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Title: On Optimizing the Deterrence of Cartels

Author: Ke Li*

Abstract:

While World Competition Day (December 5) went unnoticed this year in the United States, the need to increase the current level of cartel sanctions should not be downplayed. Empirical evidence shows that cartelization raises price and overcharges consumers billions of dollars in the United States alone, but the combined sanctions from both criminal prosecutions and private suits have failed miserably to achieve the optimal deterrence. This paper describes some of the harmful effects caused by cartels and outlines five important recommendations made by Professors John Connor and Robert Lande in raising the existing level of sanctions so that they are more nearly optimal.

Keywords: Cartel, Overcharges, Optimal Deterrence, Combined Sanctions

Author Contact: 1102.li.ke@gmail.com

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* Ke Li has a B.A. in economics from Sichuan University, China, and a J.D. from The George Washington University Law School. He received ABA 2009 Summer Antitrust Fellowship and is a Research Fellow with The American Antitrust Institute.

ON OPTIMIZING THE DETERRENCE OF CARTELS

Ke Li

World Competition Day will be celebrated this year on December 5, 2011.¹ The American Antitrust Institute (AAI) supports the institutionalization of this day in recognition of the dramatic growth of antitrust around the world.² Today, there are well over 100 market-oriented nations with antitrust laws. The theme of this year's event is the harmful effects of cartels on consumers.

Private cartels³ fix prices, rig bids, or divide customers or markets cause harm to competition and consumers. Cartels are unlawful in countries that appreciate the benefits of a free marketplace and for this reason have established a workable antitrust law regime.⁴ For example, in the United States, cartels violate Section 1 of Sherman Act as agreements in restraint of trade and are penalized by fines and prison. Cartels can also be subject to private treble damage suits by the victims of the cartelization.⁵

The most obvious harm caused by cartels is the overcharges they impose on consumers. Competition compels firms to charge competitive prices whenever feasible in order to get and retain customers, but collusion allows firms to keep prices artificially high so that they will reap additional profits from customers with no cheaper alternatives. In the United States, more than \$9 billion was returned to victims of cartels through private enforcement since 1990 in cash alone in just 25 private cases for which settlement information was obtainable, not including other forms of recovery, such

¹ See http://www.incsoc.net/World_Competition_Day.htm.

² The American Antitrust Institute is an independent, non-profit research, education, and advocacy organization. See <http://www.antitrustinstitute.org>. This statement was approved by its Board of Directors.

³ There are also cartels that are established by statutes or treaties and operate under the protection of national sovereignty. These state-sponsored cartels, such as registered export cartels, are legal and often closely regulated, and thus fall outside the scope of our discussion in this paper, but the harmfulness of export cartels deserves more public attention.

⁴ Some cartels may involve state owned or controlled firms but are nonetheless considered private schemes for antitrust law enforcement purposes.

⁵ These sanctions will be discussed *infra*.

as products or discounts.⁶ Given the low detection and conviction rates, the direct harm caused to U.S. consumers from cartels is many times greater.⁷ The E.U. Commission estimated in 2008 that E.U.-wide cartels or cartels operating within a single European country overcharged European consumers and businesses between approximately €25 billion and €69 billion annually.⁸ It is worth noting that, from the U.S. perspective, international cartels have been 75 percent more effective in raising prices than their domestic counterparts.⁹ This emphasizes the importance of national competition authorities working together to expand the battle against cartels.

Cartelization also causes many other types of economic harm.¹⁰ It gives the participants a suboptimal incentive to innovate and often restricts the non-price choices available to consumers.¹¹ When cartelization eliminates price competition from a geographic market or an industry, it becomes particularly important to preserve non-price competition so that consumers can choose desirable products or services based on quality, taste or other non-price attributes. Collusion among cartel members, however, discourages them from attempting to encroach upon each other's territory by offering products or services with superior non-price attributes.

There are many ways that cartels are sanctioned and deterred in the United States. The Antitrust Division of the Department of Justice (DOJ) plays a crucial role in prosecuting both domestic and

⁶ See Robert H. Lande & Joshua P. Davis, *Benefits from Private Antitrust Enforcement: An Analysis of Forty Cases*, 42 U.S.F. L. REV. 879, 913 (2008), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1090661.

⁷ The weight of scholarly opinion is that only approximately 25% of cartels are detected. See John M. Connor & Robert H. Lande, *Optimal Cartel Deterrence: An Empirical Comparison of Sanctions to Overcharges*, at 37-42 (AAI Working Paper No. 11-08, Sept. 19, 2011), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1917657. Professor Connor is a member of the AAI Advisory Board and Professor Lande is a Director of the AAI.

⁸ *Impact Assessment—Accompanying Document to the White Paper on Damages Actions for Breach of the EC Antitrust Rules*, at 14-15, COM (2008) 165 final (Feb. 4, 2008) (E.U.).

⁹ John M. Connor & Robert H. Lande, *How High do Cartels Raise Prices? Implications for Optimal Cartel Fines*, 80 TUL. L. REV. 513, 559 (2005), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=787907.

¹⁰ To name just a couple, the artificial control of prices is similar to what a monopolist does, thus causing deadweight loss to consumers and the society as a whole, which is called allocative inefficiency by economists. Also, some nonparticipants in the same market as a cartel operates can “free ride” and charge supracompetitive prices without violating antitrust laws while consumers bear the cost from this so-called umbrella effects with no or virtually no avenue of recourse. For a detailed discussion on allocative inefficiency effects and umbrella effects, see John M. Connor & Robert H. Lande, *supra* note 7, at 32-36.

¹¹ For a general discussion on the consumer choice theory, see generally Neil W. Averitt & Robert H. Lande, *Using the “Consumer Choice” Approach to Antitrust Law*, 74 ANTITRUST L.J. 175 (2007), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1121459.

international price-fixing conspiracies under the U.S. antitrust laws. The most common penalties in its enforcement arsenal are prison sentences and criminal fines for the individuals and corporations involved in the illegal scheme. It also sometimes requires restitution or injunction to restore competition to the affected markets.¹² In addition, private parties can sue cartels for treble damages, which to a significant extent supplements the DOJ enforcement mechanism. Both the DOJ prosecution and private treble-damage actions help to deter collusion, although the best evidence suggests that, by far, the majority of cartels go undetected.¹³

The generally accepted approach to deterring antitrust violations was developed by Professor Williams Landes.¹⁴ In his famous optimal-deterrence formula, damages from an antitrust violation should equal the violation's expected net harm to others divided by the probabilities of detection and conviction.¹⁵ The "net harm to others" includes primarily the overcharges from cartelizing.¹⁶ Further, the "net harm to others" should be multiplied by a number larger than one because not every cartel is detected or successfully proven.¹⁷ At a minimum, we are certain that cartels will be significantly undeterred if the combined antitrust sanctions only total the actual damages.¹⁸

Despite theoretical concerns of over-deterrence, the combined sanctions under the current U.S. anti-cartel regime have actually failed to optimally deter illegal cartelizing. In a forthcoming article dealing with optimal cartel deterrence, Professors John Connor and Robert Lande calculated and compared the actual and optimal sanctions for 75 cartels for which they were able to ascertain the necessary data.¹⁹ The overall results indicate that the monetary value of the combined actual

¹² "Frequently restitution is not sought in criminal antitrust cases, as damages are obtained through treble damage actions filed by the victims." U.S. DEP'T OF JUSTICE, ANTITRUST DIVISION WORKLOAD STATISTICS FY 2001-2010, at n.13 (2011), available at <http://www.justice.gov/atr/public/workload-statistics.html>.

¹³ See John M. Connor & Robert H. Lande, *supra* note 7.

¹⁴ See William M. Landes, *Optimal Sanctions for Antitrust Violations*, 50 U. CHI. L. REV. 652, 656 (1983).

¹⁵ *Id.* at 657.

¹⁶ For other harms from collusion, see John M. Connor & Robert H. Lande, *supra* note 7, at 7 n.26; 32-36 (deadweight loss adds 3% to 20% to overcharges).

¹⁷ See John M. Connor & Robert H. Lande, *supra* note 7.

¹⁸ John M. Connor & Robert H. Lande, *supra* note 9, at 520.

¹⁹ See John M. Connor & Robert H. Lande, *supra* note 7, at 48.

sanctions, including corporate and individual fines and imprisonment²⁰, has been much less than they should have been for society to obtain optimal deterrence against cartels.²¹ This analysis is confined to the effects within the United States.²² For more recent cartels, the E.U. Commission has been imposing fines that are larger on average than those in the United States.²³ Regardless of managers' assessment of the feasibility of cartelizing in the European Union, however, we know from the results that the combined level of U.S. sanctions is woefully inadequate to deter them from operating in the United States.²⁴

To optimally protect victimized U.S. consumers and businesses, the AAI proposes the combined level of anti-cartel sanctions should be multiplied by a factor of five.²⁵ Having recognized that any decision to increase anti-cartel sanctions is political in nature and will surely meet strong opposition, Professors Connor and Lande outline five important steps to raise the existing levels of sanctions so that they are more nearly optimal.²⁶

First, Congress should enact a law adding prejudgment interest to both private treble damage actions and criminal fines.²⁷ The addition would substantially increase the effective size of the sanctions, particularly for durable cartels and cartelists that use delaying tactics during plea-bargaining or litigation.²⁸ This change would be intuitively reasonable to many practitioners and scholars.²⁹

²⁰ Professors Connor & Lande assumed a year in prison or under house arrest was the rough equivalent of a \$6 million fine. *Id.* at 28.

²¹ *Id.* at 48. If mean average figures are used, the total value of the actual sanctions were only 15.7% to 20.7% of their optimal level; if median figures are used, the actual sanctions averaged only 9% to 12% of optimality. *Id.*

²² *Id.* at 49.

²³ See generally John M. Connor, *Has the European Commission Become More Severe in Punishing Cartels? Effects of the 2006 Guidelines*, 32 EUR. COMPETITION L. REV. (ISSUE 01) 27 (2011), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1737885.

²⁴ John M. Connor & Robert H. Lande, *supra* note 7, at 50.

²⁵ *Id.* Recent developments in antitrust law have not negated the policy import of the results. *Id.*

²⁶ *Id.* at 52.

²⁷ *Id.*

²⁸ *Id.*

²⁹ *Id.*

Second, the U.S. Sentencing Commission should double its presumption that cartels raise price by an average of 10 percent.³⁰ In another joint work of Professors Connor and Lande, they surveyed about 200 serious social-economic studies of cartels (containing 674 observations of average overcharges) and the final verdicts in decided U.S. cartel cases.³¹ Their findings indicate that the 10 percent benchmark significantly underestimates the overcharges in practice, which average 49 percent in the economic studies and 31 percent in case verdicts.³²

Third, as a method to further increase the fine levels, the DOJ could change its administrative practice of recommending fine discounts from the bottom of the Sentencing Guidelines' range and start instead from the middle or top of the range.³³

Fourth, the DOJ should, as part of its settlement negotiations, require corporations never to hire as officers, directors, or consultants people convicted of antitrust felonies.³⁴ This is because too often the corporate attitude towards price fixing felons has been that they "took a bullet for the team" and should be forgiven or rewarded.³⁵

Fifth, the DOJ should require corporations not to indemnify culpable employees for the criminal fines imposed against them as individuals or the costs of their legal defense, if convicted.³⁶ Both the no-hire and no indemnity proposals are designed to educate and dissuade corporate executives

³⁰ *Id.* at 53. The current criminal fines for cartels are established by the Sentencing Guidelines promulgated by the Commission. See 2011 Federal Sentencing Guidelines Manual §2R1.1 (d)(1) (U.S. Sentencing Comm'n, effective Nov. 1, 2011), available at http://www.ussc.gov/Guidelines/2011_Guidelines/Manual_PDF/Chapter_2_L-X.pdf. The Sentencing Guidelines double the 10% presumption (providing for "20 percent of the volume of the affected commerce") and further adjust the base fine level by aggravating or mitigating factors. See §2R1.1 (d). This doubling apparently reflects the consideration of other harmful effects of cartelizing, such as allocative inefficiency, umbrella effects, etc. See John M. Connor & Robert H. Lande, *supra* note 9, at 521.

³¹ See John M. Connor & Robert H. Lande, *supra* note 9, at 559-60.

³² See *id.* at 561-62. Median figures, however, are only 22-25%. See *id.*

³³ John M. Connor & Robert H. Lande, *supra* note 7, at 53.

³⁴ *Id.*

³⁵ *Id.* Their survey, although admittedly small and preliminary, suggests that it may be common for a corporation to forgive and even reward employees who violate the antitrust laws. *Id.*

³⁶ *Id.* at 53-54.

contemplating antitrust violations, as they would effectively raise the personal cost of management decisions to violate the law. The increased penalties on employees would be especially beneficial if principal-agent problems exist, where employees fail to take sufficient care to avoid legal risks for the corporation and the corporation is unable to impose a financial penalty as high as required by criminal fines.³⁷

³⁷ *Id.* at 11.