.e. the drawing-up of strategic and day-to-day schedules and utilization of services provided by wholesale dealers in LDPs, can be viewed as a method to ensure manufacturers' liability in the conditions of rigorous delivery schedules, and to provide for required flexibility (deal with logistics challenges) in the conditions of presumed "just-in-time" pipeline construction.

This thesis is definitely important for understanding the selected method of organization of LDP supplies, but the materials in the case do not make it possible to build a complete enough picture of the construction organization system for cross-country pipelines to allow us to properly assess the required degree and scope of the resources required to provide LDP supplies.

Studying the interaction between the LDPs manufacturers and the OJSC Gazprom group allows us to interpret this interaction in terms of indicative planning. Risks incurred by the LDP manufacturers were partially offset by an increased degree of certainty required not only for making private investment decisions to create new facilities, but also for manufacturing LDPs

based on the relevant specifications, and by using the strip materials purchased, without restrictions, from third-party entities.

From this perspective, it is arguable that what is happening is not the squeezing-out of competition on the side of LDP manufacturers, but rather the partial substitution of the price mechanism by alternative methods of interaction organization between LDP manufacturers and the OJSC Gazprom group as the main consumer. Therefore, we have a case where the choice of complex mechanisms of governance disagrees with antitrust law enforcement.

APPENDIX 1: Box 1—Encouraging the Development of New Production Operations

The pipe-manufacturing industry is a capital-intensive type of production operation. According to international practices, the main constituent element of the state policy for developing such industries at the initial stage is ensuring the required level of investments that can be implemented in several ways.

1. If we are talking about setting up a production operation "from scratch," the following variants are possible:
    a) Establishing a state-owned company (such as setting-up of POSCO, an iron-and-steel company, as a state monopoly in South Korea.)[27]
    b) Raising foreign investments (demonstrated by an amendment of Brazilian laws to limit the import of finished automobiles and encourage foreign investments in the development of the automotive industry in Brazil, which initiated billions of dollars worth of investments by key global brands.)[28]
2. If, however, we are talking about encouraging a new type of product to be manufactured at already existing facilities, it is necessary to offer incentives to private companies to make considerable investments. At the same time, the presence of demand for new products guaranteed by the state (for a certain initial period) will be essential to companies:
    c) Grants for certain developments of state orders with simultaneous encouragement of internal demand (such as the provision by NASA in 2008 of $50 million grants to private companies to organize manned flights to the near-earth orbit[29] The young companies of the U.S. aerospace industry already have customers to put cargo into orbit by using new-type rocket vehicles).
    d) Motivating private companies to make investments without direct financing by the state.
3. Essentially, the Russian Government used this very method to develop the manufacturing of LDPs. According to the minutes of the meeting with the Chairman of the Government of the Russian Federation, No. VP-P9-25pr dd. July 24, 2009 (Magnitogorsk),[30] the issue of using the following tools was studied as part of state policy measures:
    e) increasing import duties;

[27] http://www.perspektivy.info/rus/ekob/otraslevaja_promyshlennaja_politika_kak_motor_modernizacii_ekonomiki_2012-01-27.htm

[28] http://www.latindex.ru/content/articles/9068/

[29] http://news.bbc.co.uk/2/hi/science/nature/8489097.stm

[30] Not publicly available. Provided as an excerpt from the materials in the case to understand the situation context.

f) reducing duties on individual types of raw materials and equipment for the metallurgical complex;

g) applying federal law on the regulation of the procedures for goods (services) procurement by natural monopoly entities and state-owned corporations as related to the application of preferences for suppliers of Russian goods to procurement of products for the metallurgical industry;

h) issuing a directive for OJSC Gazprom representatives concerning organization of tenders requiring they provide for Russian supplies of pipes in proportion to the share of the Russian party in any gas transmission network development projects; and

i) issuing orders concerning the development of the demand and supply balance for pipes.

APPENDIX 2: Literature

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