

*The Manager's Dilemma:  
To Collude or Not to Collude?*

Høstkonferansen 2016

Europa i endring: Migrasjon, korrupsjon og nullrente

Joseph Harrington

The Wharton School

19 October 2016

# Introduction

- Competitive markets are the ultimate meritocracy.
- Collusion distorts this process because sellers coordinate their behavior behind a facade of competition.
- In recent years, cartels have involved some of the most well-known companies and some of the largest markets in the world.
- Cartelists include Apple, Google, Christie's, British Airways, Archer Daniels Midland, Samsung, Akzo Nobel, DuPont, ...
- Cartelized markets include vitamins (global), auto parts (global), foreign exchange (global), elevators (EU), eBooks (US), cement (Germany), processed chicken (Chile), shipping (Norway) ...

# Introduction

## Overview

- 1 Should a company participate in a cartel?
- 2 If a company decides not to collude, what should it do if rival firms are in a cartel?

# Should a Company Participate in a Cartel?

Collusion is often not the action of a rogue employee but rather the decision of upper level management.

- 76% of cartels involved senior management
  - ▶ Data: 56 international cartels, European Commission (1990-2009)

Highest Level	Frequency	Job titles
Leader	47%	CEO, managing director, chairman, president
Senior managers	29%	Vice-president, head of sales and/or marketing

# Should a Company Participate in a Cartel?

- 56 international cartels, European Commission, 1990-2009

# of Managerial Levels Participating in the Cartel	Frequency
1 level	38%
2 levels	41%
3 levels	13%
4 levels	6%
> 4 levels	2%

# Should a Company Participate in a Cartel?

- Parcel tanker shipping cartel (Norway)

**Stolt-Nielsen** 



- August 1998 - Executives created a bid rigging cartels for shipping contracts.
- April 2001 - Chairman of the tanker division of Stolt asked an employee to evaluate the profitability of the cartel agreement. The report concluded that the agreement was profitable.
- Collusion was probably profitable even after accounting for expected penalties.

# Should a Company Participate in a Cartel?

Table 12A. Real Global Sanctions Relative to Real Overcharges, 1999-2005

Product Market	United States			Other Jurisdiction			World <sup>a</sup>
	Govt.	Private	Total <sup>a</sup>	Canada <sup>b</sup>	EU	Other	
	<i>Percent of 2005 U.S. dollars</i>						
Beta carotene	37.9	85.9	123.8	82.3	27.2	0	54.7
Canthaxanthin	4.3	10.1	14.4	9.8	48.9	0	13.5
Biotin (vitamin H)	0	138.8	138.7	0	0	0	42.6
Choline chloride	1.3	22.4	23.6	27.9	22.2	0	13.4
Folic Acid (B9)	0	208.5	208.5	0	0	0	44.5
Vitamin A	23.4	72.8	96.2	69.6	16.5	1.9	39.5
Vitamin B1	0	131.0	131.0	0	0	0	42.0
Vitamin B2	51.0	99.4	150.3	90.0	59.1	0	74.4
Vitamin B3	46.3	62.2	108.5	86.7	0	0	39.7
Vitamin B5	30.9	75.4	106.3	89.4	57.4	0.3	66.1
Vitamin B6	0	84.8	84.8	0	0	0	15.8
Vitamin B12	0	5.1	5.6	202.4	0	0	2.7
Vitamin C	38.1	74.4	112.4	87.6	19.1	0.8	39.7
Vitamin D3	0	0	0	0	252.4	0	75.8
Vitamin E	26.6	67.0	93.6	59.5	13.4	1.2	42.8
Premixes	23.6	48.9	72.5	110.9	0	0	23.4
<b>Total</b>	<b>24.8</b>	<b>61.3</b>	<b>86.0</b>	<b>74.0</b>	<b>15.4</b>	<b>0.5</b>	<b>33.7</b>

Sources: Tables 14A and 17A

- Vitamins cartel was profitable even after paying government fines and customer damages!
- *If collusion is profitable then why should a company not collude?*

# Should a Company Participate in a Cartel?

**Collusion is unethical** - Consumers think you are competing for their business and you are not.

Ministério da Justiça SDE

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

*“Companies that participate in cartel get dirty”*



# Should a Company Participate in a Cartel?

## **Companies are beholden to employees who participate in cartels.**

- It can be difficult to terminate an employee who might expose the cartel in retaliation.
- Archer Daniels Midland may have known that Mark Whitacre was embezzling millions of dollars, yet ADM could not afford to fire him because of the risk that he would expose the company's involvement in the citric acid and lysine cartels.

# Should a Company Participate in a Cartel?

**Companies caught colluding are the recipient of consumer resentment.**

- Toilet paper cartel in Chile - consumers used social media to organize a boycott of toilet paper produced by cartelists.



# Should a Company Participate in a Cartel?

**Enforcement is becoming increasingly effective and severe.**

- Detection is on the rise.
- Corporate penalties are on the rise.
- Criminalization and incarceration is on the rise.

**Collusion may soon be unprofitable.**

# Should a Company Participate in a Cartel?

Detection is increasingly likely because of

- leniency programs
- whistleblower rewards
- screening

# Should a Company Participate in a Cartel?

## Leniency programs

- A *leniency program* offers reduced penalties to corporations and/or individuals involved in collusion, in exchange for cooperating with enforcement authorities.
- More than 65 countries and unions have a leniency program.

### Reduction in Fines from Leniency Program - Norway

First firm	100%
Second firm	30-50%
Third firm	20-30%
Later firms	0-20%

# Should a Company Participate in a Cartel?

Whistleblower programs provide rewards to those who are not involved in a cartel and report a suspected cartel to the government.

- 4 countries have whistleblower rewards, but it is likely to grow.
- Employees learn about cartels
  - ▶ 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 and ... were relatively unconcerned by competitor reactions."
  - ▶ Fine arts auction houses (US, EU): "Some of [Sotheby's] personnel commented that they had a 'feeling' that the introduction of the fixed vendor's commission structure may have arisen out of some sort of understanding with Christie's."

# Should a Company Participate in a Cartel?

Screening is the analyzing of market data for the purpose of discovering collusion.

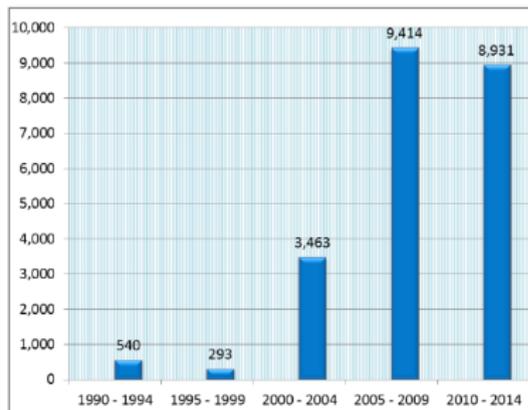
- ICN meeting of chief/senior economists from 28 competition authorities (Vancouver, Sept 2016)
  - ▶ 18 of the competition authorities were engaging in some form of screening.
- Cartels discovered by a competition authority through screening:
  - ▶ Generic drugs (Chile, Mexico)
  - ▶ Construction (Korea, Switzerland)
  - ▶ Retail gasoline (Brazil)
  - ▶ Shrimp (The Netherlands)
  - ▶ Cement (South Africa)
- Deutsche Bahn has a cartel detection unit.



# Should a Company Participate in a Cartel?

Corporate penalties are on the rise.

- Rising government fines



European Commission Fines

- Truck manufacturers (European Commission, July 2016)
  - ▶ Total: €2.93 billion
  - ▶ Daimler: €1.01 billion

# Should a Company Participate in a Cartel?

Corporate penalties are on the rise.

- Growing private litigation with customer damages.
- Nov 2014 - European Parliament adopted the Directive on Antitrust Damages Actions.
- In United States
  - ▶ customer damages exceed government fines
  - ▶ vitamins: damages were 2.4 times as large as fines
  - ▶ private litigation can occur without a public case



Issue 2015-1 | January 2015

ISBN 978-92-79-44977-2, ISSN: 2315-3113

## Competition *policy brief*

Occasional discussion papers by the Competition Directorate-General of the European Commission

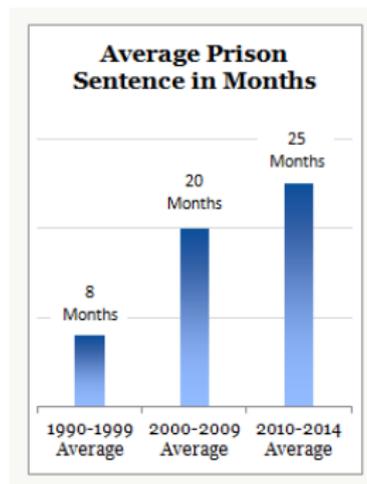
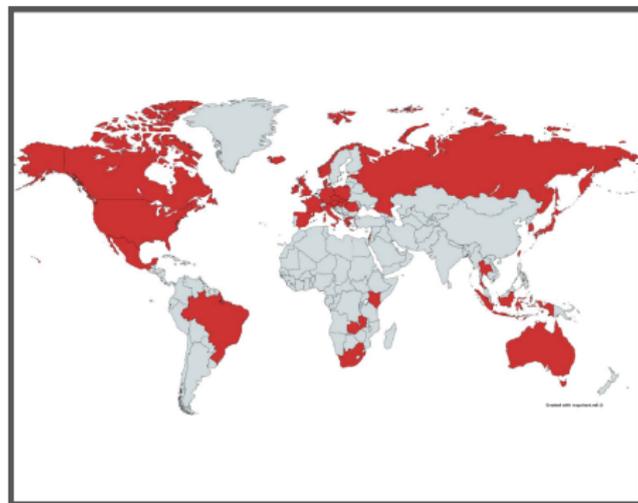
### **The Damages Directive –**

Towards more effective enforcement of the EU competition rules

# Should a Company Participate in a Cartel?

Criminalization and incarceration is on the rise.

- 35 countries have criminalized cartel participation.
- U.S. Dept of Justice - average prison sentence has tripled in the last 20 years



# Should a Company Participate in a Cartel?

*What are the options for senior management?*

- **Actively collude** - Engage in unethical (but profitable) behavior that makes the company beholden to employees, risks consumer resentment, and makes them liable for severe corporate fines and damages.

# Should a Company Participate in a Cartel?

- **Passively collude** - Don't promote it but don't forbid it, while pressuring managers to deliver high profits.
- ACCC v. Tyco Australia Pty. Ltd: "[An individual] who held a very senior position learned of what his subordinates were engaged in, well appreciated it was wrong but failed to intervene to put a stop to the conduct, preferring to remain as ignorant as possible of what his subordinates were doing."
- Bryan Allison (served 2 year sentence for his involvement in the marine hoses cartel): "I think the majority of people causing cartels are usually doing it not for personal gain but for their business. They are doing it because it is expected of them, because they've always done it, or because it's the only way they are going to survive. I don't view it as dishonest."

# Should a Company Participate in a Cartel?

- **Actively not collude**

- ▶ Involves much more than implementing an antitrust compliance program.
- ▶ Actively monitor for collusion using screening and other methods.
- ▶ Impose severe penalties on employees who collude.
- ▶ Treating price-fixing like accounting fraud, embezzlement.

# Should a Company Participate in a Cartel?

Collusion can permeate a company's culture and once there could be difficult to eliminate.

- Antitrust attorney Gabriel A. Fuentes (Jenner & Block): "Psychology of the Cartelist"

*"In the wake of large antitrust cases such as the auto parts investigation, the compliance challenge in Japan is not to root out the 'criminal minds.' It is to promote an internal corporate culture in which the company's management and employees understand that the threat of antitrust enforcement and costly civil litigation is so great as to pose unacceptable business and personal risks."*

# Should a Company Participate in a Cartel?

AkzoNobel - Largest global paints and coatings company and one of the largest producers of specialty chemicals.

- Involved in 9 cartels discovered over 1998-2011.
- CEO Hans Wijers' emphasis on antitrust compliance (Aug 2008)
- If he is serious, will he succeed in changing the culture?

## Competition law compliance manual



### Letter from the CEO

AkzoNobel has a policy of absolute compliance with competition law. AkzoNobel companies and their employees worldwide must strictly observe and adhere to this policy.

The Board of Management considers compliance with competition law to be more than a legal requirement; it is core to AkzoNobel's value of integrity and responsibility. Our reputation and long-term success are based not only on how well we comply with competition law, but also on how we live with competition law, have an adverse impact on business results. On the other hand, disciplinary action will be taken against any employee who violates competition law. Such disciplinary action may include dismissal. In this area we are "a zero tolerance company".

# Dealing with a Cartel as a Non-Colluding Company

Why is there a problem if competitors collude and you do not?

- Wouldn't a company benefit from rival firms setting higher prices?
- Challenges for the non-colluding firm in a market with a cartel
  - ▶ Retaliation
  - ▶ Corruption

# Dealing with a Cartel as a Non-Colluding Company

## Retaliation: District heating pipes cartel

- Swedish firm Powerpipe declined an invitation to join the cartel.
- Retaliation
  - ▶ Cartel members recruited key employees of Powerpipe.
  - ▶ Cartel conveyed to Powerpipe that it should withdraw from the German market.
  - ▶ Cartel implemented a collective boycott of Powerpipe's customers and suppliers.
- Powerpipe reported cartel to the European Commission.

# Dealing with a Cartel as a Non-Colluding Company

## Corruption: Petrobras case in Brazil

- Cartel members paid bribes to Petrobras employees involved in the procurement process.
- Cartel members are informed of the (private) reserve price.
- Non-cartel members are disqualified (for not paying a bribe).

### A Rigged Game

In September 2007, Brazilian President Luiz Inácio Lula da Silva broke ground on the Abreu e Lima oil refinery on the country's northeast coast. Prosecutors say an illegal cartel rigged the bidding for construction contracts, pushing costs to \$16.5 billion, eight times the original budget. Here is the scheme, as described by prosecutors and in court testimony.



1

The alleged cartel meets in the São Paulo offices of one of its members. The engineering firm UTC is deemed alone to draw up contracts at inflated prices? (UTC denies being part of a cartel.)



2

A representative for Odebrecht, Brazil's biggest builder, secretly tells Petrobras to restrict bidding to members of the alleged cartel? (Odebrecht denies being part of a cartel.)



3

Petrobras formally limits bidding to the companies on the list? Petrobras executives hide the chosen companies close to the maximum allowed by the company, in exchange for rebates?



4

The original budget for the refinery was \$2.5 billion, inflated to \$16.5 billion by Petrobras to boost the budget to \$16.5 billion when construction begins in 2009. Years of cost overruns inflate the cost even more.\*

# Dealing with a Cartel as a Non-Colluding Company

*What does a company do when it suspects a cartel?*

- Develop evidence of collusion.
- Report cartel to the competition authority
  - ▶ Benefits company.
  - ▶ Benefits consumers.
  - ▶ Harms rival firms.

# Final Advice for the Cartelist

Recommendation: Do not end up on the "cartel" sofa.

- Terence Wilson of ADM talking to a competitor at a meeting of the lysine cartel in Maui, Hawaii (FBI Surveillance Video Tape)



# Final Advice for the Cartelist

- Don't use profanity ...
- ... as you may be recorded and it looks bad in judicial proceedings.
- Transcript of phone call between Robert Crandall (CEO, American Airlines) and Howard Putnam (CEO, Braniff Airlines) in 5th Circuit Court decision.



## Final Advice for the Cartelist

- **Crandall:** I think it's dumb as hell for Christ's sake, all right, to sit here and pound the \*\*\*\* out of each other and neither one of us making a \*\*\*\*ing dime.
- **Putnam:** Do you have a suggestion for me?
- **Crandall:** Yes. Raise your goddamn fares twenty percent. I'll raise mine the next morning. You'll make more money and I will too.
- **Putnam:** We can't talk about pricing.
- **Crandall:** Oh bull \*\*\*\*, Howard. We can talk about any goddamn thing we want to talk about.

# Final Advice for the Cartelist

- Don't write it down ...
- ... as the competition authority may read it.
- Toy manufacturer Hasbro organized a price-fixing agreement between retailers Argos and Littlewoods with respect to Hasbro's products.
- Email from Hasbro Sales Director Mike Brighty to Neil Wilson and Ian Thomson (19 May 2000):
- 

'Ian ... This is a great initiative that you and Neil have instigated!!!!!!!!!!!! However, a word to the wise, never ever put anything in writing, its highly illegal and it could bite you right in the arse!!!! suggest you phone Lesley and tell her to trash? Talk to Dave. Mike'

# Final Advice for the Cartelist

## Gallery of Price Fixers

