

Leniency Programs and Customer Damages in the Fight Against Cartels

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Introduction

- Background
 - What are the objectives of competition law and enforcement?
 - Claim: Deterrence is undervalued.
- Session 1
 - How does a leniency program achieve the goals of shutting down active cartels and deterring prospective cartels?
 - What are some potential challenges with a leniency program?
- Session 2
 - Should a competition authority allow leniency recipients to avoid liability for damages?
 - What factors should be considered in such a decision and how should one deal with consumers' rights?

Objectives of a Competition Authority

- Cartels create consumer harm
 - “Cartels are cancers ...” - Mario Monti, former European Commissioner for Competition, 2000
 - Collusion “is the supreme evil of antitrust.” - U.S. Supreme Court Justice Antonin Scalia, 2004
- Objective of a competition authority is to minimize that harm by
 - shutting down active cartels
 - deterring prospective cartels from forming.
- Stages of enforcement
 - 1 Discovery
 - 2 Prosecution
 - 3 Penalization
 - 4 Evaluation (of policies and programs)

Objectives of a Competition Authority

Claim: Deterrence is undervalued.

- Primary goal should be to deter cartels from forming rather than shutting down cartels.
- Competition authorities focus on convicting cartels rather than lowering the number of cartels that are operating because
 - convictions inform a CA that it is having an impact.
 - convictions and penalties promote political support.

Objectives of a Competition Authority

- Bill Baer, Assistant Attorney General - Congressional Testimony (March 9, 2016)

Last year we obtained over \$3.6 billion in criminal fines and penalties. ... Over the last seven years, we have prosecuted over 400 individuals who committed antitrust crimes. ... From 2006 to 2015, the average number of individuals sentenced to prison increased 85 percent, and the average sentence increased 65 percent over the preceding decade.

- All are impressive accomplishments, but *are there fewer cartels in 2016 than in 2006?*

Objectives of a Competition Authority

- Concern that convictions becomes viewed as an end in itself, rather than a means to reducing the presence of collusion in the economy.
- How might insufficient attention to deterrence manifest itself in the behavior of a CA?
- Discovery - Not pursuing policies that would lead to the discovery of more cartels.
 - If there are ample cases to keep case handlers busy, a CA focused on convictions may not be interested in programs that uncover new cases such as
 - screening market data for suspected cartels.
 - whistleblower programs that offer rewards for uninvolved people reporting cartels.

Objectives of a Competition Authority

- Prosecution - Avoiding challenging cases
 - If the focus is on convictions, this may lead a CA to avoid difficult cases out of concern of not getting a conviction.
 - But prosecuting a difficult case could establish
 - an important precedent and expand the set of unlawful practices
 - a reputation that no cartel is immune from prosecution.
- Penalization - Not being as aggressive in levying high penalties
 - If the focus is on convictions, there may be an inclination to settle on a penalty acceptable to the defendants.
 - Committing to high penalties could be critical for deterrence.
 - DoJ's policy of putting people in jail serves well the deterrence goal.

Objectives of a Competition Authority

- Evaluation (of policies and programs)
 - A program's success is not to be measured by the number of convictions but by how many cartels there are in the economy.
 - Failure to recognize that the cartel rate is the proper measure can result in a CA not collecting the data one needs in order to address it.
 - As a result, a program is put in place but we don't really know if it is succeeding.
 - Should it be modified? Should penalties be increased? Does the CA need more resources? Should other programs be developed?
 - Recent example of the costs from failure to evaluate: Merger "remedies" in the U.S. The evidence is that they do not work.

Benefits of a Leniency Program

Description

- A *leniency program* offers reduced penalties to corporations and/or individuals involved in collusion, in exchange for cooperating with enforcement authorities.
- Overview
 - Benefits of a leniency program
 - Challenges of a leniency program

Benefits of a Leniency Program

Description

Reduction in Fines from Leniency Program

	Before an Investigation			After an Investigation		
	U.S.	EU	Peru	U.S.	EU	Peru
First firm	100%	100%	100%	100%	30-100%	30-50%
Second firm	Plea	30-50%	30-50%	Plea	20-30%	20-30%
Third firm	Plea	20-30%	20-30%	Plea	0-20%	0-20%
Later firms	Plea	0-20%	0-20%	Plea	0-20%	0-20%

Plea - Reduced fine from plea bargaining. In the U.S., the second cartel member to plead guilty received a mean discount from the maximum recommended sentence of 75% (Connor, 2007)

Benefits of a Leniency Program

Discovery of cartels

To what extent can a leniency program decrease cartel duration and reduce the number of cartels?

- Provides incentives for a cartel member to report in exchange for a lower penalty.
- How can a CA enhance those incentives? (Harrington, *Journal of Industrial Economics*, 2013)
 - A firm is more inclined to apply for leniency if it thinks there is a higher chance it'll be caught and convicted.
 - **Prosecution effect:** A firm applies because it thinks it is sufficiently likely that the CA will prosecute and convict it without any cartel member applying for leniency.
 - **Preemption effect:** A firm applies because it thinks it is sufficiently likely that another cartel member will apply for leniency.

Benefits of a Leniency Program

Discovery of cartels

Prosecution effect is magnified through the preemption effect

- A stronger prosecution effect makes each firm more inclined to apply for leniency because it thinks the CA is more likely to convict.
- Each firm realizes that the stronger prosecution effect makes other firms more inclined to apply which then makes a firm more inclined to apply in order to preempt other firms.

Rise in Prosecution Effect \Rightarrow Rise in Preemption Effect

Benefits of a Leniency Program

Discovery of cartels

- If a CA develops a reputation of only going after cartels with a leniency applicant then the prosecution effect is lessened which lowers the incentive to apply for leniency and thus weakens the leniency program.
- Prosecution effect is enhanced by making detection more likely when no one applies for leniency.
 - Screening
 - Whistleblower rewards

Benefits of a Leniency Program

Discovery of cartels

- *Screening* is the analyzing of market data for the purpose of discovering collusion.
- Screening is
 - intended to provide evidence to justify an investigation
 - **not** intended to deliver the evidence to prosecute a case
- Screening has been performed by the competition authorities of Brazil, Chile, Korea, Mexico, Peru, The Netherlands, South Africa, Sweden.

Benefits of a Leniency Program

Discovery of cartels

Screening and leniency programs are complements

- Screening enhances the efficacy of a leniency program
 - The more likely a cartel member believes it'll be caught, the more inclined it is to apply for leniency.
- A leniency program enhances the efficacy of screening
 - If a CA discovers a suspected cartel then an investigation might induce a firm to apply for leniency.

Benefits of a Leniency Program

Discovery of cartels

- *Whistleblower programs* provide rewards to uninvolved people who report a suspected cartel to the government.
- Countries with whistleblower rewards:
 - South Korea (2005) - up to (approx.) 3 million Peruvian Sol
 - United Kingdom (2008) - up to 500,000 Peruvian Sol
 - Hungary (2010) - at least 1% of govt fine up to 600,000 Peruvian Sol
 - Taiwan (2015) - 5-20% of govt fine up to 5 million Peruvian Sol

Benefits of a Leniency Program

Discovery of cartels

- Examples of uninvolved employees having information about a cartel
 - Cement (Argentina): “disgruntled employee revealed to a newspaper that the cement companies were exchanging information and dividing their market shares” .
 - Cement (Brazil): Former employee of Votorantim Cimentos reported the cartel.
 - Carbonless paper (EU): “A Sappi employee admits that he had very strong suspicions that two fellow employees had been to meetings with competitors. They would come back from trade association meetings with a very definite view on the price increases that were to be implemented.” (EC Decision, 2001)
- Why wait for them to become disgruntled or depart? Why be content for them not to report? *Incentivize with financial rewards.*

Benefits of a Leniency Program

Discovery of cartels

Marketing may enhance the preemption effect.



Nationwide marketing campaigns
(airports, weekly magazines & postal cards)

“Companies that participate in cartel get dirty”



Benefits of a Leniency Program

Discovery of cartels

Marketing may enhance the preemption effect.

- Advertise to encourage reporting of collusion through leniency and whistleblower programs.
- Plant the concern in a cartel member's mind that another cartel member may apply for leniency.
- Target industries prone to collusion using trade publications and presentations at trade association meetings - cement, construction, chemicals, etc.

Benefits of a Leniency Program

Prosecution and conviction of cartels

- Leniency program delivers the best evidence: a cooperating cartel member.
- Leniency program can provide incentives for a cartel member to retain evidence for the purpose of a future leniency application.
 - Not destroying written documents (e.g., fine arts auction houses)
 - Recording cartel meetings (e.g., Australian packaging)
- How can that incentive to retain (and create) evidence be increased?
 - For the first firm to come forward, be generous in providing amnesty.
 - For later firms, hold them to a stringent standard of substantively advancing the case with hard evidence.

Benefits of a Leniency Program

Penalization of cartels

- Every nuevo sol of leniency given to a cartel member lowers its penalty but indirectly enhances deterrence by raising expected penalties to other cartel members.
- ① Start with high penalties.
 - Why bother to apply for leniency and disrupt collusion if penalties are low?
 - Low penalties may explain why some leniency programs have few applications.
- ② Create a significant differential between the penalty paid when applying for leniency and when one does not apply.

Benefits of a Leniency Program

Penalization of cartels

Toilet Paper Cartel (2005-2014)

- Annual market sales = US\$237 million/year
- Price = \$0.20/roll, Quantity = 1.2 billion
- Cartel: Market share = 88%, Quantity = 1 billion
- Overcharge = 10-20%, approx. \$.03/roll
- Incremental profit = $.03 \times (1B) \times (10 \text{ years})$
= \$300 million
- "The fines ... could exceed \$1 million for each company."



Fines are too low and will weaken the leniency program.

Benefits of a Leniency Program

Evaluation

- Providing leniency makes sense only if it
 - reduces cartel duration because a firm from an active cartel applies for leniency
 - deters cartel formation because it increases expected penalties.
- To determine a leniency program's efficacy, we need to understand:
 - Is it shutting down active cartels?
 - Is it deterring cartels from forming?
 - Is it reducing the cartel rate in the economy?

Benefits of a Leniency Program

Evaluation

Proper documentation of a case can assist in addressing these questions.

- Why did a firm apply for leniency at this time?
 - What induced it to apply? Was it a customer complaint? Cartel death?
- How do cartels discovered through a leniency program differ from those discovered through other means?
 - Are they more likely to be inactive? Is duration shorter? What are the characteristics of the industry (e.g., retail vs. wholesale vs. manufacturing)?

Challenges of a Leniency Program

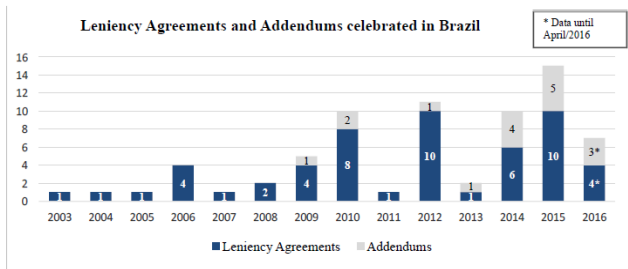
Overview

- 1 A leniency program may not be active.
- 2 A leniency program may be active but not be as effective as one would like because
 - 1 applications are coming from inactive cartels
 - 2 caseload is biased towards less stable and less harmful cartels.

Challenges of a Leniency Program

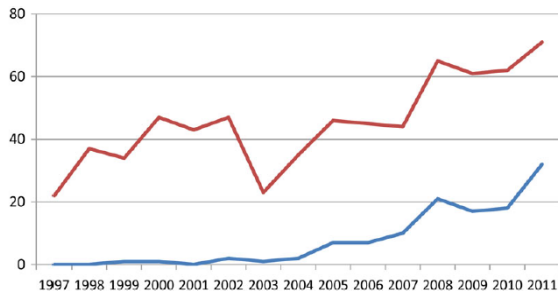
Will a leniency program have applications?

- Leniency programs are not always active
 - Very few applications in Estonia, Israel, Latvia, Lithuania, Poland, Turkey (OECD Policy Roundtable, 2013).
- Leniency programs can be slow to develop



Challenges of a Leniency Program

- Leniency programs can be slow to develop



Republic of Korea

Red : Convicted cartels

Blue: Convicted cartels with leniency

Challenges of a Leniency Program

- Chile
 - 2009 - leniency program instituted
 - After five years - 4 applications
- South Africa
 - 2004 - leniency program instituted
 - After five years - 28 applications

Will a country be Chile or South Africa?

- **Recommendation:** Adopt complementary instruments - such as screening and whistleblower rewards - to augment a leniency program's efficacy.

Challenges of a Leniency Program

Will a leniency program largely bring forth applications from dying cartels?

- Evidence from the European Commission
 - EC official Olivier Guersent expressed this concern at the 11th Annual EU Competition Law and Policy Workshop (June 2006)
 - 1996-2012: 97 out of 110 cases with a leniency awardee involved applications *after the death of the cartel*.
- Incentives to applying for leniency are stronger when a cartel is no longer active.
- If applications are coming from dying cartels then a leniency program is contributing to deterrence (by raising penalties) but it is not shutting down active cartels.
- **Recommendation:** Keep track of how a cartel is discovered and whether or not it was active.

Challenges of a Leniency Program

Will a leniency program crowd out the prosecution of non-lenieny cases?

"My concern is that most of the cases that are brought today are ... generated exclusively from firms that decided to come forward and seek a leniency application I'm worried that the success of the leniency program combined with budget constraints that your Division faces will, in effect, give you incentives to pursue only the companies that come forward ... [A]s I know from personal experience, some of the most egregious and harmful of the cartels may have nobody coming forward."

- U.S. Senator Bill Blumenthal speaking to Assistant Attorney General Bill Baer, U.S. Senate Hearing on "Cartel Prosecution: Stopping Price Fixers and Protecting Consumers" - November 14, 2013

Challenges of a Leniency Program

Harrington and Chang (*Journal of Law and Economics*, 2015)

- Theoretical analysis shows that a leniency program can *increase* the duration of the most stable cartels.
 - A leniency program is more likely to be used by collapsed cartels.
 - The large number of leniency cases can induce a CA not to take on non-lenieny cases because of a resource constraint.
 - The more stable cartels - which are less likely to collapse and apply for leniency - may find the probability of prosecution to be lower.
- António Gomes, President of the Portuguese Competition Authority (2014):

Cartels which have already become unstable ... are more likely to lead to a leniency application. On the other hand, cartels whose members are successful in maintaining stable collusion rules for several years ... are more difficult to be detected through leniency programs.

Challenges of a Leniency Program

- Avoid making the environment more hospitable to the most stable cartels.
- **Recommendations:**
 - Complement the institution of a leniency program with high penalties and a process that expeditiously handles leniency cases.
 - Use screening and whistleblower rewards.
 - Maintain a balance of initiating investigations with and without leniency applicants.

Customer Damages and Leniency

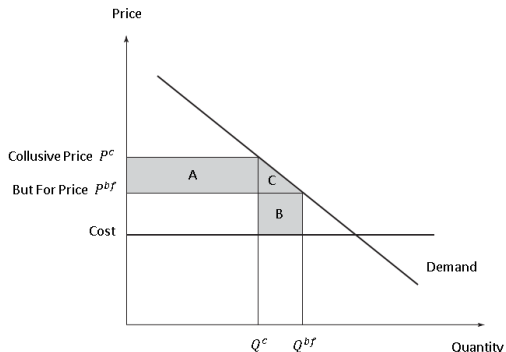
Overview

- What is the purpose of customer damages?
- Why might we want to absolve a leniency applicant of customer damages?
- How should we evaluate the benefits and costs to consumers of less compensation?
- How can we promote use of the leniency program while mitigating its impact on compensation?

The Case for Customer Damages

Cartel damages are typically calculated to be $(P^c - P^{bf}) Q^c$ (area A)

- P^c is the observed (collusive) price.
- Q^c is the number of units sold.
- P^{bf} is the "but for" (or counterfactual) price.
- $P^c - P^{bf}$ is the overcharge.



The Case for Customer Damages

Damages serve deterrence

- ① Damages increase the magnitude of the penalty.
- ② Damages more closely tie the financial penalty to the incremental profit from collusion and, therefore, are better designed than government fines to deter cartel formation.
 - Deterrence requires making collusion unprofitable in expectation which means a higher penalty when the incremental profit from collusion is higher.
 - Government fine is tied to sales: Maximum fine in Peru is up to 12% of sales.
 - Tying the level of fines to sales does not ensure that more profitable cartels are subject to higher penalties.
 - Damages are often a good approximation for the incremental profit from collusion though overestimate by area B.

The Case for Customer Damages

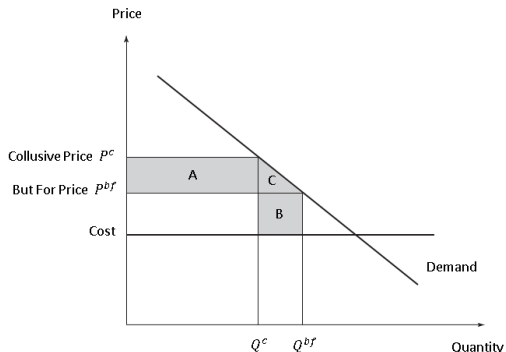
Damages provide compensation

- For those units purchased at an inflated price, consumers are reimbursed for the additional amount paid.
- In no jurisdiction is compensation complete because of practicality, deterrence, convention.
 - ① Foregone purchases: Damages are not collected on units no longer purchased.
 - ② Indirect purchasers: In some jurisdictions, damages can only be collected by direct purchasers.
 - ③ Umbrella pricing: Damages are often not collected from higher prices paid to non-cartel members.

The Case for Customer Damages

Customers are not compensated for foregone surplus from units no longer purchased (area C)

- A consumer who stops buying because of collusion does not collect damages.
- This consumer loss can be estimated but is not typically done as part of damage calculation.



The Case for Customer Damages

In some jurisdictions, indirect purchasers are not compensated.

- In U.S. at the federal level, only direct purchasers can sue.
- In many intermediate goods cartels, there is probably a high cost-pass through rate with minimal quantity effects so that direct purchasers are minimally harmed and final consumers realize most of the harm.
- Primary rationale for only allowing direct purchasers to sue is deterrence.
 - Direct purchasers, who are often industrial buyers, are best positioned to monitor for collusion. We want to incentivize them to monitor and sue.
 - The Seventh Circuit notes that “[t]his may result in a windfall for the direct purchaser, but preserves the deterrent effect of antitrust damages liability while eliding complex issues of apportionment.” (*Motorola Mobility*, 2014)

The Case for Customer Damages

Customers are typically not compensated for buying at higher prices from non-cartel suppliers.

- When cartel members raise their prices, non-cartel members will also raise price to a level below the collusive price (umbrella pricing)
- That price increase would not have occurred but for collusion.
- It is no more difficult to measure the but for price for purchases from a non-cartel member than from a cartel member.
- European Court of Justice (June 2014) ruled that victims may obtain compensation when the cartel is shown to be "liable to have the effect of umbrella pricing being applied by third parties acting independently."

Customer Damages: U.S. vs. EU

- United States - damages are designed to deter
 - Historically, government fines were low and damages were the primary corporate penalty.
 - Treble damages (though single damages at settlement is typical)
 - Only direct purchasers can sue
- European Union - damages are designed to compensate
 - Government fines are high and viewed as the primary corporate penalty.
 - Single damages
 - Indirect purchasers can sue

Customer Damages and Leniency

Proposal: A firm that receives leniency is not liable for customer damages.

- *Why might we want to absolve a leniency applicant of damages?*
 - A firm has a stronger incentive to apply for leniency when the differential penalty between applying and not applying is larger.
 - That differential is increased if a leniency awardee both avoids paying a government fine and customer damages.
 - Avoiding customer damages can then help shut down cartels and deter cartels.
- *How should we evaluate the trade-off between disabling and deterring more cartels and reducing compensation?*
- *What policy minimizes net harm to consumers?*

Customer Damages and Leniency

Judge Frank Easterbrook

"Deterrence is ... the first, and probably the only, goal of antitrust penalties. If awarding damages to an injured party also compensates them, that is a pleasant by-product."

- This is correct **if** penalties can deter a cartel from forming. In that case, there is no harm.
- If a cartel is not deterred then one should consider whether reduced compensation is offset by a reduction in harm.

Customer Damages and Leniency

$$\text{Net harm} = \text{annual harm} \times \text{duration} \\ - \text{prob. of conviction} \times \text{damages collected}$$

Allowing a leniency awardee to avoid paying damages

- increases net harm due to smaller damages collected.
- decreases net harm if it results in
 - shorter cartel duration
 - a higher probability of damages being collected

Customer Damages and Leniency

- Giving a firm leniency is beneficial to consumers only if it
 - reduces cartel duration (because a firm from an active cartel applies for leniency)
 - deters cartel formation (because it increases expected penalties and makes collusion unprofitable)
- Any reduction in compensation from damages should be offset by less harm due to fewer cartels or shorter cartel duration.
- This then requires determining whether a leniency program is
 - inducing applications from *active* cartels.
 - deterring some cartels from forming.

Customer Damages and Leniency: U.S. Experience

- Treble damages
 - If there is a guilty verdict then treble damages are paid.
 - Most private litigation is settled and single damages are common.
- Interest on past damages is not collected which means damages are less than harm.
- Joint and several liability with no contribution
 - A plaintiff may sue or enforce a judgment against any one of the cartel members and recover from it three times the damages attributable to *all cartel members*.
 - A cartel member cannot sue another cartel member for the damages it paid.

Customer Damages and Leniency: U.S. Experience

Urethane Antitrust Litigation (2014)

- Four defendants settled for \$140 million.
- Dow Chemical did not settle, went to court, and was found guilty.
 - Damages assessed at \$400 million for the cartel, trebled to \$1.2 billion.
 - Dow's share reduced to \$1.06B because of the \$140M paid by the other defendants.
- Dow settled with plaintiffs for \$835 million.
- Dow paid 85% of total damages but its market share was around 25%.

Customer Damages and Leniency: U.S. Experience

U.S. Corporate Leniency Program

- First firm to apply (and application is accepted) receives amnesty - no government fines.
- Later firms are not eligible (though can plead guilty and negotiate lower fines).

Antitrust Criminal Penalty Enhancement and Reform Act (ACPERA) passed in 2004

- Liability is limited to single damages for the recipient of amnesty
- Recipient is relieved of joint and several liability.
- Other defendants are responsible for the double damages the leniency recipient avoids.

Customer Damages and Leniency: U.S. Experience

Antitrust Criminal Penalty Enhancement and Reform Act (ACPERA) passed in 2004

- Statute's legislative history: Purpose is to provide "increased incentives for participants in illegal cartels to blow the whistle on their co-conspirators and cooperate with the Justice Department's Antitrust Division."
- Defendant must choose to opt for ACPERA
 - It might not do so because it requires providing "satisfactory cooperation" with plaintiffs during litigation.
- Impact of ACPERA is unclear
 - "Since its enactment in 2004, only a handful of cases have even mentioned the statute." ("Making ACPERA Work," *Antitrust*, Summer 2015)

Customer Damages and Leniency

How can one further incentivize firms to apply for leniency, while recognizing the rights of consumers to be compensated?

- Recommendation: Joint and several liability (with no contribution)
 - With joint and several liability, the damages not paid by the first leniency recipient can be paid by other cartel members.
- Recommendation: Only allow the first leniency recipient to be absolved of liability for damages.
 - First firm may be the one most discouraged from applying because of the concern of resulting in damage suits.
 - Creates a stronger race for leniency.
- Remember: Damages $<$ harm in all jurisdictions.