Section 1 compliance: An economic perspective

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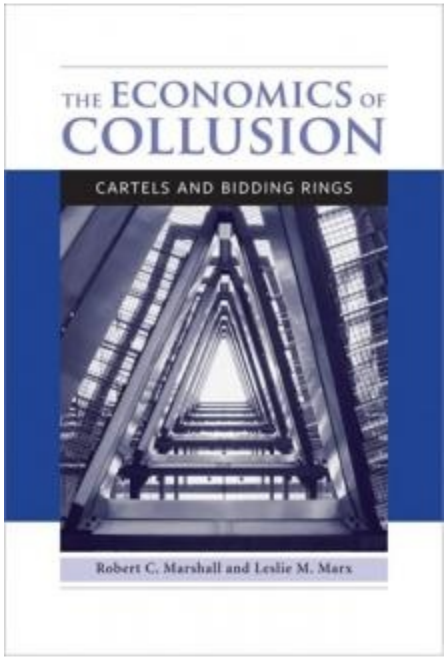
Overview of presentation

- *Economics of Collusion: Cartels and Bidding Rings*
- Intro to Section 1 Compliance
- Economics of Collusion
- More on Section 1 Compliance



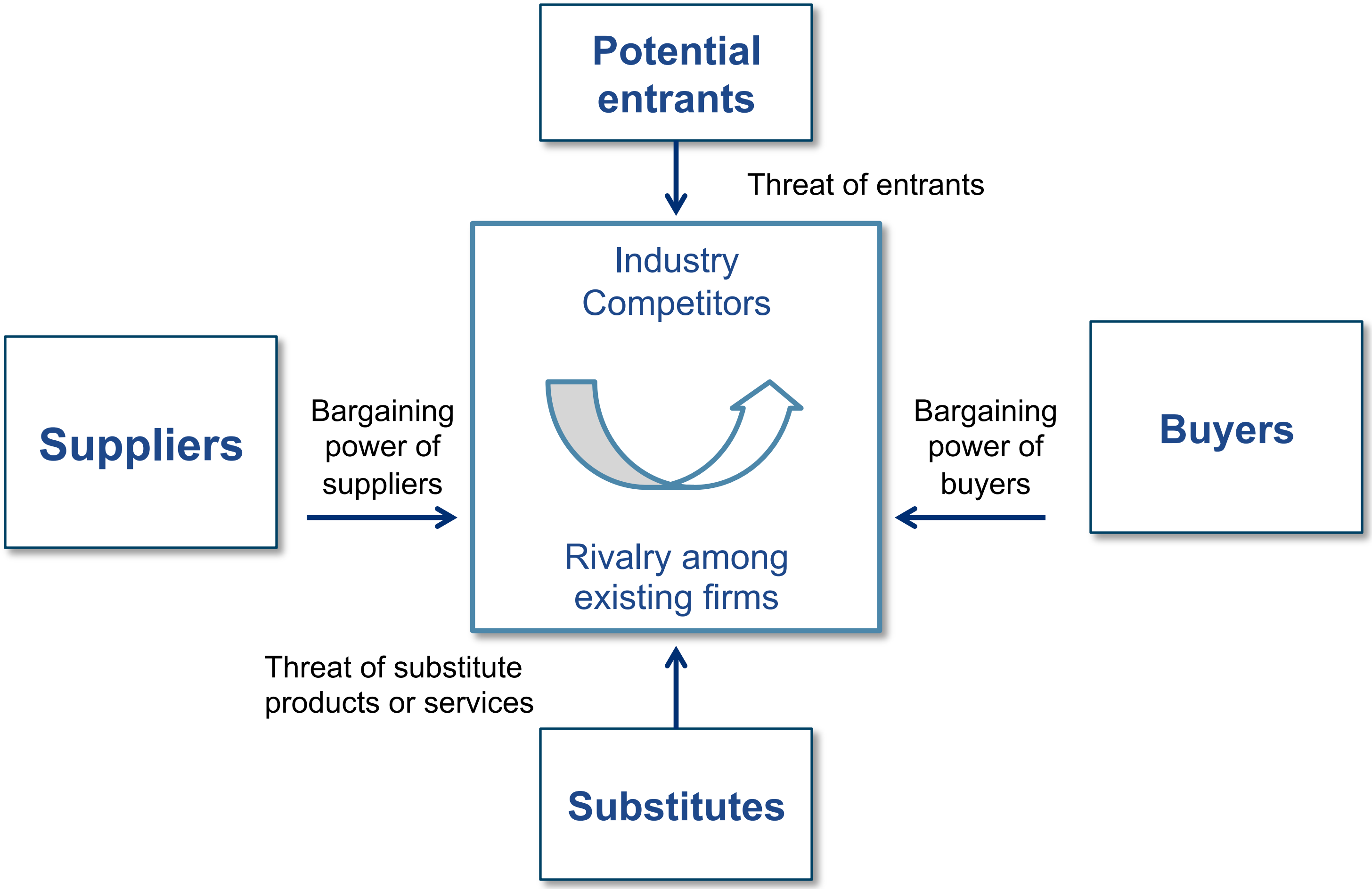
Perspective of compliance is in the eye of the beholder

- Attorneys teach compliance as:
  - Description of the law
  - Boundaries of an agreement
  - Penalties for violation of the law
  - Hypotheticals to illustrate the boundaries
- Economists emphasize instead:
  - The difficulty of effective collusion
  - The economic conduct and outcomes that allow the inference of collusion
    - Many plus factors cannot be avoided without compromising the effectiveness of the collusion

Economic experts evaluate pricing behaviors

- What are we looking for?
  - All relevant pro-collusive changes just prior to the alleged conspiracy
  - Every inter-defendant transaction
  - Every inter-defendant communication
    - Direct or Indirect
  - All competitively sensitive information that each competitor knows about others
  - All evidence of dominant firm activities
  - Initial modeling—does actual exceed but-for?

Sources of industry profit



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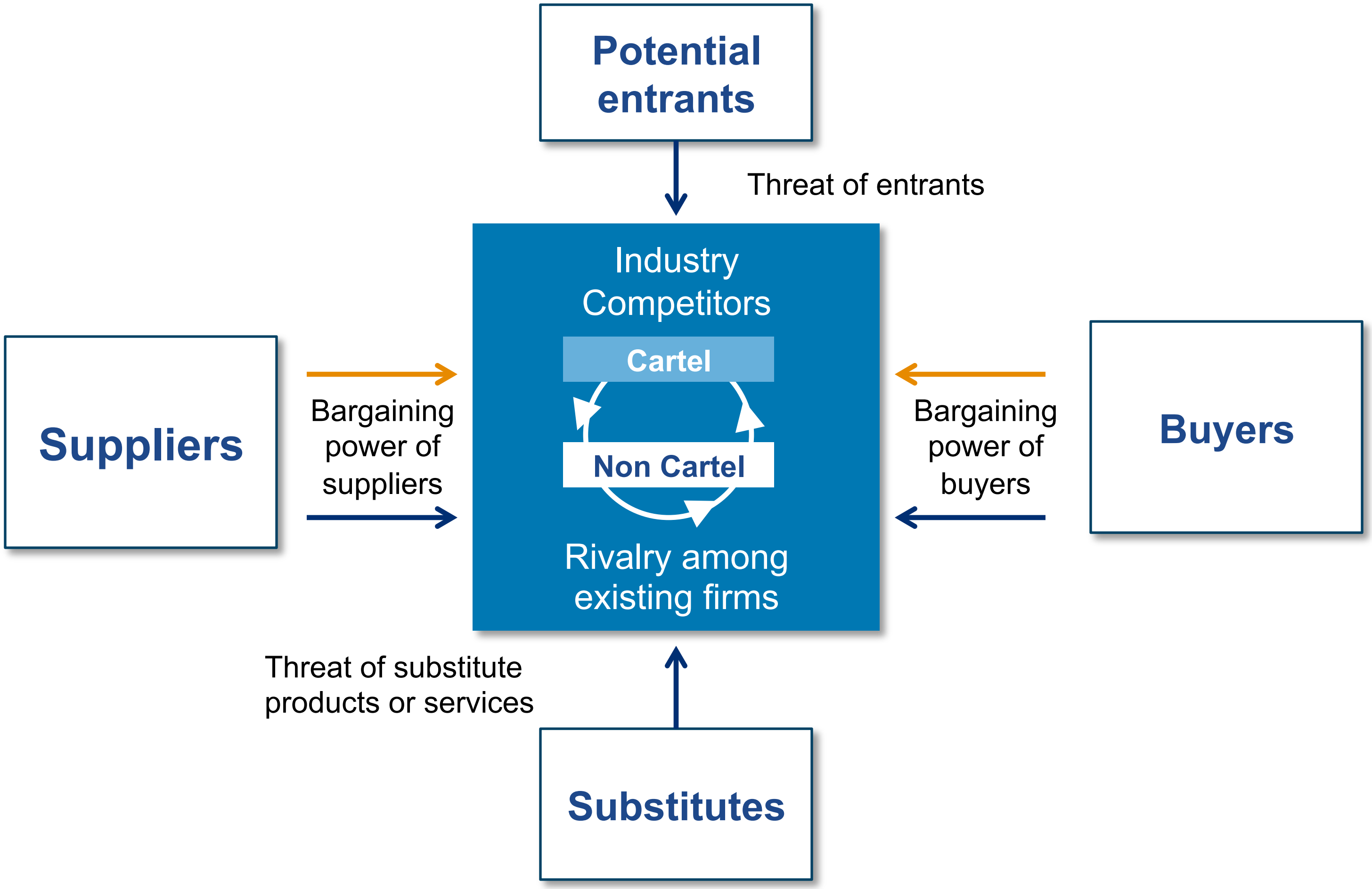
Sources of industry profit with a cartel



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Effective compliance training addresses collusive structures and conduct

- Within a multi-product firm, antitrust compliance training is most important in the product division where the expected payoff to collusion is biggest
  - But that is often very difficult to determine
- Training should emphasize:
  - The difficulty of effectively colluding
  - Company records will leave a trail of plus factors that economists will discover in the event of litigation
  - The risk outweighs the payoff
    - Significant negative payoffs occur from weak collusive structures

Structures to support collusive profits

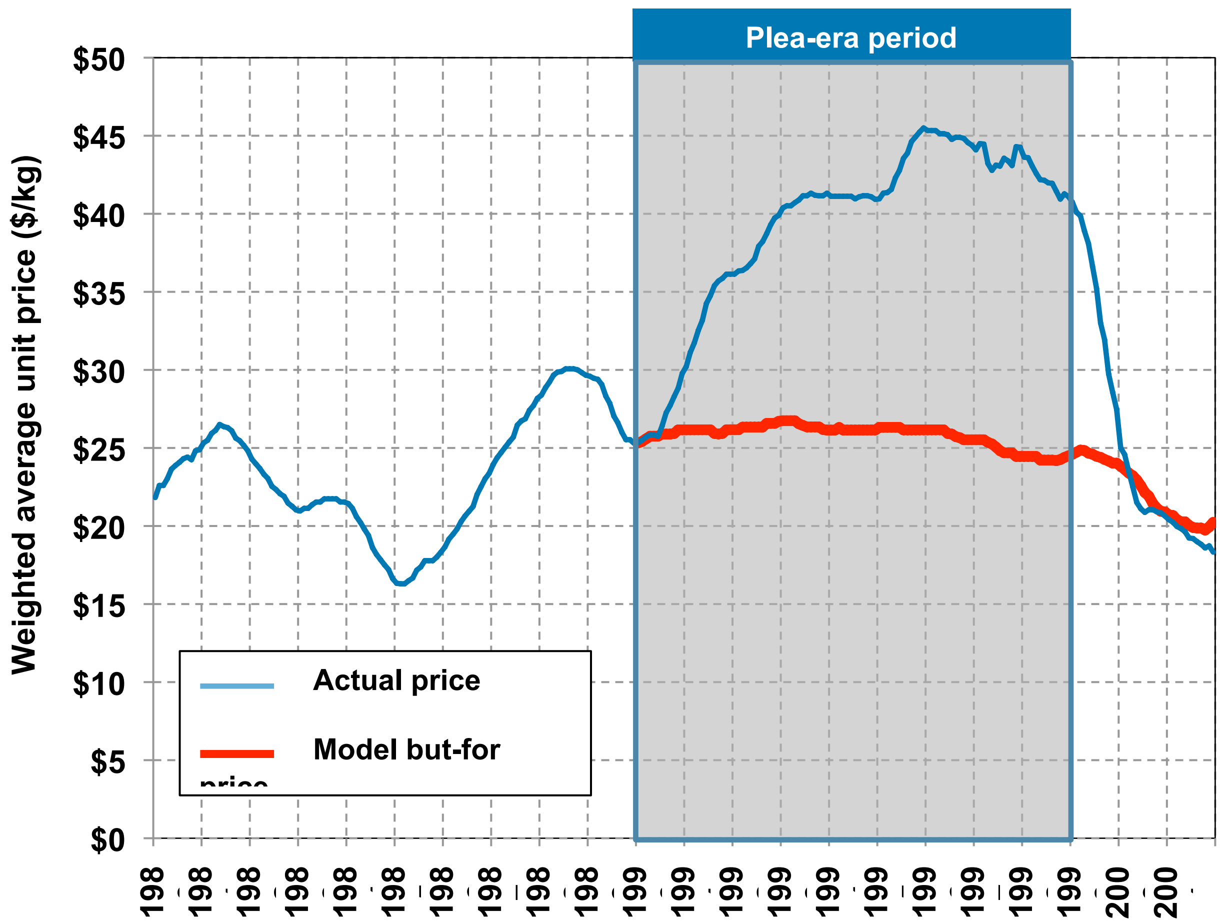
- Stigler (1964) identified “secret deviations” as the key problem facing cartels
- To control secret deviations, a cartel must put in place three collusive structures

Source: Marshall and Marx (2012, Fig. 6.1).

Highly problematic conduct and outcomes

- Transfers between competitors
- Elevated prices and profits with excess production capacity
- Altering incentives of sales force to emphasize price instead of market share
- Dominant firm conduct when there is no dominant firm in the industry
- Knowing strategically sensitive information about competitors that they should not reveal unilaterally
- Actual prices exceed a reliable and accurate predictive model of price

Example: actual price exceeding but-for



Plea-era sales value:
$311,982,095

Manufacturers Cartel (product level)
Roche
BASF
Rhone-Poulenc

Non-cartel (vitamin level)
China (after '88)
Russia (after '90)
India (after '95)
Glaxo
Others

Source: Marshall and Marx (2012, Fig. 1.1).
Original Source: Expert Report of B. Douglas Bernheim, In re Vitamins Antitrust Litigation, MDL No. 1285 (D.D.C. July 16, 2001).

Section 1 compliance training

- Conclusion
  - Economists have much to add beyond
    - It is illegal
    - If you get caught there are big penalties
    - “This” is an “agreement”, but “this other thing” isn’t
  - Economists can provide an understanding, rooted in basic economic reasoning, of:
    - The difficulty of colluding effectively
    - The trail of conduct and outcomes that arises from effective collusion

Section 1 Compliance: An Economic Perspective

Anti-collusive procurement design

- Transparency regarding bids and outcomes is the ally of collusion. Compared to a lack of transparency
  - Solves many difficult monitoring problems for a cartel since deviations by cartel members are more easily observed
- First price sealed bidding is more robust to collusion