

Cartels

Just one more fix

Trustbusters have got better at detecting cartels and bolder in punishing them. But incentives to fix prices remain strong

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THE International Cartel Workshop might sound like a coaching session for would-be price-fixers. But the biennial event, run by the International Bar Association, is in fact an opportunity for lawyers to learn how their clients can avoid falling foul of the law, how to respond if they do and what is on the minds of the competition officials who attend. The latest get-together, held in Rome in February, featured a three-day-long “hypothetical” in which delegates acted out a loosely scripted scenario featuring a fictional American camera-maker that discovers its sales team has been colluding with European and Japanese rivals, and tries to limit the damage by reporting the sin to the authorities.



Grey suits, wooden acting and hour-long scenes about document discovery are not everyone’s idea of gripping drama. But cartel enforcement is a hot topic in boardrooms. Fines and jail terms have shot up in recent years, greatly raising the costs of collusion. Big firms such as GE and Bosch have assembled teams of in-house lawyers that focus solely on the issue.

Even for the biggest companies, ensuring compliance is hard. On March 20th Brazil’s cartel office announced a probe into 18 firms involved in the construction of train systems, including Siemens of Germany (which alerted authorities to the alleged conspiracy) and Alstom of France. The 15 rail contracts being investigated had a combined value of 9.4 billion reais (\$4 billion); fines could be for a similar amount. This week prosecutors charged 30 executives from a dozen of the companies.

Collusion comes in many forms: agreements to raise, freeze or even lower prices, to co-operate in tenders, not to compete in certain markets and so on. Price-fixing can be “horizontal” (among competitors in a particular product) or “vertical” (involving, say, a manufacturer and its dealers).

There is agreement on right and left (a few über-libertarians apart) that cartels are bad. They impose higher prices on customers, reduce incentives to innovate and raise barriers to entry. One estimate suggests that overcharging costs consumers in poor countries around the same as those countries get in foreign aid. “It’s tempting to see it as victimless because each customer is hurt only a little,” says Mark Whitacre. “But it’s bank robbery without the mask and gun.” He should know. In 1992 he blew the whistle on a global conspiracy to fix the price of lysine, an animal-feed additive. His story inspired a 2009 film, “The Informant”, starring Matt Damon.

Cartels have historically tended to form in industries with standardised products that inspire little customer loyalty, such as industrial components or road-building. Studies suggest that two-thirds of cartels are in industries in which the top four firms have 75% or more of the relevant market. Their median duration is five years, but some last decades.

In recent years, however, international conspiracies have been bust in fields as diverse as seat belts, seafood, air freight, computer monitors, lifts and even candle wax. A growing number of cases are in digital commerce, such as e-books, and in finance, most recently interest-rate and foreign-exchange benchmarks. The financial-market version of a smoke-filled room is the online chat room for traders.

Some of these cartels have involved a dizzying number of alleged conspirators. According to court filings, representatives of 20 or more airlines met in airports, restaurants and other places to discuss the pricing of international air-cargo services. They were caught in 2006 and forced to pay penalties of more than \$3 billion.

Cartels often form in response to tectonic shifts in the competitive landscape, such as falling trade barriers or the advent of disruptive technologies.

Manufacturers and retailers react to such pressures by squeezing their suppliers.

Squeeze too hard, though, and those suppliers might feel forced into an “existential response”, says John Connor of Purdue University.

That appears to have happened in America in car parts, the subject of the largest criminal investigation yet pursued by the antitrust unit of the Department of Justice (DoJ), according to Brent Snyder, who heads its criminal-enforcement efforts. Companies used code names, met in remote locations to fix the prices of starter motors, seat belts, radiators and more, and followed up with each other “to make sure the collusive agreements were being adhered to,” the DoJ alleges. It began raiding the companies in 2010.

Twenty-six firms, many of them Japanese, have already pleaded guilty and agreed to \$2 billion in fines. Two dozen people have been charged. There is more pain to come: cases brought so far involve 30 parts, but trustbusters believe the prices of 100-150 may have been manipulated. Other cartel authorities are on the case, too. On March 19th, the European Commission fined five makers of automotive ball bearings €953m (\$1.3 billion). Five days later the commission said it was investigating several car-parts makers suspected of fixing prices for exhaust systems.

The scale of the car-parts case owes something to the structure of the industry. By approving just a few suppliers of each part, which erected barriers to entry and encouraged supplier concentration, the direct victims, carmakers, may have created fertile conditions for cartel activity. Some may have been ripped off by firms they part-owned. Toyota owns 22% of Denso, which allegedly swapped information with rivals on “requests for quotation” made by Toyota for heater panels.

Only in the past quarter-century has price-fixing been treated as worse than a misdemeanour. Before then, most companies “saw it as like going 5mph over the speed limit,” says Roxann Henry of Morrison & Foerster, a law firm. Collusion has been illegal in America since passage of the Sherman Act in 1890. But the nation’s enforcers started to get tough only when the brazenness of the lysine conspiracy became apparent in the 1990s (members were recorded joking with each other about the FBI infiltrating their meetings).

Since then, policing and penalties have grown harsher. The maximum corporate fine in America has increased tenfold. The European Commission can fine companies up to 10% of group turnover. Fines levied on both sides of the Atlantic have jumped over the past decade (see chart). Europe’s national cartel offices are busier, too. This year Germany’s has fined brewers €106m and sugar distributors €280m.

America leads in putting price-fixers behind bars. The average jail term has risen, from eight months in the 1990s to more

Corporate punishment

Largest cartel fines on individual firms:

Company (year)	Products	\$m
imposed by the European Commission		
Saint-Gobain (2008)	Car glass	986
Philips (2012)	TV tubes	907
LG Electronics (2012)	TV tubes	884
Deutsche Bank (2013)	Interest-rate derivatives	619
F. Hoffman-La Roche (2001)	Vitamins	414
imposed by the US Department of Justice		
AU Optronics (2012)	LCD Panels	500
F. Hoffmann-La Roche (1999)	Vitamins	500
Yazaki Corporation (2012)	Car parts	470
Bridgestone (2014)	Car parts	425
LG Electronics (2009)	LCD Panels	400

Sources: European Commission; US Department of Justice

than two years. The DoJ uses Interpol red notices (arrest warrants) to put pressure on foreigners indicted in cartel cases to submit to American jurisdiction. The European Commission can only bring civil cases, but criminal penalties can be imposed in Ireland and Britain, where they are being strengthened. Authorities in large emerging markets are also getting tougher. In India, the worst that colluding firms needed to fear before 2009 was a cease-and-desist order. Now they face heavy fines.

A cartel-busting cartel

With a growing share of cartels being global in scope, competition authorities are doing more of what those they police are not supposed to do: sharing information and working

in tandem. The Japanese Fair Trade Commission played an important role in the American-led investigation into car parts. In the biggest cases, offenders can be hit with suits in a dozen countries.

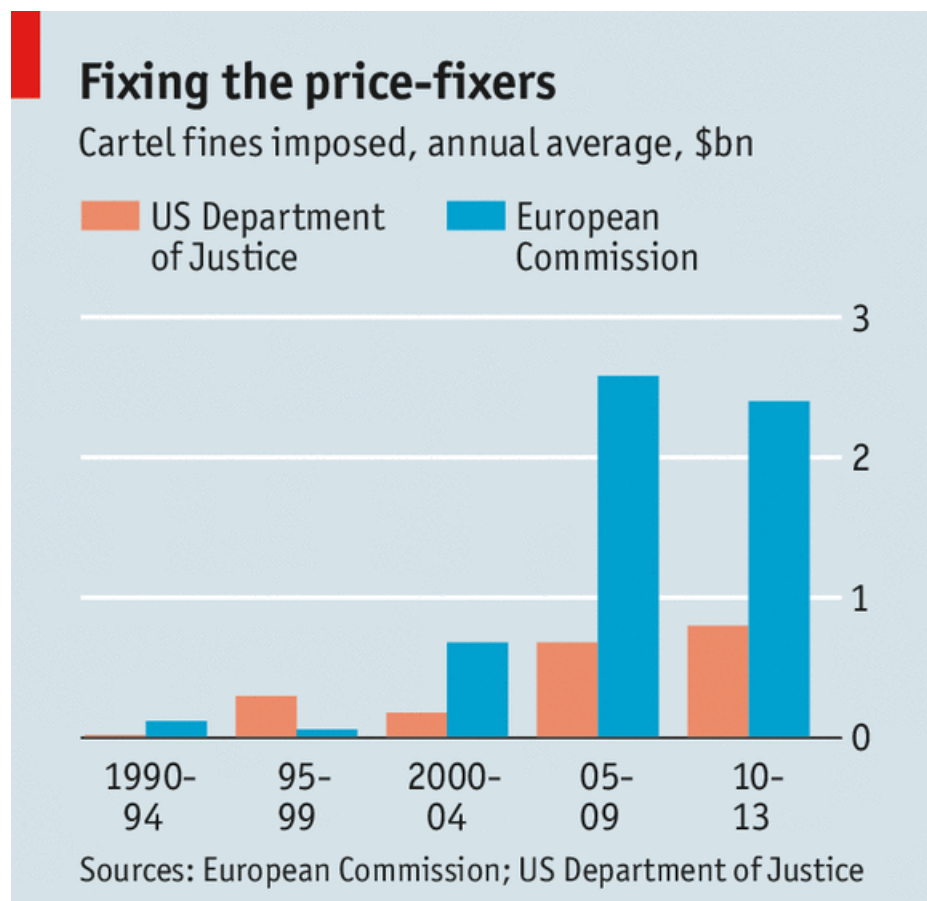
Japan's tougher stance matters because its companies have long had a lax attitude to collusion. A lawyer tells of a meeting last year with an executive at a Japanese manufacturer who claimed that collusion was a thing of the past; the lawyer's next meeting at the firm was with a middle manager who said he had been taken to meet several competitors soon after being hired. Asian firms often treat employees convicted of price-fixing as "a soldier who took a bullet for the company", says Robert Lande of the University of Baltimore's law school—though this is not solely an eastern habit. When Mr Lande looked to see what had become of dozens of price-fixers from various countries who had been jailed between 1995 and 2010, he found that roughly half had been rehired by their old employer or by another firm in the same industry.

Cartels are difficult to root out without help from insiders. To aid detection, the DoJ developed a leniency programme that provides incentives for companies to confess and snitch on rivals. This has become so successful that around 50 other countries have copied it. Most big cases today stem from such confessions.

Under the American programme, the firm that spills the beans can avoid fines, and its employees are spared prison. The second and third through the door can secure lesser benefits, though no criminal immunity, if they provide useful information. Under a policy known as "amnesty plus", a co-operating firm that exposes a separate conspiracy can secure partial immunity in that investigation, too. Samsung, for instance, was the source for several probes into computer monitors and television tubes. Leniency schemes are designed to be "trees that grow more and more branches" as edgy companies, fearful that rivals will squeal first, reveal hidden sins, says Ms Henry.

The flip side of leniency is that authorities take a particularly hard line against firms that, when admitting to one conspiracy, do not confess to participation in others. In 2011 Bridgestone paid a fine for colluding over marine-hose prices. Because it failed to disclose that it was up to the same tricks in car parts, it had to pay an elevated fine of \$425m for the second transgression.

Some countries are employing eggheads to search for suspicious price patterns by "screening" markets. These statistical tests have proved most effective in markets with lots of data, such as financial benchmarks and derivatives, though they have also been useful in cement and fishing: they provided the first evidence of manipulation of the London Interbank



Offered Rate (LIBOR) in 2008 and, last year, of foreign-exchange rates.

Not everyone is convinced by screening. The DoJ ditched it after concluding that it produced too many false positives. "Grand-jury subpoenas can rock companies," says Scott Hammond, a former DoJ cartel-enforcement chief, now with Gibson, Dunn & Crutcher, another law firm. It is a mistake to unleash them based on tests that have falsely pointed to wrongdoing.

Rosa Abrantes-Metz of New York University's Stern School of Business, whose number-crunching helped expose the LIBOR affair, thinks the Americans are too sceptical. She argues that market screening, like the medical sort, is useful as an indicator that prompts further investigation.

Price-fixers also have to worry about the growth of civil litigation, which almost always follows action by competition authorities, and in which cartelists can face treble damages. Private suits in America generated awards and settlements of \$33 billion—four times the level of official fines—between 1990 and 2008.

Most suits are class actions brought by consumers or corporate customers, but large companies are increasingly opting out of these to bring their own cases, as Ford has done in car parts. In all, 28 car-parts suits have been filed in American courts. Adding to the pain, state attorneys-general have become more forceful in asserting claims on behalf of government purchasers and state residents.

Class actions are less common but on the rise in Europe, with Britain, Germany and the Netherlands leading the way. In some countries impediments remain, for example rules that hamper document discovery. To remove these the European Commission has proposed a directive that would harmonise laws and procedures.

The wages of sin

Despite more-severe punishments, cartels still form all the time. Messrs Connor and Lande think they know why. In a joint paper, "Cartels as Rational Business Strategy: Crime Pays", they argue that deterrence is still too weak. They studied 75 cartels and concluded that these could typically raise prices by 20%. That is double the estimate used by America's Sentencing Commission when setting guidelines for fines and jail terms. Factor in the small chance of being detected, which the authors put at one in five, and American cartel sanctions are only 9-21% as large as they need to be to offer "optimal" deterrence. A lawyer at the Rome conference recounted a recent meeting with an executive from a large cement group: "He said it's hard to stop fixing prices when it's still so worthwhile."

The authors suggest increasing not only sanctions but also the chances of detection by increasing enforcement budgets, which are tiny compared with the fines levied: in 2012 the DoJ's antitrust arm took in 16 times more than it cost to run. Presumably, the DoJ's Mr Snyder would not turn down an increased appropriation, but he is less keen on quintupling penalties, which he fears would bankrupt companies and thus crimp competition. "We want [cartelists] to feel adequate pain but we also want them to remain viable. We're not in the business of reducing competition."

Despite evidence that penalties are still too small, defence lawyers complain that the authorities cause alleged cartelists unnecessary pain by applying antitrust laws extraterritorially. Each jurisdiction is meant to base its penalties on the amount of business affected in its territory. But when commerce crosses borders there is sometimes double-counting (known in the trade as "the bump"). Jurisdictions often co-ordinate their actions but they do not have to take account of each other's fines, and do not always agree.

Some firms have fought back. After AU Optronics of Taiwan was indicted and fined \$500m by America for collusion in LCD panels, the company and two executives challenged their convictions, arguing that much of the alleged activity took place elsewhere. Last December a court ordered the executives to be released, pending appeal, suggesting that the panel of judges had doubts about the government's case. However, the state is usually hard to beat once a case goes to trial: in 2003-12 it won 657 of the civil and criminal antitrust cases it brought before American courts; just 28 were lost or dismissed.

The outcome of private actions is more even. Many cases are dismissed for lack of evidence. Take the suit brought by grocers against America's three big chocolate-makers, Hershey, Mars and Nestlé, alleging co-ordinated price increases in 2002-07. A judge recently sided with the defendants, stating that "their pricing decisions, while largely identical and effectively simultaneous, were nonetheless timed and orchestrated in such a way to achieve whatever momentary pricing

advantage they could over their competitors.”

Trials expose grey areas in cartel law. Emails that reveal overt price-fixing make for a cut-and-dried case. But is it a conspiracy if a firm announces a price increase and soon afterwards rivals raise their prices to the same level? Has technology that allows rapid-fire price changes, such as the algorithms used in online travel, blurred the meaning of “agreement” and made it difficult to distinguish announcements from discussions among rivals?

One problem is that competitive and collusive markets can look very similar. If firms are pricing at marginal cost, and costs (of commodity inputs, for instance) are bouncing around, then prices shift together in a perfectly competitive industry, just as they might in a cartel. Competition authorities try to get around this problem by looking not only at pricing but at profitability too; profits in collusive environments are higher than those in competitive ones.

Trustbusters have worked hard to spell out where they consider the line between right and wrong to be, says Brady Dugan of Squire Sanders, another law firm. But their thinking is not uniform. The European Commission, for instance, often treats an exchange of information as collusion, even if there is no agreement to fix prices. The DoJ needs to see an agreement, though this does not have to be in writing.

These ambiguities mean it can be difficult for firms accused of collusion to decide whether to settle or fight. For cartelists that have not yet been accused, the decision over whether to confess or sit tight can be a tough one, too. Confession is usually the best option if the company is sure it is the first in the cartel to step forward and it senses a growing risk of detection. But for a firm that suspects others have already confessed, thus securing all the available immunity slots or penalty discounts, it might make sense to keep quiet, then litigate rather than capitulate when accused—particularly in jurisdictions where trustbusters wield civil penalties only.

The European Commission, for instance, has sometimes struggled to make its case, especially when much of the conduct took place on other continents. Of the 25 airlines it initially went after for fixing air-freight prices, 13 that offered little or no co-operation avoided fines. “Competition authorities want all our clients to believe that coming clean is always the best option,” says an antitrust lawyer who represents large European companies. “But from the board’s perspective that’s sometimes simply irrational.”

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