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Cartels: Sanctions Against Individuals

Corporate sanctions rarely are sufficiently high to be an optimal deterrent against cartels. Sanctions against natural persons can thus complement them. There is no systematic evidence proving the deterrent effects of sanctions on individuals, and/or assessing whether such sanctions can be justified. There is a trend among countries to accept as self-evident that individual sanctions, including imprisonment, can be a useful part of effective anti-cartel enforcement. If a country provides for individual sanctions, a strong argument can be made that relatively short prison sentences are the most cost effective deterrent. However, there are also reasons why countries may provide for longer prison sentences, most importantly that only longer statutory sentences adequately express a society's condemnation of hard-core cartels. In addition to increasing levels of deterrence, sanctions against individuals can be a powerful incentive for individuals to reveal information about existing cartels and to cooperate in investigations. International law does not recognise the principle of double jeopardy that would prevent authorities in different countries from prosecuting the same person for participation in the same cartel. Nevertheless, where cartels are investigated in a multi-jurisdictional context, jurisdictions may consider arrangements to ensure that only one of them prosecutes an individual.

Cartels : Sanctions against Individuals

1. Executive Summary by the Secretariat

Executive Summary

by
The Secretariat

Considering the discussion at the roundtable, the member country submissions, and the background paper, a number of key points emerge:

1. *As corporate sanctions rarely are sufficiently high to be an optimal deterrent against cartels, there is a place for sanctions against natural persons that can complement corporate sanctions and provide an enhancement to deterrence.*

There is ample empirical evidence that corporate sanctions in the form of fines are almost never sufficiently high to be an optimal deterrent, and in most cases are substantially below that level. In these circumstances, the threat of individual sanctions can strengthen the incentive of directors and employees to resist corporate pressure to engage in unlawful activity, and thus enhance the level of deterrence.

Moreover, as individuals act as agents on behalf of a corporation, it makes sense to deter those individuals directly by threatening them with sanctions, and to impose such sanctions if they violate the law. Since corporate fines rarely reach a level that would maximise their deterrent effect, they also provide insufficient incentives for a corporation to effectively monitor its agents to prevent them from acting unlawfully and from putting the corporation at the risk of being fined for participating in an unlawful cartel. In addition, it is questionable whether a corporation will always have the means to supervise its agents and deter them from unlawful conduct.

2. Systematic empirical evidence to prove the deterrent effects of sanctions on individuals, and/or to assess in a cost/benefit analysis whether such sanctions can be justified, is not available. Ultimately, countries have to consider whether they accept as self evident that individual sanctions, including imprisonment, can be a useful part of effective anti-cartel enforcement. There is a trend among OECD member countries to accept that view.

Anecdotal evidence exists that criminal sanctions against individuals can have deterrent effects. There is, however, no systematic empirical evidence

available to prove such effects, and to assess whether the marginal benefit of introducing sanctions against individuals (in the form of less harm from cartel activity) exceeds the additional costs that in particular a system of criminal sanctions entails (including the costs of prosecution as well as of administering a prison system). There appears to be agreement that it would be virtually impossible to generate the relevant data.

Ultimately, countries that use, or decide to introduce, sanctions against individuals in cartel cases do so because they accept as self evident that corporate sanctions alone cannot ensure adequate deterrence, and that individual sanctions, including imprisonment, can be useful instruments in the fight against cartels. Among OECD members, there is a trend toward accepting that sanctions against individuals can contribute to more effective anti-cartel enforcement.

At the same time, sanctions on individuals are not the only instrument available to agencies in the fight against cartels, and each country must determine its own, “right” mix of sanctions that has the most effective deterrent effects against cartels. The decision whether to provide for sanctions against individuals as part of that mix depends on a number of factors, including a country’s cultural and legal environment, its enforcement history in cartel cases, the relationship between a competition authority and courts and prosecutors, as well as the resources of a competition authority.

3. If a country provides for individual sanctions, a strong argument can be made that relatively short prison sentences are the most cost effective deterrent. There are, however, also reasons why countries may provide for longer prison sentences, most importantly that only longer statutory sentences adequately express a society’s condemnation of hard core cartels. There appears to be general agreement that the threat of financial penalties alone has little deterrent effects on individuals.

With respect to jurisdictions that provide for the possibility of imprisonment, it is frequently assumed that the optimal prison term would be short, as after a relatively short time the marginal cost to society of additional prison time likely would exceed the gains from additional deterrence.

Some, however, favour longer statutory sentences. It has been argued, for example, that cost/benefit arguments in favour of shorter prison terms assume that business leader contribute to society in a unique way, but that this assumption was frequently unfounded. In particular in cartel cases, agencies deal with business leaders who have stolen from consumers and weakened the economy. Replacing them for a longer term can be done at acceptable costs for society.

In addition, having longer statutory sentences expresses a society's condemnation of hard core cartels. This might be important also with respect to prosecutors and courts, who may sometimes fail to recognise that cartels are serious offences. With shorter statutory sentences, prosecutors might be less likely to pursue a case, and courts might be more inclined to let defendants off the hook and impose alternative sentences instead. Longer sentences can send a signal to them that cartels should be considered a serious criminal violation.

Some countries consider that disqualification of directors of public corporations can have deterrent effects as well, although they recognise that this type of sanction does not deter managers who do not serve as directors. There appears to be widespread agreement that financial penalties on individuals alone are relatively ineffective because it is difficult to prevent a corporation from reimbursing the individual.

4. In addition to increasing levels of deterrence, sanctions against individuals also can be a powerful incentive for individuals to reveal information about existing cartels and to cooperate in investigations.

Individuals who have information about cartels may have little incentive to reveal evidence about cartels if there is no risk of sanctions against them. Threatening credible sanctions against individuals creates incentives for an individual to disclose cartels that are separate from the incentives of a corporation. They can thus create a greater likelihood that someone will defect from a cartel arrangement and offer information and co-operation. As a result, a leniency programs should become more effective.

In addition, even after a cartel has been disclosed and the investigation is under way, the threat of sanctions against individuals, and the ability to avoid them through co-operation, will strengthen a competition authority's position. The larger number of participants with different interests that can be played off against each other, the greater the likelihood that someone will cooperate with the authority during an ongoing investigation.

The extent to which individual sanctions are an incentive to come forward and cooperate will be influenced by several factors, including i) the ability of a single authority to operate the leniency program and prosecute criminal cases, or, where these tasks are allocated to separate authorities, close coordination between them; ii) a credible risk of severe criminal sentences against individuals; iii) a well-developed, highly transparent and predictable leniency program; and iv) the ability to offer defendants lesser sentences or immunity in exchange for their co-operation during an investigation.

5. *If a jurisdiction provides for criminal sanctions against individuals, several issues need careful consideration, including i) the proper definition of the criminal offence; and ii) where responsibility for criminal prosecutions is assigned to public prosecutors,*

proper coordination between prosecutors and the competition authority to ensure that criminal sanctions support leniency programs.

Several countries that recently considered introducing criminal sanctions against individuals were in favour of using a separate definition of the hard core cartel offence that is narrower than the definition of anticompetitive conduct in general competition law. Such a more targeted definition enables individuals potentially subject to sanctions to *ex ante* clearly understand what conduct would put them at risk, thus ensuring that their fundamental rights are protected. In addition, it minimises the risk that criminal sanctions might have excessive deterrent effects if the conduct to which they apply is not clearly defined.

Other countries that obtain criminal convictions based on the general language of their competition statutes rely on consistent case law, prosecutorial discretion, and, sometimes, approval or exemption systems to ensure that there is no uncertainty about the scope of the criminal offence and to avoid the potential risk of over-deterrence. Relying on the general competition law definition of anticompetitive conduct can hinder criminal enforcement, however, if there is no recognition of a *per se* cartel offence. Otherwise, elements of a competition law violation such as market definition, entry barriers, and effects on competition may have to be proven under criminal standards, making it exceedingly difficult to obtain criminal convictions in courts.

Where the authority to criminally prosecute cartels has been allocated to public prosecutors, there is a risk that the effectiveness of leniency programs could be undermined unless there is proper coordination between prosecutors and the competition authority. Individuals as well as corporations might be more reluctant to voluntarily provide information about cartels if they fear the possibility of criminal prosecution of individuals. Clear and transparent rules must assure individuals who come forward and seek leniency that they will also have protection against criminal prosecution. Coordination and compatibility of leniency schemes and criminal sanctions may be particularly important in regional organisations such as the European Union to minimise the risk that leniency applications before one authority lead to criminal prosecution of the applicant's employees or ex-employees by other authorities.

6. *International law does not recognise the principle of double jeopardy that would prevent authorities in different countries from prosecuting the same person for her participation in the same cartel. Nevertheless, where cartels are investigated in a multi-jurisdictional context, jurisdictions may consider arrangements to ensure that only one of them prosecutes an individual.*

As the number of countries increases that provide for criminal penalties against individuals, multiple prosecutions of individuals in multi-jurisdictional cartel cases become more likely. International law does not

recognise double jeopardy or *ne bis in idem* principles. Thus, in principle several jurisdictions could prosecute the same individual for participation in the same international cartel. There is nevertheless a question whether in such a case authorities should take the prosecution of an individual in another jurisdiction into account. If there is something like an “optimal” term of a prison sentence, or it is at least recognised that shorter prison terms are the most efficient deterrent, an accumulation of prison terms in several jurisdictions would be undesirable. Moreover, coordination to avoid prosecutions in more than one country could reduce overall enforcement costs.

In fact, it appears that jurisdictions with a criminal sanctions system have in the past been willing to make arrangements with another jurisdiction which investigated the same cartel to ensure that only one of them would prosecute an individual.

Cartels: Sanctions against Individuals

2. Background Note

Background Note

by

Andreas Reindl

Introduction

The Competition Committee as well as this Working Party has on various occasions considered the important role of sanctions against individuals in the fight against hard core cartels.

The 1998 Cartel Recommendation already indicated the importance of sanctions against individuals by recommending that member countries provide for “effective sanctions, of a kind and at a level adequate to deter firms and *individuals* from participating in such cartels”, to ensure that their competition laws effectively halt and deter hard core cartels.¹

The Competition Committee’s Report on Harm and Sanctions² as well as the Second Cartel Report³ discussed in greater detail the important role of sanctions against individuals as effective deterrent and enforcement mechanism against hard core cartels. The Second Cartel Report explained:

“Whether or not it is legally possible to impose an optimal organisational fine and practically possible to calculate it in a given case, actually imposing it might present problems. The optimal fine could simply be too large for the entity to bear, causing bankruptcy and possible exit from the market, which itself could diminish competition. Thus, there is a place for sanctions against natural persons, placing them at risk individually for their conduct. Such sanctions can complement organisational fines and provide an enhancement to deterrence.”

The Second Cartel Report recommended that member countries consider i) introducing and imposing sanctions against natural persons; and ii) introducing criminal sanctions in cartel cases where it would be consistent with social and legal norms.

The Second Cartel Report also acknowledged, however, that introducing sanctions against individuals, especially criminal sanctions, may raise questions in member countries:

“The laws of several OECD countries, but less than half, permit the imposition of administrative fines on natural persons for cartel conduct. In a distinct minority of countries cartel conduct is a crime, punishable by imprisonment, as well as by fines. The prospect of spending time in jail can be a powerful deterrent for businesspeople considering entering into a cartel agreement. Not all countries consider that criminalising cartel conduct is appropriate, however. Such a step may conflict with existing social or legal norms in a jurisdiction. It also has the effect of imposing a higher burden of proof on the prosecutor and it may make it more difficult to acquire evidence in certain circumstances, as additional procedural safeguards apply in criminal investigations.”

While acknowledging the importance of sanctions on individuals in the fight against hard core cartels, the above documents also demonstrate that this is an area where the potential for strengthening the law and enforcement practice in most member countries is significant. A survey of the 1998 to 2000 period disclosed that sanctions against natural persons had actually been applied in only a few countries. Even though 13 countries responding to the survey provided for the possibility of fines on individuals, only four, *Australia, Canada, Germany* and the *United States*, had actually imposed them, and only two, *Canada* and the *United States*, had imposed jail sentences.⁴

A number of member countries have in the recent past undertaken reviews of their sanctions policy with a view toward increasing penalties for cartel conduct, and have considered introducing sanctions against individuals, including criminal sanctions. These reviews have addressed a number of interesting questions that may be raised in other countries as well that are considering or will consider introducing or strengthening sanctions against individuals. This paper proposes to include in the roundtable discussion some of the questions raised in these reviews. The following topics for discussion are proposed: i) what kind of sanctions against individuals can be imposed, and how effective are these sanctions as a deterrent and as an incentive to cooperate during an investigation; ii) is there something like an “optimal” level of sanctions against individuals; and iii) what are the specific issues raised by criminal sanctions, including a) possible objections to criminal sanctions against individuals; b) what is a proper definition of the criminal offence; c) if civil/administrative and criminal sanctions co-exist, what criteria can be applied to decide which one to apply; and d) could criminal prosecutions of the same individual in more than one jurisdiction raise concerns.

1. The role of sanctions on individuals in hard core cartel cases

Individual sanctions can be important element in enforcing laws against hard core cartels. Some have concluded that sanctions against individuals are the most effective element in the arsenal of various enforcement tools an agency may have available in the fight against hard core cartels.⁵ Properly implemented, they can mean the difference between viewing cartels on a cost/benefit basis as a reasonable risk-taking exercise and serious deterrence that prevents unlawful cartel arrangements. In addition to deterring unlawful conduct, sanctions against individuals also can be a useful tool during the investigation of a cartel.

1.1. *Deterrence*

There is a case for deterring not only corporations, but also individuals from unlawful conduct. Hard core cartels do not occur in the abstract, but involve individuals who act on behalf of a corporation. Thus, as agents of corporations commit violations of competition law, it makes sense to prevent them from engaging in unlawful conduct by threatening them directly with sanctions and to impose such sanctions if they violate the law.

The risk of sanctions also may strengthen the incentive of individuals to resist corporate pressure to engage in unlawful activity. Even if the risk of participating in a cartel appears to be acceptable to a corporation in light of the potential gains and the probability of fines, the risk assessment on the part of the individual executive may be very different if she takes her own, personal risks into account, including the risk of spending time in jail. Moreover, a corporation's risk/benefit calculation may be affected when it includes the risks to its own executives, and the cost of losing their services, into its analysis.

1.1.1. *Complementing corporate sanctions*

The case for sanctions against individuals would be much weaker if one could assume that corporate sanctions should be sufficient to (indirectly) prevent individuals from breaking the law. One could argue, for example, that imposing fines on corporations should be a sufficient incentive for a corporation to supervise its agents in order to prevent them from acting unlawfully and from putting the corporation at the risk of being fined for participating in an unlawful cartel.⁶

For several reasons, however, corporate supervision might not always work as effectively as sanctions directly imposed on the agents of a corporation: First, to provide an effective incentive to implement the necessary supervision of its agents, potential corporate fines would have to be an effective deterrent. It is commonly assumed, however, that corporate fines rarely reach a level that would maximise their deterrent effect.⁷ Thus, the

corporation may have insufficient incentive to prevent its agents from entering into an unlawful cartel arrangement, if – despite the risk of sanctions – the corporation expects a cartel to be profitable.⁸

The ability of shareholders to effectively control the management is also questionable if shares are widely dispersed. The financial impact of a corporate fine on individual shareholders may be too small to provide sufficient incentive for them to more effectively control management.⁹ Last, there are questions whether a corporation will always have the means to deter its agents from unlawful conduct. For example, a manager of a division that has been underperforming for a while may already fear for his position. The threat of dismissal, which is a corporation's most effective sanction against employees engaged in unlawful conduct, may not be much of a threat for him.

1.1.2. *The effectiveness of various sanctions against individuals*

The Second Cartel Report states in general terms that sanctions against individuals are an important complement to corporate fines. However, a variety of factors will determine whether any given sanction in fact has deterrent effects and therefore is an effective complement, including whether i) there is a reasonable probability that unlawful conduct will be detected; ii) the potential sanction is perceived to be severe; and iii) an individual believes with some degree of certainty that the sanction will be imposed.

The prospect of spending time in jail will be the most powerful deterrent for business executives considering entering into a cartel agreement. It appears less certain that other sanctions against individuals have strong deterrent effects as well, including, for example, (criminal and non-criminal) fines, barring individuals from serving as an officer of a public company, loss of licenses required to do business, community service, and requirements to publish the fact of a violation of competition laws.¹⁰

The effectiveness of fines might be limited by two factors: First, it may not be possible to impose fines that are sufficiently high to effectively deter individuals from participating in cartels for reasons similar to those which suggest that corporate fines alone are not effective deterrents. Determining the parameters of an “optimal” fine typically will be even more difficult in the case of an individual than in the case of a corporation.¹¹ And if it is possible to make reasonable assumptions about an “optimal” fine, such a fine might exceed statutory ceilings and/or the individual's ability to pay.

Second, the effectiveness of fines will depend on whether an individual can expect that she – in whatever form – will be reimbursed by the corporation. Reimbursement schemes may be lawful in some countries as their prohibition may be considered an unjustified interference with internal corporate affairs.¹² But even if reimbursement is outlawed, a corporation might find some way of reducing or eliminating the risk to its executives,

either by paying in advance a premium to compensate for the risk or by reimbursing for fines that actually were imposed on individuals through pay increases or other ways not prohibited by law.

Questions also have been raised about the effectiveness of other sanctions against individuals. A (temporary or indefinite) prohibition from serving as an officer of a public corporation, for example, potentially could be more “effective” in the sense that it will be more difficult to shift the cost of the sanction from the individual to a corporation.¹³ It cannot be excluded, however, that other, informal arrangements can be found that enable an individual to work for the corporation. And even if prohibitions against such arrangements are effective, the question remains whether the risk of losing the ability to serve as a director of a public company alone would be enough to deter an individual from participating in a cartel. Along the same lines, it can be questioned whether other individual sanctions, such as the creation of negative publicity, for example, through mandatory advertisement in journals, or community service, can be an effective deterrent.

On the other hand, even if it is uncertain whether sanctions other than imprisonment can effectively deter individuals from entering in cartel arrangements if imposed in isolation, a combination of them might create a sufficiently strong deterrent. The deterrent effect of a specific sanction also may depend on its criminal or civil/administrative nature. Criminal convictions represent a condemnation by society of certain conduct in a way that the imposition of a civil penalty cannot. The fact that certain violations of the law are characterised as criminal offence may already be sufficient for individuals to comply with the law and resist attempts by its corporation to engage in unlawful cartel activity. And the prospect of having a criminal record, even if not related to jail time, might sufficiently deter individuals from participating in an unlawful cartel arrangement. Although it is difficult to determine how substantial these losses can be, they might be substantial and therefore create an incentive that might be a much stronger motivation for compliance than the incentive created by civil sanctions.¹⁴

The following questions could be discussed:

1. *What sanctions in addition to those mentioned above in paragraph 15 can be imposed on individuals who participate in a hard core cartel?*
2. *What are the experiences concerning the effectiveness of various sanctions? Are there ways to assess the effectiveness of sanctions, including combinations of sanctions? How effective are fines imposed on individuals if there is no prohibition against reimbursing an individual? On the other hand, can prohibitions against reimbursement be effective?*

1.2. Increased effectiveness of investigations

In cases where the threat of sanctions was not a sufficient incentive for individuals to prevent their corporation from engaging in an unlawful cartel, the ability to impose sanctions on individuals nevertheless can be a powerful tool for a competition authority in the investigation of cartels.

Individuals have information about cartels, but in the absence of a risk of sanctions against them, they will have little incentive to come forward to reveal evidence. Threatening credible sanctions directly against them creates such incentives that are separate from the incentives of a corporation, thus creating a greater likelihood that someone will defect and offer co-operation. As a result, a leniency programs (and other programs that promise reduced sanctions in exchange for co-operation) should become more effective.

In addition, even after a cartel has been disclosed and the investigation is under way, the threat of sanctions against individuals, and the ability to avoid them through co-operation, will strengthen a competition authority's position. The larger number of participants with different interests that can be played off against each other, the greater the likelihood that someone will come forward and not only disclose the existence of a cartel, but also cooperate with the authority during an ongoing investigation.

The important role of sanctions against individuals in the United States Department of Justice's ("DOJ") fight against hard core cartels has been widely recognised. For example, a 2001 Report to the UK Office of Fair Trading published in connection with the introduction of criminal sanctions against individuals in the United Kingdom acknowledged that despite the European Commission's successful anti-cartel enforcement some distance between the EC and US leniency programs remained: "Under EC law, unlike in the US, participation in a cartel is not a criminal offence and hence the incentive for individuals to inform on other cartel participants in return for immunity from prosecution is lessened under circumstances in which there is no possibility of facing the imposition of custodial sentences."¹⁵ The same Report also more explicitly acknowledges that the DOJ's ability to selectively enter into plea bargaining agreements is the key to success of the US leniency program.¹⁶ Commentators have referred to the dog-eat-dog environment that DOJ has created, which considerably increases the government's leverage and ability to obtain co-operation by individuals and corporations.

US law enforcement institutions and procedures may be uniquely suited for such a program, however, and it may be difficult to replicate it elsewhere. For example, because DOJ administers the leniency program and is prosecuting authority, it does not have to reach an arrangement with a public prosecutor or another prosecuting authority to implement a leniency program. Moreover, the credible risk of severe criminal sentences against

individuals, a well-developed, highly transparent leniency program, and the ability to offer defendants lesser sentences or immunity in exchange for their co-operation during an investigation, all appear to contribute to the success of the program.

The need to coordinate a leniency program and criminal sanctions will raise more difficult issues in systems where criminal prosecution is the responsibility of another authority which technically is not bound by decision and policies of the competition authority. In such a system the competition authority might not have the ability to guarantee immunity from prosecution for being the first to disclose an unlawful cartel. In addition, a competition authority may not have the option to offer a defendant a lesser sentence or immunity in exchange for co-operation and, along the same lines, may not have the ability to obtain sentences, including imprisonment, without the need to go through a full trial and produce the necessary evidence to obtain a long prison term and/or stiff fine.¹⁷ For example, the 2001 UK Report concluded that in the absence of a plea bargaining system in the UK the OFT would face the difficulty of being able to provide informants sufficient comfort that they would not face criminal prosecution and/or custodial sentences in exchange for their co-operation.¹⁸

The following questions could be discussed:

3. *What are the elements that maximise the effectiveness of sanctions against individual during investigations as an incentive to co-operate with authorities?*
4. *If the authority to implement a leniency program and the authority to prosecute criminal cases are divided, what can be done to limit or eliminate the risk that the discretion of public prosecutors to pursue a case could undermine certainty for defendants that they will not be prosecuted if they come forward first?*
5. *In countries in which plea bargaining does not exist, are there mechanisms that can be developed to assure that the competition authority is able to obtain co-operation from individuals in exchange for a promise of immunity or a lesser sentence if neither prosecutors nor courts are bound by such arrangements?*

2. Is there an “optimal” level of sanctions against individuals?

It is commonly accepted that pecuniary fines imposed on corporations should take into account the unlawful gains from the participation in a cartel as well as the probability that unlawful cartels are being detected in order to be an “optimal” deterrent. In principle the same question about “optimal” fines can be asked for various types of individual sanctions as well. In this case, however, it will be even more difficult than in the case of a corporate defendant to determine an “optimal” level of a fine.

One could consider whether, as in the case of corporations, fines against individuals would be an optimal deterrent if they take into account the unlawful gains of an individual related to the participation in an unlawful cartel, multiplied by the likelihood that cartels are detected.¹⁹ However, it will typically be impossible to determine how much an individual gained from cartel activity. Any gains related to job promotion or higher performance-based salaries might not result only from the unlawful cartel activity of a corporation. In the alternative, taking away a “sufficient” amount of an individual’s net worth and earning power may be considered an “optimal” deterrent. But then, again, the question arises how much of a fine would be “sufficient”.

In jurisdictions that provide for the possibility of imprisonment, it can be asked whether there is something like an “optimal” jail sentence or, at least, whether criteria exist to determine what length of prison term most cost effectively serves the goals of deterrence and increased co-operation. Some have suggested that the optimal prison term should be rather short, in particular because after a relatively short time the marginal cost to society of additional prison time might exceed the gains from additional deterrence. This view is based on the assumption that that even short term prison sentences are viewed by business executives as extremely undesirable and costly, and that the stigma and reputational losses associated with a criminal conviction to serve time in jail would exist for any non-trivial time in jail. The marginal deterrent effect of prison time might remain high only for a relatively short time, however, as an individual might get used to long prison terms and prospects of being able to enjoy a comfortable life after prison diminish. On the other hand, the marginal cost of imprisonment probably would slightly increase over time.²⁰ Another commentator suggested that it was “more important that the potential defendant knows with some certainty that she was likely to be sentenced to jail than that long sentences be imposed”.²¹ This also appears to suggest that even short sentences can be an effective deterrent, provided there is a credible threat that they actually can be imposed.

On the other hand, there also is a case for longer statutory sentences. Having a longer statutory sentence might send a signal to prosecutors and courts that cartels should be considered a serious criminal violation. With shorter statutory sentences, courts might be more inclined to let defendants off the hook and impose alternative sentences instead.

The following questions could be discussed:

6. *Is there a way of determining what an “optimal” level of fines is that can be imposed on individuals in hard core cartel cases?*

7. *What are the opinions concerning the above argument in favor of shorter, rather than lengthy prison sentences? What parameters determine the statutory term of imprisonment and the prison terms actually imposed on defendants?*

3. Issues specifically related to criminal sanctions against individuals

3.1. Concerns raised in connection with criminal sanctions

One commentator, after analysing the effects of sanctions against individuals on anti-cartel enforcement in the United States, opined with respect to other countries “the case of individual sanctions appears to be relatively strong, which makes the reluctance [to impose them] so particularly puzzling”.²²

However, despite the obvious advantages of criminal sanctions in the deterrence and prosecution of cartels, there can be a number of reasons why countries are reluctant to provide for sanctions against individuals in cartel cases, and in particular to criminalise participation in cartels. A country might consider, for example, that criminal sanctions are not compatible with its values and social norms, that imprisonment imposes significant costs on society and that non-criminal sanctions would be more cost effective, and/or that criminal sanctions actually might decrease the level of enforcement.

3.1.1. Consistency with social and legal norms

A country might decide against introducing criminal sanctions against individuals because hard core cartels are not considered sufficiently reprehensible to justify this kind of punishment. It could be that this assessment applies generally to white collar-type offences, or specifically to antitrust violations. If a country provides for criminal sanction in other “white collar” cases, such as tax fraud or securities violations, but not with respect to cartels, the decision might be based on the belief that in connection with hard core cartels – unlike tax fraud or certain securities crimes – individuals rarely enrich themselves and that their conduct benefits primarily the corporation (which accordingly should be subject to fines) rather than its directors.

For perhaps similar reasons, a country also could decide to criminalise only selected categories of hard core cartels, especially cases of bid rigging, but not others, or at least to impose harsher sanctions on bid rigging offenders than other participants in cartels. This decision could be based on the assumption that cartels that affect public institutions (and public finances) are more reprehensible than other cartels and therefore should be subject to stiffer sanctions.

3.1.2. Costs of criminal sanctions, in particular imprisonment

Another concern related to the criminalisation of cartels could be that criminal sanctions that include imprisonment can be an expensive form of punishment for a society and that other sanctions can be more cost effective. According to some economists, for example, a social cost/benefit analysis suggests that only fines (preferably civil fines) should be imposed on individual defendants, provided the defendant is able to pay a fine that has the same deterrent effect as the threat of imprisonment. In principle it would be feasible to determine an “exchange rate” to arrive at an “optimal” (pecuniary) fine has the same deterrent effect as a prison sentence.²³

Others have rejected this line of reasoning on the following grounds: First, even if it were possible to determine an “optimal fine”, the fine would have to be extremely high to have a deterrent effect equivalent to imprisonment, and typically it would be beyond the defendant’s ability to pay. Second, “optimal fine” models should not be applied to hard core cartels. They assume that certain conduct, even if unlawful, can be efficient and society would be better off by taxing the conduct in the form of fines rather than prohibiting it. This assumption, however, cannot be applied to hard core cartels which will virtually never be beneficial for society and therefore should never be considered acceptable conduct that can be paid off by paying a fine.²⁴

3.1.3. Can criminalisation make law enforcement less effective?

Concerns also have been raised that criminalising anti-cartel laws could make anti-cartel enforcement less effective. This was the conclusion of the report published when New Zealand reviewed its system of sanctions against cartels. The Report concluded that higher standards were likely to lead to fewer prosecutions and a reduction in the number of successful cases.²⁵ Obtaining a conviction could be more difficult in a criminal system in particular because of higher standards of evidence and the right against self-incrimination. For example, the right against self-incrimination will make it more difficult to obtain evidence from individuals involved in a cartel, unless they are willing to co-operate.

As the Harm and Sanctions Report observed, criminalisation of cartel law can therefore have opposite effects: “criminalisation of cartel conduct for individuals makes voluntary co-operation more possible, because of the threat of personal sanctions, but also makes it more necessary, because a right against self-incrimination attaches.”²⁶ This suggests that criminal sanctions against individuals could be most effective in systems where the government has a broad range of tools available to make voluntary co-operation an especially attractive option for at least a few member of an unlawful cartel.

Criminalisation might limit effective anti-cartel enforcement also if a competition authority finds it difficult to persuade prosecutors to investigate

and bring cases, and judges to impose the criminal sanctions provided for in the law. Prosecutors might not consider white collar crimes, and hard core cartel case in particular, a high priority in their work, compared with violent crimes and crimes against property. Along the same lines, judges might be reluctant to impose criminal sanctions in cases that in their view do not involve a sufficient degree of “criminality”. Court and prosecutors might be confronted with defendants who are considered respectable business people, “pillars of the community”, and/or supporters of good causes who pose no physical danger.

The threat of criminal sentences also might make the detection and prosecution of cartels more difficult because they might make individuals more careful, causing them to increase their efforts to hide cartels. In addition, individuals as well as companies might be even more reluctant to provide information in response to requests given the possibility of criminal procedures against individuals.²⁷

The following questions could be discussed:

8. *In countries that have considered or are considering introducing criminal sanctions against individuals, or have changed their system of criminal sanctions, have there been any discussions concerning the appropriateness of criminal sanctions for cartels and their consistency with social norms? What arguments were raised in this context? If criminal sanctions exist in other “white collar” areas, but not in cartel cases, what explains the differences?*
9. *If differences exist between bid rigging cases and other forms of hard core cartels in terms of sanctions that can be imposed on individuals, what explains those differences?*
10. *Have considerations about the cost-effectiveness of criminal fines such as the ones discussed above played a role in a country’s discussion whether to introduce criminal sanctions against individuals?*
11. *Is there any evidence that criminal sanctions actually can decrease the level of anti-cartel enforcement for the reasons stated above, e.g., because of higher standards of evidence and/or the right against self incrimination?*
12. *In some countries, it may be (or may have been) difficult to “persuade” courts to actually impose criminal sanctions and prosecutors to bring more cases. What can be/has been done to “encourage” courts to impose sanctions more frequently and/or to impose tougher sanctions, and/or prosecutors to bring more cases and demand higher sanctions?*

3.2. Definition of a criminal offence

In several countries that in the recent past considered introducing criminal sanctions against individuals in cartel cases questions were raised

about the proper definition of an offence that would be subject to criminal punishment. In particular, it was discussed whether criminal sanctions against cartel participants should be imposed within the framework of the general competition laws or whether a separate offence should be more narrowly defined. Defining the criminal offence in some detail was considered necessary or at least advisable for several reasons. First, concerns were expressed that criminal sanctions might have excessive deterrence if the conduct to which they apply is not clearly defined. Co-operation between competitors can be beneficial in many arrangements and the line between *per-se* prohibited conduct (including hard core cartels) and permissible conduct may not always be clear to those operating a business. In these circumstances, the threat of criminal sanctions might deter pro-competitive and innovative arrangements if acts to which criminal sanctions apply were not clearly defined.²⁸

A separate, clear definition of acts that are subject to criminal sanctions also may be required to ensure that those potentially subject to sanctions can *ex ante* clearly understand what conduct would put them at risk. A defendant could argue that a criminal conviction would be unlawful and contravene fundamental rights if the unlawful conduct has not been defined with sufficient precision.

There could be various solutions to the above concerns. First, a country could define the culpable act(s) explicitly and more narrowly, for example by listing various types of hard core cartel activity in the definition of the offence, either as an exhaustive list or as an illustration of possible criminal conduct. For example, the new law in the United Kingdom defines the criminal offence in a provision that is separate from the general (national and European) competition provisions and specifically lists various types of conduct that are subject to criminal sanctions. The United Kingdom also decided to introduce a “dishonesty” requirement as part of the definition of the criminal offence, presumably to require that only serious criminal conduct can be subject to criminal sanctions.

Other jurisdictions have been able to obtain criminal convictions based on the general language in the antitrust statute apparently without facing any of the above problems. Thus, it appears possible to rely on case law and prosecutorial discretion to ensure that criminal cases are brought only in clearly defined circumstances that are considered *per se* unlawful and to refrain from criminal proceedings in cases that raise questions because, for example, there is no clear evidence of the existence of an agreement or of the necessary state of mind, there are innocent/pro-competitive reasons for the agreement, and for other reasons it is not clear whether the conduct in question would be considered *per-se* unlawful.

The following question could be discussed:

13. *How have countries addressed concerns related to the definition of hard core cartels as a criminal offence? If the general language in an antitrust statute is used to seek criminal sanctions, how can concerns related to over-deterrence and necessary legal certainty be addressed?*

3.3. Allocating responsibility for prosecuting a criminal case

There are also questions related to the institutional design, in particular whether a competition authority should be in charge of pursuing criminal cases or whether criminal cases should be allocated to a public prosecutor or some other prosecuting authority. There are several reasons to authorise a competition authority to pursue criminal cases. The competition authority may be best suited to investigate a cartel case based on its competition law expertise. There also would be less concern whether a public prosecutor will always be motivated to focus on cartels when she is burdened with cases concerning violent crimes and/or whether she will demand sufficient sanctions. There will be no need to coordinate leniency programs and decisions to prosecute between two separate authorities.²⁹ Last, there might be concerns that a government could instruct a public prosecutor not to pursue a case, whereas it might not have such an authority over an independent competition agency.

On the other hand, the competition agency will not always have expertise and resources to bring criminal cases. It may not always be cost effective to build up staff for prosecution of criminal cases, especially if it is expected that there will not be many such cases. Using an outside agency or public prosecutor also may be considered useful in terms of checks and balances. If two institutions are involved, and it is the competition authority's decision whether a case should be pursued under criminal statute, the need to convince the public prosecutor to pursue the case may limit criminal cases to those where criminal prosecution is really warranted.

The following question could be discussed:

14. *What are the advantages and disadvantages of having two separate authorities involved in hard core cartel cases where criminal sanctions are being sought? If there are two separate authorities, how can the two coordinate their tasks? In particular, how can the problem of effective co-operation be addressed most effectively to ensure the effectiveness of leniency programs?*

3.4. Sanctions under concurrent criminal and civil statutes

3.4.1. Decisions whether to prosecute under a criminal statute

In some jurisdictions, hard core cartels might qualify as criminal as well as civil offence, and the competition authority has discretion to seek a prosecution under a criminal statute or investigate an alleged cartel under a civil statute. Even in jurisdictions where hard core cartels are always investigated as criminal offence, the authority presumably has power to charge a less serious, civil offence in borderline cases. This could be the case, for example, where the amount of affected commerce is small, it appears unlikely that sufficient evidence for a criminal conviction can be obtained, or it is not entirely clear whether the conduct under investigation clearly is considered *per se* lawful or might fall in a grey area where the *per se* categorisation is less clear.

Especially where an authority has full discretion to pursue an investigation under either statute, a number of questions arise. First, there will be a question what criteria the authority can use to decide whether to seek a criminal conviction. Criteria could include the amount of commerce affected by a cartel, the cartel's duration, and the role of a defendant in a cartel. The amount of available evidence required to meet increased evidentiary requirements under criminal law, including proof of intent, also might be an important factor. However, the decision whether to seek a criminal proceeding presumably would have to be made at an early stage of a proceeding, and it might be unclear at this point how much evidence will be discovered. Thus, such decisions presumably have to be made based on limited evidence.

Second, if the competition authority itself can bring only civil cases, but not criminal cases, there must be early coordination between a prosecutor and the competition authority. The possibility that the competition authority can initiate a civil investigation may make a prosecutor more reluctant to bring a criminal action. This suggests that the two authorities may have to find an arrangement to decide under which statute to proceed.

On the other hand, private parties might be concerned that a competition authority's discretion to pursue a case under either a criminal or a civil statute might confer inappropriate leverage on the authority, using the threat of criminal proceedings to obtain evidence where it had no intention to bring a criminal case.³⁰

The following question could be discussed:

15. *What are the factors used to determine whether criminal sanctions should be sought in a specific hard core cartel case? If an authority has the choice between criminal and civil sanctions, when and how can it decide which sanctions it should seek?*

3.4.2. Obtaining and using evidence

Jurisdictions in which civil and criminal proceedings are possible in the same cartel case (for example, by permitting the authority to bring a civil case against a corporation while a criminal case can be brought against its directors) also face questions about how evidence obtained in a criminal procedure can be used in a civil/administrative procedure and *vice versa*. For example, statements that can be used in civil procedures may be inadmissible in criminal procedures because of the right against self-incrimination, whereas documents obtained through criminal enforcement powers may not be admissible in civil trials. Evidentiary admissibility rules must ensure that evidence obtained in one procedure cannot be misused in the other.

The following question could be discussed:

16. *What limitations exist concerning the use of evidence obtained in a criminal procedure in a civil trial and vice versa? Can such limitations affect criminal proceedings against individuals?*

3.5. International investigations and double jeopardy

The principle of double jeopardy would – in very general terms – prevent a single jurisdiction from subjecting an individual twice to criminal prosecution for participation in the same cartel. There appears to be no similar principle in public international law that would prohibit authorities in different countries from prosecuting the same person on the basis of the same facts.³¹ A question nevertheless can be asked whether authorities should take prosecutions of an individual in other jurisdictions into account when they consider bringing criminal charges against the same individual for participation in a cartel. For example, if it were accepted that there is something like an “optimal” term of a prison sentence, or at least that in principle shorter prison terms are the most efficient deterrent,³² there could be a question whether an accumulation of prison terms in several jurisdictions would be desirable. Coordination to avoid prosecutions in more than one country also could reduce overall enforcement costs.

Given that in the past criminal sanctions have been imposed on individuals only in a small number of countries, there was only a small probability that in an investigation of an international cartel by several competition authorities the same individual could be subject to criminal sanctions in more than one country. Especially in cartels affecting Canada and the United States, however, such a situation may already have come up, or may at least have been discussed between the competition authorities in both countries. As more countries consider introducing criminal sanctions against individuals, it is conceivable that situations will arise more frequently where

two or more authorities consider bringing criminal charges against the same person in connection with the same cartel.

The following question could be discussed:

17. *If two or more countries prosecute a cartel under their criminal statutes, could there be concerns about prosecuting the same individual based on the same facts more than once? If so, how could these concerns be addressed?*

Notes

1. Council Recommendation Concerning Effective Action Against Hard Core Cartels, C(98)35/FINAL (emphasis added).
2. Report on the Nature and Impact of Hard Core Cartels and Sanctions Against Cartels under National Competition Laws, (hereinafter Harm and Sanctions Report).
3. Second Report by the Competition Committee On Effective Action Against Hard Core Cartels.
4. Israel also has in the recent past imposed jail sentences on participants in cartels. See most recently Annual Report for 2002.
5. Donald I. Baker, *The Use of Criminal Law Remedies to Deter and Punish Cartels and Bid-Rigging*, 69 Geo. Wash. L. Rev. 693, 713 (2001).
6. Such a system of vicarious liability arguably could be more efficient than a system that relies on imposing sanctions on individuals. See, e.g., Bruce H. Kobayashi, *Antitrust, Agency, and Amnesty: An Economic Analysis of the Criminal Enforcement of the Antitrust Laws Against Corporation*, 69 Geo. Wash. L. Rev. 715, 737 (2001).
7. See, e.g., Harm and Sanctions Report, *supra* note 15.
8. The costs of supervision (including indirect costs if an effective supervision mechanism becomes so intrusive that it creates distrust among employees) may also lower a corporation's incentive to supervise management and employees.
9. Further, there is the possibility that management will have left a firm when the firm's participation in an unlawful cartel is detected.
10. One commentator, for example, opined that only prison sanctions would have sufficiently strong deterrent effects. Wouter P.J. Wils, *Does the Effective Enforcement of Articles 81 and 82 Require not only Fines on Undertakings but also Individual Penalties, in particular Imprisonment?*, in *Effective Private Enforcement of EC Antitrust Law* (Ehlerman and Atanaiu eds. 2001).
11. The issue of "optimal" sanctions is more fully discussed *infra*, at 19.
12. The New Zealand Commerce Commission, for example, did not support a proposal to prohibit reimbursements for this reason. See, *Optimal Sanctions in Cartel Cases*, Report by New Zealand on the Review of the Penalties, Remedies and Court Processes under the Commerce Act 1986.
13. In addition, because barring someone from serving as an officer functionally is very similar to a fine (based on the difference between the future income in the occupation from which a defendant is barred and the best alternative occupation),

a corporation also might stipulate to compensate an individual for any lost income related to such a sanction.

14. New Zealand Report, *supra* note 12, at 20.
15. Anthony Hammond and Roy Penrose, Proposed criminalisation of cartels in the UK (2001), at 29.
16. *Id.*, at 30.
17. In the United States, all criminal sentences must be imposed by a court, but plea bargaining makes it possible to do so without the need for a full trial or detailed evidentiary hearing.
18. Hammond and Penrose, *supra* note 15, at 30. It appears that in the United Kingdom the OFT and the authorities responsible for prosecuting criminal antitrust offenses have found arrangements that enables the OFT to offer a potential informant immunity from prosecution under its leniency program with a high degree of certainty.
19. Even though a corporation will be the principal beneficiary of an unlawful cartel, individual executives also might directly benefit from unlawful cartels in the form of higher remuneration and better careers, especially if remuneration is tied to the corporations financial performance. Sometimes direct advantages from cartel activities also can be substantial. See Scott Hammond, *Lessons common to detecting and deterring cartel activity*, in *Fighting Cartels – why and how*, Proceedings of the 3rd Nordic Competition Policy Conference on Fighting Cartels (2001), at 193.
20. Gregory J. Werden and Marilyn J. Simon, *Why price fixers should go to jail*, 1987 The Antitrust Bulletin 917. They concede, however, that it would be difficult to determine the marginal cost /benefit relationship in reality, and it might well be that the marginal benefits will always exceed the marginal costs, which would support longer rather than shorter prison sentences.
21. Baker, *supra* note 5, at 706.
22. Baker, *supra* note 5, at 695.
23. Richard A. Posner, *Optimal Sentences for White Collar Criminals*, 17 Am. Crim. L. Rev. 409 (1980). Posner also argues that ultimately sanctions against individuals should be avoided because so long as sanctions can be imposed on corporations and these sanctions are sufficiently high, the corporations will take effective measures to monitor its agents.
24. Werden and Simon, *supra* note 20.
25. New Zealand Report, *supra* note 12, at 20.
26. Harm and Sanctions Report, at 16.
27. Julian Joshua, *A Sherman Act Bridgehead in Europe, or a Ghost Ship in Mid-Atlantic? A Close Look at the United Kingdom Proposals to Criminalise Hardcore Cartel Conduct*, 23 ECLR 231, 237 (2002).
28. For example, prior to introducing criminal sanctions in the UK, there was considerable discussion concerning the appropriate definition of the new criminal offence to ensure it clearly covers only hard core restrictions. See, e.g., DTI, White Paper: A World Class Competition Regime (2001), at § 7.22; Hammond and Penrose, *supra* note 15, at 10.
29. See *supra* at 18.

30. Review of the Trade Practices Act 1974 (Dawson Report), Chapter 10, Penalties and other remedies, at 156 (2003).
31. See, e.g., Case T-224/00, *Archer Daniels Midland Company v. Commission*, Court of First Instance of the European Communities, 9 July 2003, at 92. The Court also emphasised that different rules apply within the European Union.
32. See *supra*, at 19.

Cartels: Sanctions against Individuals

3. Summary of the Discussion

Summary of the Discussion

The Chairman opened the discussion by pointing out that the insufficient deterrent effects of corporate sanctions and the incentive sanctions create for individuals to cooperate in cartel investigations were the most commonly used justifications for imposing sanctions on individuals. However, the Chairman observed that the written submissions had not addressed the questions whether sanctions against individuals are more efficient than other sanctions as a deterrent of unlawful conduct and whether the social costs of such sanctions are lower than their benefits. Costs of individual sanctions could include both enforcement costs (such as costs of imprisonment) and costs of higher burden of proof which may make it more difficult to successfully prosecute cartels.

1. Deterrent effect of sanctions against individuals

The Chairman asked the United States to explain why cartels continued to exist in the United States, even though the United States submission asserted that the current system of sanctions against individuals was considered an effective deterrent.

The **United States** responded that cartels – as other criminal conduct – will continue to exist because of human nature. It has not been possible to develop convincing empirical data to support the argument that jail sentences sufficiently increase deterrence to offset the additional costs because there was no reliable way to determine the causes of things that have not happened. But there was anecdotal evidence of the effectiveness of sanctions against individuals: Experience in the past has been that cartel members avoided meetings in North America in the mistaken believe that they could avoid US jurisdiction, which indicates that cartel participants at least are aware of the sanctions they could face in the United States. And many defendants have offered DOJ to pay higher fines if they could avoid time in jail, but no defendant has ever offered to spend extra time in jail in return for a reduced financial fine.

Canada explained that its views of criminal and other sanctions were based on experience and feedback from various stakeholders. No single sanction is a sufficient deterrent, but it was important that a panoply of

sanctions is available to combat cartels. Even the threat of class actions or civil actions can be an effective deterrent.

Switzerland explained that during the reform of Swiss cartel law, the Government had been open to new ideas concerning effective measures against cartels. Hearings were held that included presentations by international experts. The hearings and discussions, however, did not provide convincing arguments in favor of individual sanctions. The hearings confirmed that imposing financial sanctions on individuals was mostly ineffective because fines typically were paid by the company. The Parliament was reluctant to provide for penal sanctions against cartel members, as the trend in Switzerland is towards de-criminalisation of minor offenses, and only serious offenses are subject to criminal fines. A revision of this position would be possible, if there was convincing evidence from other countries that criminal sanctions against individuals were an effective instrument in the fight against cartels.

The law currently provided for the possibility of certain sanctions against individuals, but those sanctions have not been imposed because it was difficult to determine the person within a company who met all the criteria required to establish criminal liability.

The Chairman asked Switzerland to explain a statement in its submission that the experience worldwide demonstrated that severe sanctions against individuals are not effective as a deterrent of unlawful conduct. **Switzerland** responded that this was more a question of social norms and legal culture. In Switzerland, even the most severe offenses such as murder were sanctioned with a maximum 20 year sentence. In those circumstances imposing severe jail sentences on corporate executives would have been considered inappropriate.

The Chairman next turned to the role of sanctions as a means to educate society about the reprehensiveness of cartel conduct and to create a competition culture. He asked Chinese Taipei to report about its experience concerning the introduction of criminal sanctions, as it appeared from the submission that the introduction of criminal sanctions was met with stiff resistance, thus casting doubt on the ability of criminal sanctions to support the creation a competition culture.

Chinese Taipei reported that the Fair Trade Act, which was adopted in 1992, introduced criminal sanctions, including jail terms of up to 3 years. However, there was broad resistance against criminal sanctions within the business community, academics, the judicial system, and the FTC itself. Businesses were frequently engaged in cartel conduct. Some FTC Commissioners refused to impose criminal sanctions in white-collar cases.

Prosecutors and court also resisted. The FTC thus had to review the appropriateness of criminal sanctions.

In 1994, the FTC proposed amendments to the law which introduced the principle of administrative sanctions prior to criminal sanctions. Criminal sanctions would not be imposed on first time offenders, who could be subject only to desist orders by the FTC. Since the amendments became effective, no cartel participant was involved in cartels twice. This could be because administrative sanctions were sufficient to deter cartels, or because offenders had learned how to avoid detection.

Australia explained how the author of the Dawson Report as well as the Australian public had been persuaded of the need to introduce criminal sanctions. The ACCC initially had proposed criminal sanctions only for large corporations, but later agreed that criminal sanctions should apply without distinction to all cartels. This move persuaded the author of the Dawson Report to support criminal sanctions. Big business also supported criminal sanctions for cartels, hoping that the Dawson Report would adopt a more lenient position with respect to unilateral conduct.

The proposition to introduce criminal sanctions was broadly accepted for several reasons. First, Australia has developed a competition culture that is shared by government institutions. Second, it was believed that criminal sanctions would provide more effective deterrence. Under the current system, decisions whether to enter into a cartel were based on a purely financial cost/benefit analysis. Such an analysis would have to be substantially adjusted if the risk of time in jail was factored in. Third, there were equity considerations. Even minor offenses against securities regulations could result in jail sentences. There was agreement that participants in a cartel also should be threatened with jail terms.

The Dawson Report highlighted the difficulty of adequately defining what is a “hard core cartel”. A working party has been established to find a workable definition. The Dawson Report suggested that criminal sentences should be the exclusive sanction. The ACCC, however, preferred having the option between civil fines and criminal prosecution, where a lower level of proof would be required for civil sanctions. As regards civil penalties, there was agreement that sanctions should go beyond financial penalties. It was important that individuals could be banned from holding office in any company. Australia further reported that in its view a prohibition against indemnifying directors was relatively easy to enforce. Based on its experience concerning similar prohibitions, it appears that the regular auditing process would reveal whether a corporation unlawfully indemnified a director for an individual penalty.

As regards the public reaction to the proposals, Parliament required that the issue of defining a hard core cartel be resolved first. Once this issue was resolved, there will be unanimous support in Parliament for the proposal.

The Chair summarised the first part of the discussion by pointing out that the cultural and legal environment of a country, rather than empirical evidence about the deterrent effects of sanctions against individuals, appears to be the most important factor in determining whether cartel conduct was considered a criminal offence.

2. Optimal level of sanctions

The Chairman next raised the question whether an optimal level of sanctions can be defined.

Chinese Taipei explained that prison sentences of up to three years could be imposed in cartel cases on second time offenders. Many investigations concerned local cartels, frequently with numerous participants. When imposing sanctions, the authorities also have to take into consideration that especially imprisonment may impose disadvantages not only on individuals, but also on their families and communities. These costs can be reduced if shorter prison sentences are imposed. Since shorter prison sentences are an effective deterrent and less costly, they generally are considered sufficient. Typically, courts impose prison sentences of 6 months to one year.

Norway stated that in its view the arguments for shorter prison terms were weak. There was no proof that imprisonment as such is a sufficient deterrent. Longer prison sentences are likely a better deterrent. The cost/benefit argument in favor of shorter terms assumes that business leader contribute to society in a unique way. This assumption, however, is frequently unfounded. In particular in cartel cases, agencies deal with business leaders who have stolen from consumers and weakened the economy. Replacing them for a longer term can be done at acceptable costs for society. Principles of equality and justice also are reasons against shorter prison sentences.

With respect to the courts' reluctance to impose longer sentences, Norway explained that courts tend to be conservative. The competition authority would need many cases to change the attitude of courts. But in the past, the authority was not in a position to bring a sufficient number of cases and in that way to raise awareness of cartel activity.

The **United States** explained that it favored relatively short prison terms, compared to other crimes. Cartels are considered fraud on consumers and other purchasers of goods. But prison sentences for antitrust crimes pale in comparison with sentences for other white collar crimes. For example, an embezzlement scheme causing harm comparable to the harm caused by vitamins cartel could have led to a prison sentence of up to 20 years. For the

vitamins cartel, the maximum prison sentences would have been three years. Thus, although the average prison sentence in antitrust cases of 18 months is relatively long, it is relatively short compared to other white collar crimes.

The Chairman followed up by referring to the relatively high costs of keeping individuals in prison. In those circumstances, longer sentences would be justified only if additional costs are outweighed by benefits of additional deterrence that results from longer prison sentences. The **United States** responded that there was very little empirical evidence available concerning the marginal deterrent effect. Moreover, the response likely would be different from society to society, and may also change over time.

Israel explained that prison sentences have been imposed only in one case in which five executives were sent to jail. There was no empirical evidence available to study the issue of additional deterrence and costs. But conversations with the business community indicate that jail terms are taken very seriously and that the imposition of individual sanctions was effective. Israel did not have enough experience to know what length of sanction would be sufficient to deter cartel conduct. Defense attorneys keep comparing their cases to a single case, the “floor tile” case, thus indicating that this case was considered a landmark case. It will be necessary to ensure that other cartel cases result in imprisonment, so that the “floor tile” case does not stand out as an exception and imprisonment becomes a more typical sanction in cartel cases. The length of sentences depended on the size of corporation, the size of the market affected, the period of unlawful conduct, and the level of awareness of cartel participants.

3. Level of proof

The Chairman introduced the next topic by pointing out that the increased standard of proof might be a downside risk of introducing criminal sanctions. It asked the United Kingdom to explain the elements that must be proved in a criminal cartel case under the new statute, in particular the dishonesty requirement.

The **United Kingdom** first added a comment to the previous discussion concerning the effectiveness of criminal sanctions. The effectiveness of criminal sanctions could be more easily established where police was used to crack down on criminal activity and there was evidence of changes in criminal conduct following such intervention. Such effects are more difficult to prove in cartels where the unlawful effects consist of increased prices. The level of prices is determined by multiple factors, so it would be impossible to use statistical data to establish the effect of criminal enforcement on price levels. In the end, there is a question whether it is held to be self evident that jail time

is a better deterrence of corporate executives. There is at least strong anecdotal evidence that criminal sanctions have such deterrent effects.

The definition of the criminal cartel offense was narrower than the civil definition for two reasons: First, the civil definition followed the definition of Article 81 of the Treaty of Rome, which prohibits conduct even if it has only the effect, but not the object, of restricting competition. Such a wide definition would be inappropriate for a criminal offense which under UK law should include the requirement of a proven guilty mind. Second, there was a need to define the criminal offence with greater precision to avoid endless litigation about the exact scope of the offense.

“Dishonesty” was a UK-specific feature that was well-known to prosecutors. It required that prosecutors can prove to a jury that the person who committed the act knew that his act was wrong, and that reasonable people also would have regarded the conduct as wrong. It could be imagined that a jury would be more likely to find dishonesty in cartel cases where top executives were prosecuted. It would be necessary to show that individuals thought that they could financially benefit from cartel conduct.

The Chairman pointed out that the important question addressed by the roundtable was whether criminal sanctions could deter cartels, not necessarily whether they lead to lower prices. A large body of literature existed about the deterrent effects of criminal sanctions, and it might be worth examining whether this literature suggested ways in which the effects of criminal sanctions on cartels could be established in a reliable way.

Canada explained that the definition of a restrictive agreement in Section 45 of the Competition Act was considered overly broad because it captured a great number of agreements and not only hard core cartels, but also overly narrow because it included an “undue lessening of competition” requirement. The “undue lessening of competition” standard required the showing that the agreement conferred such market power on the parties that they could conduct business independent of market forces. There was no bright line test to determine when “undue lessening of competition” existed. Economic concepts such as market definition, entry barriers, and price elasticity had to be proven under criminal standards which required proof beyond reasonable doubt. Courts also required that cartel participants knew or should have reasonably known that their agreement would unduly lessen competition. A Government discussion paper has recently been issued to consider reforms. According to the paper, hard core cartels would remain criminal offenses which would be prohibited per se. There would be no need to show the effect of such agreements on competition. All other types of agreements would be reviewed under the substantial lessening of competition standard as a civil offense.

Israel stated that its statute provided a very wide definition of a criminal offense, but that the agency used discretion to decide whether to criminally prosecute a cartel. There was not much concern that the wide definition might over-deter. Every business person who had even a slight doubt about the lawfulness of a proposed arrangement could apply for approval or exemption. Thus, the business community is able to rely on a safe harbor, and frequently uses this opportunity. The broad definition of the criminal offense nevertheless creates problems for the prosecution. There is no legal tradition about the exact scope of the criminal offense, and the authority has not issued guidelines. At the same time, it was difficult to come up with a precise, narrower definition of a criminal offense. Thus, there always would be some discretion for the authority to decide whether to criminally prosecute an alleged cartel.

4. Co-operation with prosecutors

The Chairman turned next to the question of co-operation between antitrust agencies and criminal prosecutors in bringing criminal cartel cases and in applying leniency programs.

Israel explained that the threat of higher sanctions may lessen incentives for defendants to enter into plea bargaining arrangements. If prosecutors propose plea bargaining agreements that include jail sentences, defendants in many cases believe that they have better chances in court because jail terms are rarely imposed. Imprisonment was imposed only in one case. Reaching plea bargaining agreements without jail time would be easier, but it was the competition authority's stated goal to increase the number of cases in which imprisonment is part of the sanction. This might be a transitional problem while the authority is trying to raise the level of fines. Once courts accept the view of the authority and impose jail time more frequently, reaching plea bargaining agreements that include jail time will be easier.

The **United Kingdom** explained that under the Enterprise Act the prosecuting authority is bound by a grant of immunity by the OFT. Clear rules have been published that should ensure that individuals will come forward and seek leniency. The immunity program required continued co-operation by the person seeking leniency, and this may also require co-operation in court by providing evidence. Last, relying purely on testimony by a person who was granted immunity would not be sufficient, but corroborating evidence would be required to obtain a conviction.

5. General discussion

The **European Commission** pointed out that no provision existed under EC law to hold individuals responsible for participating in cartels, despite the

Commission's cartel-related activity. There were two major reasons for this situation: First, there was divergence among member state laws and policies concerning sanctions against individuals. Six member states currently provide for sanctions against individuals. Second, at the moment, and for the foreseeable future, no provisions existed in the Treaty to guarantee protection of individuals through a proper legal process in criminal cases. This situation could change only through an agreement reached by member states.

The Commission is of the view that sole reliance on corporate sanctions cannot ensure adequate deterrence. Corporate sanctions have an indirect effect on individuals and cause them to be accountable to their stakeholders. However, deterrence has to be addressed in a comprehensive way. The deterrent effect of sanctions against individuals, including jail time, would be appropriate considering the level of harm to competitors and consumers. Ultimately, the EU should be moving toward a system that provides for criminal sanctions, provided there is adequate certainty and protection of the rights of individual.

As of May 2004, national authorities will apply EU law in parallel with national laws. Criminal prosecution will be possible through the parallel application of national laws that provide for criminal sanctions. In this heterogeneous situation, where EU law and national laws can be applied in parallel, several challenges exist. First, the compatibility of leniency schemes and criminal sanctions must be ensured. Differences between leniency programs on a national level can cause significant problems. It can be envisaged that leniency applications could lead to criminal prosecution of employees or ex-employees by national authorities, following information exchanges within the network of competition authorities or co-operation between the Commission and national courts. The Regulation specifically provides that custodial sanctions can be imposed only if the law of a transmitting authority either foresees sanctions of a similar kind or ensures that information is collected under rules that protect the rights of individuals similar to the rules applicable in the jurisdiction of the receiving authority. The rules being developed within the Community therefore emphasise the need to coordinate between authorities that implement leniency programs and those that criminally prosecute cartel participants.

In the Commission's view the culture of competition in the EU is moving towards sanctions against individuals. It must be ensured that the development of consensus in this area is not made more complex by the inefficient interaction between national and Community rules. Last, it will have to be ensured that leniency applications for corporations and for individuals are handled in a parallel way.

BIAC emphasised that the business community had an interest in effective anti-cartel enforcement as businesses frequently are victims of cartels. Individual sanctions generally are also supported by the business community. The threat of sanctions also can provide an incentive to cooperate with government authorities.

However, the business community also could become the unintended victim of misdirected enforcement action, and of disproportionate penalties. These concerns existed in particular in a multijurisdictional context. For every clear-cut cartel case, there are many close cases with complex business arrangements that are not clearly unlawful. The risk of sanctions may affect the willingness of individuals to provide evidence. Evidence based on individual testimony might not always be reliable. In a multijurisdictional context, evidence from one jurisdiction could be used elsewhere, thus subjecting an individual to prosecution in multiple jurisdictions. This might significantly reduce the incentive to plead guilty in the first jurisdiction. Even the threat that the first jurisdiction may share information with another jurisdiction may affect the individual's right and ability to defend himself.

The notion of optimal deterrence is a complex issue in the case of individuals. Calculating benefits individual derive from cartels may be difficult. In a multijurisdictional context, short prison terms can become long, and fines may become excessive. BIAC suggested that in cases of multiple prosecutions, coordination among jurisdictions would be advisable to avoid unfair and excessive penalties. As to the question of overdeterrence, it was conceivable that collaborative conduct that may be appropriate and lawful may be deterred. Corporate executives may fear the threat of investigations and sanctions even when considering procompetitive arrangements.

Ireland commented that while imprisonment was a useful instrument in fighting cartels, it should not be the only instrument available to agencies. Especially in jurisdictions where anti-cartel enforcement is relatively new and developing, where for example government ministers used to host meetings of cartels, judges are less likely to convict individuals for their participation in cartels. In those circumstances, administrative fines should be part of the agency's portfolio as well. Class action was not considered a preferable alternative, given the negative experience with class actions elsewhere.

As to optimal sentences and the effectiveness of lengthy sentences, there were steeply decreasing returns for longer sentences. On the other hand, the costs of imprisonment increase more than linearly over time, especially because the negative effects on the imprisoned individuals increase. In addition, in a situation where small countries can send people to jail for smaller, national cartels, but no prison sentences can be imposed for larger, European-wide cartels, concerns could be raised about the proportionality of

longer prison sentences. The 5-year maximum jail time in Ireland was largely an expedient device to enable the agency to carry out investigations more effectively. Last, Ireland emphasised that timing of sanctions is important. Prison sentences should be imposed swiftly to be effective, and not several years after a cartel has been detected.

Australia explained that in its view the current mix of available sanctions was suboptimal. It was very difficult to come up with an objective way to determine the right mix of sanctions that has the most effective deterrent effects and can ensure compliance, given that competition culture, agency practice, but also the role of prosecutors and court are variables that impact the effectiveness of various sanctions. A study on compliance outcomes currently is being undertaken. Preliminary results indicate that the publicity of sanctions had significant deterrent effects.

New Zealand agreed that hard core cartels should be seen as a serious offense and that individuals should be subject to significant sanctions. New Zealand followed the developments in Australia with great interest, given the integration of the two economies. However, New Zealand has so far resisted the introduction of criminal sanctions against individuals. First, there was the concern that criminal sanctions could make it more difficult to impose sanctions than under the current system of civil sanctions. Even if criminal sanctions were introduced as an alternative to civil sanctions, the effects in a small economy like New Zealand would be rather limited, given the higher standards of proof and the small number of cases brought by the agency. Pursuing criminal cases could take several years and require significant resources. Moreover, there was the risk that agencies might ultimately not succeed in imposing sanctions, which could create the perception that the law was not effective.

Mexico explained that even though criminal sanctions are provide for in the law, it had been difficult to persuade prosecutors to pursue cases. There was a lack of awareness in society that cartels were a reprehensible conduct.

Germany explained that administrative fines can be imposed on individuals in cartel cases, but that those sanctions were not very effective because corporations typically would pay fines imposed on individuals. Criminal sanctions would certainly help in this respect. Germany then explained that it is in the process of reforming its law in connection with the EU's competition law reform. Strengthening the rights of third parties was one of the goals of the law reform. In Germany, there was the impression that the fear of treble damages sometimes was the most effective deterrent, more effective even than the risk of going to jail. Germany asked the United States to explain how it viewed the relationship between treble damages and criminal sanctions in terms of deterring cartels.

The **United States** confirmed that the fear of treble damages had a strong deterrent effect, but that it was effective mostly with respect to corporations. Individuals were not exposed to treble damages. Potential jail time had the most effect on individual behavior.

The United States rejected BIAC's point that aggressive anti-cartel enforcement might lead to over deterrence. The Justice Department criminally investigated only cases that were clearly hard core cartels. While it was true that investigations were closed without bringing a criminal case, this was because there was not enough evidence to bring a criminal case and not because the conduct under investigations was ambiguous.

As to prosecution in a multijurisdictional context, the increasing number of countries that provided for criminal penalties against individuals made multiple prosecutions of individuals more likely. In the past, the United States had made arrangements with other jurisdictions which investigated the same cartel to ensure that only one jurisdiction would prosecute an individual and only one would impose jail sentences.

Concerning the cost of criminal sanctions, the United States pointed out that the costs of jail sentences are only a minor cost factor, compared to costs of investigating and prosecuting cartels. In response to a remark by the Chair, the United States confirmed that leniency programs were a useful tool in the prosecution of cartels that made anti-cartel enforcement less costly. However, even in cases with leniency applications, the cost of prosecution remained substantial.

BIAC suggested that jurisdictions should consider entering into more MLAT/IAEAA-type bilateral co-operation agreements that allow for co-operation in the securing of evidence in other jurisdictions. Such action could be a wake-up call to corporations and business persons because the risk of investigations would substantially increase and could affect the careers of individuals. Awareness of and compliance with antitrust laws would increase.

The Chair closed the roundtable by pointing out that while individual sanctions were recognised as a useful tool in the fight against cartels, the costs of imposing such sanctions, local competition culture and legal environment, and the size of country also should be taken into account. Otherwise the use of sanctions against individuals could create a backlash. Overall one could observe a tendency toward sanctions against individuals. There was a need to think creatively about the right mix of sanctions.

Cartels: Sanctions against Individuals

4. Country Contributions

Further information from the following jurisdictions on Prosecuting Cartels without Direct Evidence of Agreement is available at: www.oecd.org/competition under the topic “Best Practice Roundtables”.

Country contributions

Australia	Norway
Canada	Switzerland
Chinese Taipei	United Kingdom
Israel	United States
Japan	

Prosecuting Cartels without Direct Evidence of Agreement

Circumstantial evidence is employed in cartel cases in all countries. The better practice is to use circumstantial evidence holistically, giving it cumulative effect, rather than on an item-by-item basis. Complicating the use of circumstantial evidence are provisions in national competition laws that variously define the nature of agreements that are subject to the law. There are two general types of circumstantial evidence: communication evidence and economic evidence. Of the two, communication evidence is considered to be the more important. Economic evidence is almost always ambiguous. It could be consistent with either agreement or independent action. Therefore it requires careful analysis. National treatment of cartels, such as whether they are prosecuted as crimes or as administrative violations, can affect the burden of proof that applies to the cases, and hence the use of circumstantial evidence. It can be difficult to convince courts to accept circumstantial evidence in cartel cases, especially where the potential liability for having violated the anti-cartel provisions of the competition law is high. There are circumstances in countries that are relatively new to anti-cartel enforcement that could affect the extent to which they rely on circumstantial evidence in their cases.

Prosecuting Cartels without Direct Evidence of Agreement

1. Executive Summary

Executive Summary

by

The Secretariat

Considering the discussion at the roundtable, the delegates' written submissions and the Secretariat's background paper, several key points emerge:

1. *Circumstantial evidence is employed in cartel cases in all countries.*

Competition law enforcement officials always strive to obtain direct evidence of agreement in prosecuting cartel cases, but sometimes it is not available. Cartel operators conceal their activities and usually they do not co-operate with an investigation of their conduct, unless they perceive that it is to their advantage to participate in a leniency programme. In this context, circumstantial evidence can be important. Almost every country making a written or oral contribution to the roundtable described at least one case in which circumstantial evidence was used to significant effect. At the same time, there are limits to the use of circumstantial evidence. Such evidence, especially economic evidence, can be ambiguous. It must be interpreted correctly by investigators, competition agencies and courts. Importantly, circumstantial evidence can be, and often is, used together with direct evidence.

2. *The better practice is to use circumstantial evidence holistically, giving its cumulative effect, rather than on an item-by-item basis.*

One delegate described the methodology for evaluating circumstantial evidence as like an impressionist painting, comprising many dots or brush strokes which together form an image. Another likened the process to a jigsaw puzzle. In this way, circumstantial evidence, which by definition does not describe the specific terms of an agreement, can be better understood. The materials submitted for the roundtable described a few cases in which courts declined to use this holistic approach, requiring instead that each item of evidence be linked directly to a specific agreement. The result was that the cases failed. Of course, given the ambiguous nature of some circumstantial evidence, the holistic approach can result in errors. Business

representatives urged that no case be based solely on circumstantial evidence, given the significant liability facing businesses that are found to have participated in a cartel. It did not appear that any other delegation embraced this position. On balance, the holistic approach is much preferable to a requirement that each item of circumstantial be linked directly to a specific agreement.

3. *Complicating the use of circumstantial evidence are provisions in national competition laws that variously define the nature of “agreements” that are subject to the law.*

The anti-cartel provisions of all competition laws apply to more than straightforward explicit agreements. Laws use such terms as “concerted practice”, “understanding” and “arrangement”. When evaluating an evidentiary record, the nature of the agreement to which it applies may not be fully clear. This issue arises in the context of “facilitating practices”. These are practices, such as information exchanges, which can facilitate an underlying cartel agreement. Evidence of them is circumstantial evidence of a cartel agreement, but it is probably not sufficient by itself to prove such an agreement. In some countries, courts have separately evaluated facilitating practices for their anticompetitive effect. In others, however, an underlying cartel agreement must be shown. In other respects, it seems that in most countries the evidentiary burden facing the law enforcement agency does not vary according to whether the conduct is considered to be an “agreement” or some other kind of concerted action described in the law.

4. *There are two general types of circumstantial evidence: communication evidence and economic evidence. Of the two, communication evidence is considered to be the more important.*

Communication evidence is evidence that cartel operators met or otherwise communicated, but does not describe the substance of their communications. It includes, for example, records of telephone conversations among suspected cartel participants, of their travel to a common destination and notes or records of meetings in which they participated. Communication evidence can be highly probative of an agreement. Almost all of the circumstantial cases described by delegations included communication evidence; in some the evidence was compelling.

5. *Economic evidence is almost always ambiguous. It could be consistent with either agreement or independent action. Therefore it requires careful analysis.*

Economic evidence can be categorised as either conduct or structural evidence. The former includes, most importantly, evidence of parallel conduct by suspected cartel members, *e.g.*, simultaneous and identical price increases or suspicious bidding patterns in public tenders. It can also include evidence of facilitating practices, though that conduct could also be

characterised as “quasi-communication evidence”. Structural economic evidence includes evidence of such factors as high market concentration and homogeneous products. Of these two types of economic evidence, conduct evidence is considered the more important. Economic evidence must be carefully evaluated. The evidence should be inconsistent with the hypothesis that the market participants are acting unilaterally in their self interest. Economics, including the use of game theory, can be instructive on how to make this judgment. It appears that in most countries, however, that kind of analysis is not yet employed. But further, economic evidence can play an important role in the initial stages of a cartel investigation. A proper analysis of it could provide a basis for deciding which of several possible cases are likely to be the most fruitful to pursue, with the hope and expectation that better evidence of agreement, both direct and circumstantial, will be discovered.

6. *National treatment of cartels, such as whether they are prosecuted as crimes or as administrative violations, can affect the burden of proof that applies to the cases, and hence the use of circumstantial evidence.*

In most countries, cartels (and other violations of the competition law) are prosecuted administratively. The principle administrative sanctions applied to this conduct are fines, usually only assessed against organisations but sometimes against natural persons, and remedial orders. In a minority of countries, but a growing one, cartels are prosecuted criminally. In most instances the burden of proof facing the competition agency is higher in a criminal case. The result is that it is usually more important that direct evidence of agreement be generated in these cases. The United States has long used the criminal process in the cartel cases prosecuted by the government, and virtually all of its cases are built on direct evidence. Still, circumstantial evidence is admissible, and useful, in that country and elsewhere.

7. *It can be difficult to convince courts to accept circumstantial evidence in cartel cases, especially where the potential liability for having violated the anti-cartel provisions of the competition law is high.*

A few jurisdictions in which there has been judicial review of decisions by competition agencies in cartel cases reported that courts sometimes view cases built on circumstantial evidence with scepticism. In this regard, as more cases are appealed to courts, the standards that they apply to circumstantial evidence are continuing to evolve. Hopefully, courts will come to see that circumstantial evidence subjected to sound economic analysis and viewed holistically can be highly probative.

8. *There are circumstances in countries that are relatively new to anti-cartel enforcement that could affect the extent to which they rely on circumstantial evidence in their cases.*

A country just beginning to enforce its competition law may face obstacles in obtaining direct evidence of a cartel agreement. It probably will not have in place an effective leniency programme, which is a primary source of direct evidence. There may be lacking in the country a strong competition culture, which could make it more difficult for the competition agency to generate co-operation with its anti-cartel programme. In short, the competition agency could have relatively greater difficulty in generating direct evidence in its cartel cases, which would imply that it will have to rely more heavily on circumstantial evidence. A few delegations confirmed that this is the situation in their countries. But there is a countervailing phenomenon: the relatively high incidence in these countries of “naïve cartels” – cartels in which their members do not attempt to conceal their activity, either because they are unaware that their conduct is unlawful or because they are not sufficiently sophisticated to do so. In the case of naïve cartels direct evidence is relatively plentiful, rendering circumstantial evidence less important. Another point was made by a few countries in which cartels were prosecuted as crimes initially under their new competition laws. It seemed that the higher burden of proof associated with criminal prosecution made the competition agency’s anti-cartel burden more difficult. The advice from these countries was to begin administratively, perhaps later moving to criminal prosecution. Finally, there was general agreement in the discussion that a strong competition culture is an essential component of a successful anti-cartel programme. Education and public persuasion are important means of developing such a culture, but an even better one is vigorous enforcement of the law. The competition agency should strive to generate good cartel cases in important sectors, supported by strong evidence and demonstrating the benefits to consumers of effective anti-cartel enforcement.

Prosecuting Cartels without Direct Evidence of Agreement

2. Background Note

Background Note

by

John Clark

Circumstantial evidence is of no less value than direct evidence for it is the general rule that the law makes no distinction between direct and circumstantial evidence but simply requires that before convicting a defendant the jury must be satisfied of the defendant's guilt beyond a reasonable doubt from all of the evidence in the case.

* * *

In order to prove the conspiracy, it is not necessary for the government to present proof of verbal or written agreements. Very often in cases like this, such evidence is not available. You may find that the required agreement or conspiracy existed from the course of dealing between or among the individuals through the words they exchanged or from their acts alone.

The above quotations, taken from the jury instructions in the recent successful criminal prosecution of the Chairman of the Sotheby's auction house,¹ illustrates that cartel conspirators can be prosecuted, even against the highest standards of proof, without direct evidence of the agreement or of their involvement in it. Indirect (circumstantial) evidence is used in most jurisdictions including those with the longest and most successful records of cartel prosecutions, where competition law enforcers now enjoy the virtuous circle of strong sanctions in past cases energising leniency programs, which generate direct evidence in new cases, and more strong sanctions.² Indirect evidence is particularly important for competition law enforcers in jurisdictions without such enforcement records, given that cartel conspiracies are cloaked in secrecy and direct evidence is not forthcoming.

The focus of this paper is on the use of indirect evidence in cartel investigations, typically triggered by an episode of suspicious parallel pricing or other behaviour that is not readily explained by usual market forces. When the competition agency suspects that the conduct is the result of an agreement but cannot discover direct evidence to prove the existence of an

agreement, what amount and quality of circumstantial evidence is sufficient for this purpose?

The key points for the reader to take from the paper are:

- The provisions of competition laws prohibiting anticompetitive agreements apply not only to explicit agreements but also to other types of joint arrangements, variously identified as “arrangements”, “combinations” or “concerted practices”. In all cases, however, liability for a competition law violation can be imposed only if it can be shown that the parties reached some “conscious commitment to a common scheme”.
- Cartels pose a special problem for enforcers because they operate in secret, and their members usually do not co-operate with investigations of their conduct. In experienced jurisdictions, competition authorities in most cases use direct evidence to prove an unlawful conspiracy. It can be difficult to obtain direct evidence of a cartel agreement, however. Enforcers may be faced with the task of proving the existence of a cartel agreement without the benefit of direct evidence.
- Circumstantial evidence can come in several forms, including evidence of communications between rivals and economic evidence. Economic evidence consists of firm conduct, market structure, and evidence of facilitating practices. All types of evidence can be useful in a case and they should be employed together.
- Economic theories of oligopoly provide several valuable insights for competition law enforcers: They show that acts consistent with unilateral incentives can lead to a different outcome than when firms act collectively, and that oligopoly does not inevitably lead to co-operation and collective action to increase prices. As a result, enforcers and decision makers should carefully examine whether firm conduct can be described as actions in unilateral self-interest absent an agreement to act jointly, or as actions in the collective interest of all competitors. Conduct consistent with unilateral self interest does not constitute good evidence in a circumstantial cartel case.
- Consistent with economic theory, a long line of case law has recognised that evidence of parallel conduct, such as simultaneous price increases by rivals, alone is not sufficient proof of a cartel agreement. There must be additional evidence, which tends to prove the existence of an unlawful agreement as required under the applicable standards of proof. Courts sometimes refer to this additional evidence as “plus factors”.
- An important type of plus factor is evidence showing that there were communications among the suspected cartel operators in the course of which they could have reached agreement. Economic evidence is another important class of circumstantial evidence. It includes evidence both of

conduct by market participants suggesting that they are acting jointly and of market structure that lends itself to collusive activity. One method of analysing economic conduct evidence is to consider whether the conduct would have been in the self interest of the actors if they had not been acting jointly.

- Circumstantial evidence should be considered in a holistic fashion. The decision maker should assess the cumulative effect of all evidence, rather than require that each item unequivocally support the hypothesis of agreement.
- Countries differ in the way that they develop evidence in cartel cases. Several factors contribute to these differences, including whether cartels are prosecuted administratively, civilly or criminally; and whether a country has been prosecuting cartels for a long time or has begun an anti-cartel programme only recently. There is a trend in OECD countries toward building cases based on direct evidence. But countries continue to bring cases employing mostly circumstantial evidence where it is appropriate.
- It is likely that countries just beginning an anti-cartel programme will have some difficulty generating direct evidence, and hence will have to rely more on circumstantial evidence in early cases. While these cases can be difficult, it is important that the new agency establish credibility for its competition law and for its anti-cartel effort.

1. Cartel agreements

All competition laws prohibit, among other things, anticompetitive conduct by two or more parties acting jointly. Competition laws are written broadly to apply to all forms of agreements, formal and informal, explicit and implicit. Thus, for example, the United States' Sherman act applies to any "contract, combination ... or conspiracy";³ Article 81(1) of the EC Treaty applies to "agreements between undertakings, decisions by associations of undertakings, and concerted practices", Mexico's competition law applies to "contracts, agreements, arrangements, or combinations";⁴ Chinese Taipei's competition law applies to "concerted actions", which is defined as including any "contract, agreement or any other form of mutual understanding";⁵ and Tanzania's law applies to "any agreement, arrangement or understanding between two or more persons, whether or not it is: a) formal or in writing; or b) intended to be enforceable by legal proceedings".⁶

As the broad statutory language suggests, unlawful agreements among competitors can take many forms. The most common in the business context is the explicit agreement, in which the parties communicate directly, either orally or in writing, specifying the relevant terms and conditions of their enterprise. But agreements do not have to be formal. They can be reached

through informal means of communication, including conversations at an association meeting; public statements by senior officers; price announcements or advertisements; or communications through customers. One US court famously noted: “A knowing wink can mean more than words.”⁷

It is important, however, that in all cases competition laws will impose liability for entering into an unlawful agreement only if firms have consciously acted together, whether through formal or informal means of communication. To prove a competition law violation, it must be shown that there has been a “meeting of the minds” toward a common goal or result, or, in other words, some “conscious commitment to a common scheme”.⁸ Conversely, liability cannot be found where firms communicated purely in the form of market place action, or where firms communicated, but did not develop some “conscious commitment to a common scheme”.⁹

Proving the existence of a cartel agreement, whether formal or informal, poses special problems for the competition law enforcer. Cartels are usually formed and conducted in secret; their participants understand that their conduct is unlawful, and that their customers would object to the conduct if they knew about it, and so they take pains to conceal it. If an investigation into their conduct is undertaken, the participants usually do not co-operate with it, except through a leniency programme. Obtaining *direct evidence* of a cartel agreement – evidence that identifies a meeting or communication between the subjects and describes the substance of their agreement – requires special investigative tools and techniques, which the authority may lack.¹⁰ Thus, the competition law enforcer may be faced with the task of proving the existence of a cartel agreement without the benefit of direct evidence. The following section discusses which types of evidence a competition enforcer might be able to use to prove the existence of a cartel, focusing on various types of indirect evidence.

2. Available evidence for proving a cartel agreement

2.1. Categories of evidence

Evidence used to prove a cartel agreement can be classified into two types: direct and circumstantial. Circumstantial evidence, in turn, consists of “communication” evidence and economic evidence, which include firm conduct, market structure, and evidence of facilitating practices.

Common types of *direct evidence* include:

- A document or documents (including e-mail messages) essentially embodying the agreement, or parts of it, and identifying the parties to it.
- Oral or written statements by co-operative cartel participants describing the operation of the cartel and their participation in it.

There are different types of *circumstantial* evidence. One is evidence that cartel operators met or otherwise communicated, but does not describe the substance of their communications. It might be called “communication” evidence for purposes of this discussion. It includes:

- records of telephone conversations between competitors (but not their substance), or of travel to a common destination or of participation in a meeting, for example during a trade conference;
- other evidence that the parties communicated about the subject – e.g., minutes or notes of a meeting showing that prices, demand or capacity utilisation were discussed; internal documents evidencing knowledge or understanding of a competitor’s pricing strategy, such as an awareness of a future price increase by a rival.

A broader category of circumstantial evidence is often called “*economic*” evidence. Economic evidence identifies primarily firm conduct that suggests that an agreement was reached, but also conduct of the industry as a whole, elements of market structure which suggest that secret price fixing was feasible, and certain practices that can be used to sustain a cartel agreement.

Conduct evidence is the single most important type of economic evidence. As noted earlier, observation of certain, suspicious conduct frequently triggers an investigation of a possible cartel. And as the section in this paper on economics highlights,¹¹ careful analysis of the conduct of parties is important to identify behaviour that can be characterised as contrary to the parties’ unilateral self-interest and which therefore supports the inference of an agreement. Conduct evidence includes, first and foremost:

- parallel pricing – changes in prices by rivals that are identical, or nearly so, and simultaneous, or nearly so. It includes other forms of parallel conduct, such as capacity reductions, adoption of standardised terms of sale, and suspicious bidding patterns, e.g., a predictable rotation of winning bidders.

Industry performance could also be described as conduct evidence. It includes:

- abnormally high profits;
- stable market shares;¹²
- a history of competition law violations.

Evidence related to *market structure* can be used primarily to make the finding of a cartel agreement more plausible, even though market structure factors do not prove the existence of such an agreement. Relevant economic evidence relating to market structure includes:

- high concentration;
- low concentration on the opposite side of the market;

- high barriers to entry;
- high degree of vertical integration;
- standardised or homogeneous product.

The evidentiary value of structural evidence can be limited, however. There can be highly concentrated industries selling homogeneous products in which all parties compete. Conversely, the absence of such evidence cannot be used to show that a cartel did not exist. Cartels are known to have existed in industries with numerous competitors and differentiated products.¹³

A specific kind of economic conduct evidence is “*facilitating practices*” – practices that can make it easier for competitors to reach or sustain an agreement. It is important to note that conduct described as facilitating practices is not necessarily unlawful.¹⁴ But where a competition authority has found other circumstantial evidence pointing to the existence of a cartel agreement, the existence of facilitating practices can be an important complement. They can explain what kind of arrangements the parties set up to facilitate the formation of a cartel agreement, monitoring, detection of defection, and/or punishment, thus supporting the “collusion story” put together by the competition law enforcer. Facilitating practices include:

- information exchanges;¹⁵
- price signalling;¹⁶
- freight equalisation;¹⁷
- price protection and most favoured nation policies;¹⁸ and
- unnecessarily restrictive product standards.¹⁹

2.2. A brief example

Consider the following brief description of a recent Italian cartel case. It illustrates nicely how a competition authority can combine a range of different types of evidence into a persuasive story of collusion.

2.2.1. Italy – Baby milk²⁰

In October, 2005 the Italian Competition Authority announced that it had fined seven sellers of baby milk, comprising three legal entities, a total of €9 743 000 for engaging in a cartel in violation of Article 81 of the EC Treaty. The Italian Government had noted during the period 2000-2004 that these firms had engaged in parallel pricing of their products, and that their prices in Italy were significantly higher – between 150% and 300% – than prices in other European countries. The Authority developed evidence of contacts between the firms, both direct and indirect, that supported a finding of concerted action. Direct contacts included participation in special meetings at the headquarters of the manufacturers’ Association, following a request by the

Health Minister to reduce prices. The evidence showed that there was open discussion among the manufacturers regarding their response to the Minister's request, and that they agreed not to reduce prices by more than 10%.

Indirect contacts occurred as the respondents established recommended resale prices for pharmacies, which were the principal retail outlet for their product. Special characteristics of the market made it possible for sellers to compute their rivals' wholesale prices by reference to their recommended resale prices.

The Authority noted that since it began its case in 2004, prices of baby milk had declined by 25% and there had been other procompetitive developments in the market, including more advertising and consumer information, the introduction of new products and a greater presence of the respondents' products in supermarket chains.

Here is a list of the types of evidence apparently uncovered by the authority:

- direct evidence: the producers apparently agreed on a maximum price reduction;
- communication evidence: the producers had met at the trade association and discussed prices, although with the exception of the maximum price reduction there was no direct evidence that they had reached an agreement;
- conduct evidence: parallel pricing; steep price reductions and increased competition following the investigations which suggested that earlier high prices were not the result of competitive behaviour;
- conduct of the entire industry: across the board, the prices were significantly higher than in other European countries;
- market structure evidence: this was a highly concentrated industry with only three independent suppliers, and they sold a relatively homogenous product; and
- facilitating practices: recommended resale prices for pharmacies with significant price transparency, sales occurred predominantly through pharmacies which eliminated outlets such as grocery stores that likely would have used discount prices.

2.2.2. Some general comments about evidence

There are a few general points to be made about these categories of evidence. First, there is not necessarily a bright line between direct and circumstantial evidence, especially when considering various forms of communication evidence. Second, all types of evidence – direct and circumstantial – are helpful to the competition law enforcer. They can be, and often are, used together. And third, quality matters. Direct evidence in the

form of testimony from a single, unconvincing witness is less credible than strong and cumulative circumstantial evidence.

There is a broad range of conduct and other factors that enforcers and courts have considered relevant in circumstantial cases against cartels. Decisions have typically identified how much evidence is the critical mass of evidence for a successful case.²¹ This makes the task of the competition enforcer more difficult and outcomes of cases less predictable, but appears to be the inevitable result of the fact specific nature of each case. However, a closer analysis of cases and economic theory suggest that two types of circumstantial evidence are most important, including whether the parties communicated or at least had the opportunity to communicate and an analysis of whether firm conduct was in the firm's best unilateral self interest, absent an agreement to act collectively.²²

Circumstantial evidence typically is ambiguous; often it is subject to more than one interpretation. For example, certain parallel conduct may also be consistent with independent action; a meeting of parties and communications during the meeting may have had benign purposes. The principal task of the competition law enforcer when it has only circumstantial evidence is to carefully examine whether the conduct under investigation is simply the result of independent action by market participants, each acting according to its own judgment as to its best interests. When it has come to the conclusion that this was not the case, it must convince the decision maker that the evidence proves the existence of an unlawful agreement under the relevant evidentiary standards. Economics has an important role in informing the decision maker as to how to make that judgment.

3. Economic reasoning can help identify probative indirect evidence

Using economic evidence to indirectly prove the existence of a cartel agreement raises a fundamental problem: how to distinguish conduct which is likely due to an unlawful agreement from conduct which arises “innocently” as the product of independent decision-making in a concentrated industry. To make that distinction, some background in economics is necessary. This section briefly describes how economic theory may help to better understand the behaviour of firms that seem to be operating as if they had formed a cartel. The section first explains economic theories that can be used to describe firm behaviour. It then discusses how these theories can help to identify “good” economic evidence that tends to support the finding of an unlawful agreement. Last, it provides some suggestions for the use of economic evidence in cartel cases based on circumstantial evidence.

Generally speaking, one can distinguish three broad categories of economic models that describe firm behaviour. First, firms can independently pursue their “unilateral non-cooperative best response” given what rivals are doing. In these types of models the market equilibrium is determined when each firm pursues its best response given their [its?] rivals’ best response. This type of equilibrium – best responses to best responses – is typically called a Nash equilibrium. Two elementary models that use this concept to determine the market equilibrium price and output were outlined long ago.²³ Indeed, much like these very old models, modern economics makes extensive use of the Nash equilibrium concept to model firm behaviour in many different types of markets.²⁴

A second class of “models” argues that firms may at times recognise that mutual accommodation is in their best interests. Theories of this type indicate that certain actions by a firm are only profitable given an accommodating response by their rivals. And, when there is accommodation, firms’ actions become “coordinated” in the sense that neither could have achieved that result without the help of the other.²⁵ Importantly, it should be understood that in models which feature accommodation, firms do not reach an explicit (unlawful) agreement through communication with each other, but rather come to understand what was in their mutual best interests through market place interactions.²⁶

A third class of firm behaviour involves cartels. Here the key feature is that firms explicitly reach an agreement through direct communication with one another. The key difference between cartel behaviour and accommodation is that firms directly communicate with each other as they might in the proverbial smoke filled room or as in the US FCC spectrum auction case where firms communicated with each other through the prices they submitted.²⁷

Notably, in cartel cases that primarily rely on circumstantial evidence there is no “silver bullet” showing that the parties reached an agreement. Thus, the authority must build a case that attempts to separate accommodating and unilateral behaviour from behaviour tending to show that rivals reached an explicit agreement. The key question is what types of circumstantial evidence tend to push aside the idea of legitimate competition and support the finding of an explicit agreement among competitors

In order to identify economic evidence that is of high quality and hence useful at discriminating among competing theories, the competition authority should have a good sense of the appropriate model that best describes the unilateral incentives of a firm to compete in the market that is being investigated. First, the authority must identify the set of actions that can be characterised as unilateral, non-cooperative best response behaviours in a

given case. Then, and only then, can it identify actions that are inconsistent with that behaviour and thus support the hypothesis that an illegal cartel was formed. In other words, actions compatible with unilateral, non-cooperative best response behaviour serve as a benchmark to which a firm's behaviour can be compared during the period of suspicious activity.

The following two examples of dominant-firm price leadership and Cournot oligopoly illustrate this point. A model of dominant-firm price leadership indicates that when the dominant firm's marginal cost goes up, the optimal price charged by it and all of the firms in the market also goes up. Indeed, the price of all firms in the market changes simultaneously. In this model, there is no accommodation, let alone an explicit cartel. Instead, each firm is pursuing its unilateral, non-cooperative best response. This very elementary model, at the very least, serves as a warning that simultaneous or near simultaneous price movements can be consistent with alternative theories of behaviour and not just cartel conduct – let alone identifying the dominate firm as the cartel ringmaster. As mentioned earlier, the competition authority must check whether that model best describes the unilateral incentives of a firm to compete in the market that is being investigated. In the example discussed here, when parties submit that a dominant-firm price leadership model can explain firm behaviour under investigation as legitimate, unilateral conduct, a competition authority must examine whether the assumptions of that model appropriately describe the industry in question. The relevant questions could include, for example, whether in light of industry structure, price setting and other market conduct in the past (during non-collusive periods), the price leadership model is a good explanation for how prices are formed.

Similarly, the Cournot model highlights that evidence showing that prices are higher in markets where there are fewer players than in markets where there are many can be consistent with the independent, unilateral behaviour of a firm, and not only with the actions of a cartel. In fact, higher prices with fewer firms in a market is consistent with unilateral theories, accommodating behaviour and cartel actions. This type of economic evidence would not support the finding of an agreement, and therefore by itself would be of little value in a circumstantial evidence case.

Because it is necessary in each case to carefully identify which actions are in a firm's unilateral self-interest, the broad notion that “interdependent pricing may often produce economic consequences that are comparable to those of classic cartels” is not helpful in analysing circumstantial evidence cases. This point is explained below.

The prisoner's dilemma provides a good example of how unilateral incentives lead to a different outcome than when firms act collectively.²⁸ For

purposes of this paper, the fundamental point of the prisoner's dilemma is that unilateral incentives may lead each firm away from pricing high and earning high profits and towards lowering prices, even though each firm anticipates that the rival will cut prices as well. Conversely, matching the high price of a competitor may be in the collective interest of all competitors, but is not necessarily consistent with unilateral self interest. Thus, when analysing circumstantial evidence, care must be taken not to conflate the two separate concepts of unilateral self-interest and collective interest of all competitors.

Using the insight of game theory that co-operation cannot be expected to happen spontaneously, Stigler's work on oligopoly emphasised the incentives of cartel members to defect if they believe that they can gain larger profits by cheating than by conforming to the cartel agreement.²⁹ Stigler identified three "problems" that cartels need to be overcome. First, they need to reach a consensus on the terms of their agreement. This task may be extremely difficult to accomplish without communication – as game theory puts it, there is an abundance of riches, too many possible decisions of market players. Second, cartels need a detection mechanism to ensure that every member follows the cartel rules. Third, a mechanism is needed to punish those who cheat, in order to deter members from defection.³⁰ Like the prisoner's dilemma, Stigler's model of oligopoly highlights that oligopoly does not inevitably lead to co-operation and collective action to increase prices.³¹

Courts have not always been careful to distinguish between actions in unilateral self-interest and those in the collective interest of all competitors and to realise that increased prices are not a necessary result of oligopoly absent collusion. A good example where a court seems to have made an error in this regard occurred in *Reserve Supply*.³² In that case, a private action, the plaintiffs cited a series of parallel price increases during a period when demand was low. The defendant countered that it would have been "irrational to attempt to increase sales by maintaining lower prices, because lower prices would be met by their competitors, leaving no increase in market share and reduced profit levels." Finding that demand was inelastic, the court reasoned that by maintaining lower prices the defendant could have attracted only customers of the defendant's competitors. The court concluded that failing to keep prices low "does not suggest that [the defendants] 'acted in a way, that but for the hypothesis of joint action, would not have been in their interest'". Significantly, this statement is exactly the wrong reasoning. In essence the court failed to appreciate that, depending on the circumstances, firms in the pursuit of their own interests may compete prices down from high levels in ways similar to that described by the prisoner's dilemma game.³³

A classic example of an agency putting together circumstantial evidence showing that firms did not behave in accordance with their unilateral, non cooperative interest comes is *American Tobacco*.³⁴ In that case the court found a

“record of price changes” was “circumstantial evidence of the existence of a conspiracy”. On June 23, 1931 the big 3 tobacco firms in the United States all announced simultaneous price changes and no “economic justification for this raise was demonstrated”. Other simultaneous price changes followed over the next several years. Precisely because of the simultaneity and because no economic justification (like higher costs) was demonstrated, the court found that this circumstantial evidence was enough to convict the defendants all on criminal charges. In contrast, if costs had increased around the times of the price increases then it would not be clear at all whether there was a conspiracy or not.

To summarise the discussion in this section, below are four points Werden has identified that focus attention on key issues regarding the use of economic evidence:³⁵

- First, “something more than interdependence must be shown before agreement can be inferred”. For example, when a competitor raises price in response to a rival raising price such activity may be fully consistent with the each firm’s unilateral non cooperative best response given its rivals’ responses. If we cannot condemn a firm for lowering its price in response to rivals’ lowering their prices then we also cannot do so for price increases. Something more needs to be shown. (This “extra” is further elaborated in the following text.)
- Second, “the existence of an agreement cannot be inferred from actions consistent with Nash, non-cooperative equilibrium in a one shot game”. Such behaviour, in fact, is fully consistent with vigorous competition and provides a useful benchmark against which suspicious activity can be gauged.
- Third, actions that are inconsistent with the one-shot Nash non-cooperative equilibrium can be used to infer the existence of an agreement, even if they may be consistent with actions taken in an infinitely repeated game model. Infinitely repeated game models do not provide a useful benchmark to identify action contrary to self interest.
- Fourth, for practical and policy considerations, the “existence of an agreement should not be inferred absent of evidence of communications of some kind among the defendants through which an agreement could have been negotiated”. This kind of evidence is a useful indication that the conduct observed in the market place was the result of an unlawful agreement and thus can be an important factor to avoid enforcement action in cases of unilateral or accommodating behaviour.

4. Cases inferring an agreement from circumstantial evidence

Cartel cases in which there is no direct evidence of agreement often begin in a familiar way: there is an episode of suspicious parallel pricing or other behaviour that is not readily explained by usual market forces. By definition the competition agency cannot directly prove that the conduct is the result of an agreement. The question presented is, what amount and quality of circumstantial evidence is sufficient for this purpose?

Over the years, courts, competition authorities and competition experts have come to accept that “conscious parallelism”, which involves nothing more than identical pricing or other parallel behaviour deriving from independent observation and reaction by rivals in the marketplace, is not unlawful.³⁶ As explained above, this view is well grounded in economic theory. Economic theory and case law have made it clear that something more than conscious parallelism is required. Defining that “something more” has proved difficult; courts in a few jurisdictions have wrestled with the problem for decades. One formulation, developed in the United States in civil cases (criminal cases are discussed below), requires that there exist certain “plus factors”, which prove that agreement is more likely the cause of the parallel conduct than independent action. One US court described the standard in a recent decision as follows:

... [W]e have required that plaintiffs basing a claim of collusion on inferences from consciously parallel behaviour show that certain “plus factors” also exist. Existence of these plus factors tends to ensure that courts punish “concerted action” – an actual agreement – instead of the “unilateral, independent conduct of competitors”. In other words, the factors serve as proxies for direct evidence of an agreement.³⁷

Other jurisdictions do not use the same terminology as US courts, but it seems that the analysis that they apply is similar.³⁸ This section will first more closely look at how decision makers have used the two factors commonly seen as the most important types of circumstantial evidence: communication or opportunity to communicate; and action against self-interest.

4.1. Communications

One important type of plus factor is that which indicates that the parties communicated about prices in a manner that permitted them to reach an agreement, or at least had the opportunity to communicate. The evidence falls short, however, of proving an explicit agreement. The following civil case from the United States highlights the importance of communication evidence.

4.1.1. Flat glass³⁹

This case, decided in 2004, is useful because the court considered allegations of price fixing in two separate markets, one for flat glass and one for automotive replacement glass. It concluded that in the former there was sufficient circumstantial evidence of price fixing to support a finding of unlawful agreement, while in the latter the evidence was insufficient.⁴⁰ In the flat glass market there had been significant episodes of parallel pricing by the defendants. Several times in the relevant period they raised their list prices by identical amounts and within close time frames. The market structure was consistent with possible collusion. There was high concentration, featuring just a few sellers. The product was relatively homogeneous, where price was the most important distinguishing feature. There were high fixed costs; there was a substantial amount of excess capacity in the industry; and demand was static. The industry was, in the words of the court, “a text book example of an industry susceptible to efforts to maintain *supra* competitive prices”.⁴¹

There was also evidence that the price increases implemented by the defendants were not consistent with actions which would occur in a competitive market. The increases were not prompted by any change in costs or demand, and their result was to attract a new entrant. They were, concluded the court, actions “contrary to the self interest” of the defendants unless there existed a collusive agreement (that concept is discussed further below). But the court said that while this evidence was important, it was not sufficient in this case: “The most important evidence will generally be non-economic evidence ‘that there was an actual, manifest agreement not to compete.’”⁴² There was also ample evidence of this kind. There had been a series of meetings and communications in which prices were discussed. Internal records of the participants indicated that they typically had knowledge of one another’s pricing policies that they could not have acquired by public means. The court held that in its totality the circumstantial evidence was sufficient to support the finding of an unlawful agreement.

In contrast, in the automotive replacement glass market the circumstantial evidence relating to communications between the defendants was much more sparse. The conduct that formed the principle basis for the allegation of price fixing was a practice by which the industry members provided certain pricing information to a third party trade association, which then published it in a form that permitted the participants to calculate one another’s prices. The court found this evidence, standing alone, to be insufficient. Publication of pricing information, it noted “can have a procompetitive effect”. It declined to “rest on [an] inference of collusion from this ambiguous, or even procompetitive, fact”.

4.2. Economic evidence

Communication evidence is undeniably important – many would say critical in a circumstantial case. Certain economic evidence, however, also can play an important role in these cases. The following decision, written by the influential American jurist and scholar, Richard A. Posner, is a good example of how to analyse circumstantial economic evidence.

4.2.1. *High-fructose corn syrup*⁴³

The four principal manufacturers of high fructose corn syrup (HFCS), a sweetener made from corn, were alleged in a private civil damages case to have conspired to fix the price of their product during the period 1988-95. The trial court dismissed the case, but the appeals court reversed, sending the case back for trial.

Judge Posner succinctly classified the types of evidence relevant to proof of agreement under the Sherman Act:

The evidence upon which a plaintiff will rely will usually be and in this case is of two types – economic evidence suggesting that the defendants were not in fact competing, and non economic evidence suggesting that they were not competing because they had agreed not to compete. The economic evidence will in turn generally be of two types, and is in this case: evidence that the structure of the market was such as to make secret price fixing feasible (almost any market can be cartelised if the law permits sellers to establish formal, overt mechanisms for colluding, such as exclusive sales agencies); and evidence that the market behaved in a non competitive manner.⁴⁴

The court noted various elements of economic evidence in the case that were consistent with an agreement: high concentration on the selling side, a “highly standardised” product; a lack of close substitutes for HFCS, a significant amount of excess capacity maintained by the defendants, market-wide price discrimination.⁴⁵ The court then turned to (economic) conduct evidence that suggested an agreement. It described a change to a pricing formula that was not based on cost. It also pointed to a change in the length of contracts imposed by the defendants and to a suspicious pattern among defendants of buying and selling from one another. It also noted an unusual stability of market shares in the industry, under circumstances in which one would expect more volatility. And the court gave some credibility to expert testimony showing that the prices for HFCS were higher during the period of the alleged conspiracy than they were before or after.

The court also found that there was communication evidence in the record that supported such a conclusion. It consisted of documents and other statements by officers of the defendants that referred obliquely to agreements

and understandings, and gave indications that they had non-public information about their rivals' pricing decisions. The court held that the evidence in its entirety was sufficient for a trier of fact to conclude that there had been agreement.

4.2.2. "Action against self-interest"

This is a concept employed in US courts in recent years. As explained in greater detail in the economics section, it is a critical step in the evaluation of economic evidence.⁴⁶

An action against self interest is one that would be against the self interest of the actor in the absence of agreement. The firm would not have acted as it did if it had been acting unilaterally. An action against self interest might take the form of a refusal to deal with a customer or supplier, when there appear to be no economic reasons why the party would refuse such a business opportunity.⁴⁷ It could involve a pattern of information exchanges – cost information, for example, or information about transaction prices – that businesses normally consider to be confidential, and which rivals in a competitive market could use to their advantage. It could involve a pricing structure that bears no relation to cost, or that otherwise seems to have no market-based justification.

A case in which this concept was important was *Blomkest Fertiliser*.⁴⁸ It involved allegations by fertiliser manufacturers that eight potash producers, six of them Canadian, had conspired to fix the price of potash between 1987 and 1994 (potash is an important input into fertiliser). The plaintiffs' case consisted mostly of economic evidence, which included evidence of a pattern of price verifications by the defendants, a form of economic "conduct" evidence described above in Part II.

The case was heard by all of the eleven judges on the appeals court, a rarity in US practice.⁴⁹ The eleven judges split six to five in favour of the defendants, affirming the decision of the trial court to dismiss the case. The majority found the price verification evidence unpersuasive, first because it occurred only as to *past* transactions, and as such would have minimal implications for future pricing, and second, because in the court's words:

The price verifications relied upon were sporadic and testimony suggests that price verifications were not always given. The fact that there were several dozen communications is not so significant considering the communications occurred over at least a seven-year period in which there would have been tens of thousands of transactions. Furthermore, one would expect companies to verify prices considering that this is an oligopolistic industry and accounts are often very large. We find the

evidence falls far short of excluding the possibility of independent action.⁵⁰

The minority argued persuasively that such conduct would not have been in the defendants' interest if they had not been participating in a cartel:

... if there were no reciprocal agreement to share prices (and the producers certainly do not argue that there was), an individual seller who revealed to his competitors the amount of his privately negotiated discounts would have been shooting himself in the foot. On the other hand, if there were a cartel, it would be crucial for the cartel members to cooperate in telling each other about actual prices charged in order to prevent the sort of widespread discounting that would eventually sink the cartel.⁵¹

As noted above, however, this view did not prevail in the case.

A good illustration of use of the "action against self interest" concept to determine whether parallel conduct should be regarded as indirect evidence of an agreement is the appeals court opinion in *Brand Name Prescription Drugs*.⁵² There, a class of customers brought a case against drug manufacturers alleging that their uniform practice of price-discriminating among groups of customers, as a result of which the plaintiffs were forced to pay higher prices, should be viewed as (indirect) evidence that the defendants had entered into a cartel agreement. The court rejected the plaintiffs' argument, however. It reasoned that as each defendant drug manufacturer had market power as a result of the patent protection of its drugs, it was consistent with each manufacturer's self interest to exercise that market power and price discriminate among groups of customers, depending on their willingness to pay. The fact that all defendants had adopted similar price discrimination strategies therefore was consistent with action in each defendant's self interest and could not be viewed as evidence of an agreement among them.

4.3. Holistic v. item-by-item approaches to circumstantial evidence

One important issue that affects how courts evaluate circumstantial evidence is whether the court is willing to consider all evidence that is proffered as a whole, giving it cumulative effect, or whether it requires that each item unequivocally support the hypothesis of agreement. In *High Fructose Corn Syrup* Judge Posner strongly adopted the holistic approach. The trial judge in the case had refused to consider the communication evidence that was offered

... because he thought its character was such as to "require that a substantial inference be drawn in order to have evidentiary significance." This is correct in the sense that no single piece of the [communication]

evidence ... is sufficient in itself to prove a price-fixing conspiracy. But that is not the question. The question is simply whether this evidence, considered as a whole and in combination with the economic evidence, is sufficient to defeat summary judgment.⁵³

Judge Posner noted that a “trap” that confronts the court in these cases is to suppose that if no single item of evidence presented by the plaintiff points unequivocally to conspiracy, the evidence as a whole cannot defeat summary judgment.

It is true that zero plus zero equals zero. But evidence can be susceptible of different interpretations, only one of which supports the party sponsoring it, without being wholly devoid of probative value for that party. Otherwise what need would there ever be for a trial? The question for the jury in a case such as this would simply be whether, when the evidence was considered as a whole, it was more likely that the defendants had conspired to fix prices than that they had not conspired to fix prices.⁵⁴

It should be noted, however, that there are different views even within the United States. Other federal appeals courts have examined each item of circumstantial evidence independently as to whether it tended to exclude independent, unilateral action of competitors.⁵⁵

It appears that in *Wood Pulp*, an important European Union case dealing with circumstantial evidence in a price fixing case, the European Court of Justice court took a similarly strict approach on this issue of evaluating individual items of evidence.

4.3.1. *Wood pulp*⁵⁶

The European Commission had declared that more than 40 producers of wood pulp and three associations of producers had engaged in concertation during two periods between 1975 and 1981, in which their announced prices were nearly identical. It was the practice in the industry for buyers and sellers to enter into long term contracts, which gave buyers the right to purchase a minimum quantity of wood pulp at prices no higher than announced prices. The producers announced their prices each quarter, at virtually the same time. The Commission produced a substantial quantity of economic evidence, in addition to the parallel pricing conduct, in support of its decision: a large number of sellers, who differed significantly from one another in terms of national origin (they were from Finland, Sweden, Spain, Portugal, the US and Canada); varying cost structures; differing freight costs; variation in national markets across the Community; announced prices significantly above spot market prices; apparent breakdowns in price discipline twice during the

period; prices published in the trade press; prices announced in advance of their application; all prices quoted in US dollars.

The Commission also adduced communication evidence supporting concertation, consisting of documents and telexes from the files of the parties showing that they had attended meetings at which prices were discussed. However, the ECJ required the Commission to link each document to concertation between specific producers and for specific periods. The Commission took the position that it need not do so, that the evidence was relevant generally to the alleged concertation. The ECJ did not accept the Commission's view, however, and excluded the documents from consideration.

The court then turned to whether the economic evidence alone was sufficient to establish concertation. The standard that it applied to this inquiry was whether "concertation constitutes the only plausible explanation for such conduct". It concluded that there were valid business reasons for the long term relationships and the pricing practices that had evolved in the industry. The court had employed two experts, who did not rule out concertation but who also found legitimate reasons for the conduct under consideration. The simultaneity and parallelism of announced prices could be explained by the "very high degree of transparency that existed in the market".⁵⁷

The strict standard adopted by the court for evaluating the economic evidence in the case – that concertation constitutes the only plausible explanation for such conduct – may have been the principal reason for reversing the Commission decision, but it is likely that the ECJ's unwillingness to consider in a holistic fashion the communication evidence that was proffered also contributed substantially to the result. In subsequent cases decided by the Commission and EU courts, however, it does not appear that the authorities have adopted such a strict approach.⁵⁸

It is inevitable under such an "itemised" approach that each item of circumstantial evidence will almost always be ambiguous if analysed in isolation. If the evidence is cumulative, on the other hand, the overall ambiguity may be ameliorated. It would seem that the better approach, as articulated by the court in *High Fructose Corn Syrup*, would be to consider the available evidence as a whole and evaluate whether all evidence in its entirety can be sufficient under the applicable standards of proof.

5. Cartels and circumstantial evidence – the national experience

Circumstantial evidence is treated differently in different countries.⁵⁹ The law regarding the use of circumstantial evidence in cartel cases will undoubtedly develop according to these national norms. Other factors will also dictate how these cases evolve across countries, notably whether cartels

are administrative or civil violations, or whether they are prosecuted as crimes. Further, countries are at different places in the development of their anti-cartel programmes. Some countries have been prosecuting cartels for decades, others for only a short time. Some have highly effective leniency programs; others have only recently introduced one. The impact of these factors on prosecuting cartels with circumstantial evidence is explored further below.

5.1. Prosecuting cartels as administrative or civil violations

In the majority of countries cartels are prosecuted administratively or civilly (in most of these the process is administrative; that term will be employed exclusively from here on out in this section). The trend in OECD countries that treat cartels as administrative violations is toward developing direct evidence. Thus, virtually all cartel cases prosecuted by the European Commission since 2001 or so have generated direct evidence.⁶⁰ Further, the Third Report by the OECD Competition Committee on hard core cartels⁶¹ describes several recent cartel cases originating in OECD countries and a few non-Member observer countries. Almost all of these, it seems, employed direct evidence.⁶² There may be at least two reasons for this trend, and they are related: Leniency programmes, which bring a greater number of cartels to the authorities' attention and generate at least some direct evidence, are becoming ever more effective. And countries are increasingly imposing very large fines for cartel conduct. Severe sanctions make leniency programmes more effective. Independently, it is easier to justify the imposition of large fines if one has direct evidence of the violation, including, if possible, evidence of knowing, intentional wrongdoing.⁶³ Finally, countries have strengthened their investigatory techniques, including dawn raids.

There is another, important benefit from cases built on strong direct evidence: they can lead to more plea bargains and fewer appeals. In some jurisdictions, the parties in these cases usually consent to a finding of a violation and to the imposition of strong sanctions. This has significant resource implications; litigation can take a great deal of time and consume enforcement resources that could otherwise be employed in generating more cases.

Still, when only circumstantial evidence is available and it is strong, countries with a longer enforcement record continue to be willing to bring cases based on it. One example is the Italian *Baby Milk* case, discussed earlier. Another recent case is the French decision concerning a mobile phone operators cartel.

5.1.1. France – Mobile telephones⁶⁴

On 1 December 2005 the Conseil de la concurrence announced that it had fined three mobile telephone providers a total of €534 million for collusive activity. There are two parts to the case. The first is a course of dealing between 1997 and 2003 by which the respondents exchanged detailed and confidential information on the numbers of new customers signed up the previous month, and the numbers of people who opted to cancel their subscriptions. This conduct was deemed to have anticompetitive effects apart from any direct effect on prices.

More relevant to this discussion, the Conseil also found that between 2000 and 2002 the three operators had entered into a market sharing agreement centred on stabilising their market shares. The Conseil stated that it had

... uncovered a number of pieces of serious, specific and corroborating evidence pointing to the existence of such an agreement. These included handwritten documents with explicit references to an “*agreement*” between the three operators, the “*pacification of the market*” and the “*Yalta of market share*”.

The Conseil pointed to certain market practices that the respondents had simultaneously adopted in 2000, including “a hike in prices and the adoption of measures such as giving priority to contracts with commitments over pay-as-you-go cards, or the introduction of billing per 30-second increments after a minimum first minute”. The Conseil appeared to evaluate these actions in the context of the “against self interest” standard discussed above:

These measures ... could clearly have led to a drop in sales (and therefore market share) for any operator who took the step of introducing them unilaterally. The collusion was therefore intended to make it easier for the operators to introduce this strategy, by enabling them to ensure that they all adopted the same policy simultaneously, and that their market shares would consequently remain stable.

5.1.2. Brazil – Steel

In 1999, CADE, the Brazilian competition tribunal, concluded what many considered to be the first cartel case under its current competition law, which was enacted in 1988. The case involved an alleged agreement in 1996 to increase the prices of certain flat rolled steel products. There were only three domestic producers of those products, two of which were linked by a 50% cross-ownership. In July of 1996 representatives of the Brazilian Steel Institute met with officials of Brazil’s Secretariat for Economic Monitoring (SEAE) and informed them that its members intended to increase their prices on these products by certain specified amounts on a specific day. The background to

this meeting is that until 1992 these products were subject to price controls, which were administered in part by SEAE. Producers were required to submit proposed price increases to SEAE. There were no such controls in 1996, however.

On the day after the meeting SEAE informed the Institute by fax that such an agreement was a violation of the competition law and illegal. Nevertheless, the three producers each implemented price increases on these products in early August of that year. The increases were approximately the same as those given to SEAE by the Steel Institute. They were not identical across the three companies, but in most cases they did not vary by more than 0.5%. About one year later the companies implemented another, similar increase, though there was no preliminary notice given to SEAE.

The defendants denied that they had formed an agreement. They admitted that prior to the meeting with SEAE the top executives of the firms had met, but they denied that an agreement had been reached. The Brazilian competition agencies were not able to develop direct evidence of an agreement. They were unable to question executives of the three firms directly about the matter. The agencies concluded, however, that there was sufficient circumstantial evidence of agreement. That evidence included the executives' meeting prior to the SEAE meeting, the statement of intent to increase prices at the SEAE meeting, the nearly identical, nearly simultaneous increases in August of 1996, and the lack of evidence otherwise supporting independent decisions by the steel companies to increase prices at that time. CADE concluded that the 1996 conduct was unlawful. It did not include the 1997 increase as a part of the violation, however, as there was no evidence of a meeting or communications among the firms prior to that increase.

The tribunal imposed the minimum fine under the law of 1% of the previous year's gross turnover of each firm, which amounted to about R\$51 million (then the equivalent of about USD 48 million).⁶⁵ The defendants appealed the decision and the fines, and some aspects of the case, unfortunately, are still not resolved. More recently, the Brazilian competition agencies have become more aggressive in their anti-cartel effort and have perfected their use of dawn raids and other specialised investigative techniques. They have created a leniency programme, which has generated some cases.⁶⁶

5.1.3. *Latvia – Hens' eggs*

This case is a good example of the use of different types of circumstantial evidence:

- communication evidence, including evidence of meetings of competitors through an industry trade association, and documents evidencing that prices were discussed at these gatherings;

- economic evidence showing an increase in prices after the relevant meetings, and evidence rebutting the claim by the respondents that their pricing was the result of market forces.

The case is also relevant because it occurred in the agricultural products sector, where it seems that many cartels exist in countries beginning anti-cartel enforcement.

In 2003 The Latvian Competition Council initiated an inquiry into possible price fixing by producers of hens' eggs upon reading in the local press an announcement by the leading producer that it intended to raise its prices. The article also stated that the Latvian Association of Egg Producers had recommended that its members raise their prices. The Competition Council then lacked mandatory inspection powers, but its investigators appeared simultaneously at the offices of three producers to conduct voluntary interviews. Later the investigators interviewed other producers.

The investigation developed the following evidence: There were 12 members of the Producers' Association. The Latvian market was dominated by one producer, which had a market share of 50%. Three others each had shares of 8-11%. In the interviews, the investigators were told that there had been discussions about raising prices at association meetings in two periods, July-August 2002 and March-April 2003. The investigators obtained a copy of a fax sent to association members by the dominant firm prior to a meeting in March 2003. The fax stated that the agenda of the meeting would include the topic of "price policy (the increase of prices is planned starting from 1 April 2003)". The fax also stated that the dominant firm would not respond to proposals from retailers for special low price promotions for the upcoming Easter season, and it concluded: "Therefore, in order to ensure successful trade in Easter we invite you not to support the actions of retailers of above-mentioned nature."

The Council also developed economic evidence in support of its case. It analysed egg prices during the relevant periods and found that prices did indeed raise after the association meetings. Moreover, it seemed that the increases could not be justified either by higher costs or by supply and demand considerations. Indeed, the producers produced a surplus of eggs during the relevant periods.

The Competition Council concluded that the producers had engaged in price fixing activity in violation of the Latvian competition law, and fined the respondents. The case is currently on appeal.

5.1.4. Chinese Taipei – Petrol and diesel fuel

This case is useful because it occurred in a sector in which many countries initiate cartel investigations – retail sales of petrol. It is also notable

because it contains no communication evidence – only economic evidence. The competition authority apparently employed a form of economic analysis like that discussed above in Part III, but it is not clear why the agency rejected the hypothesis of unilateral non cooperative best response – in particular the dominant-firm price leadership model.

At the time the investigation began in 2003, the refined petroleum sector in the Chinese Taipei market for petrol and diesel fuel was a duopoly. The leader, with a market share of 70%, had been a monopolist until the entry of another firm in 2000. A third firm, a large American company, had entered in 2002 but subsequently withdrew.

For two years the prices charged by these two suppliers to retail petrol stations had moved in parallel fashion. There were at least 20 instances of simultaneous and nearly identical price adjustments. In each instance, one of the parties announced new prices publicly, to take effect in the future. The other party would then react, also announcing its new prices publicly. If on occasion the second party did not follow the prices announced by the first, the initiating party would either withdraw its changes or amend them to conform to those announced by the other.

There was no direct evidence of agreement. The Chinese Taipei Fair Trade Commission concluded that the duopolists had reached a “meeting of the minds”, however. It considered the following factors in making that judgment:

- the parallel conduct of the two parties, covering many price adjustments over a period of years;
- the fact that the price changes were announced publicly, and in advance;
- the fact that retail petrol station operators reacted quickly to the price changes by posting new prices; these announcements served as a monitoring mechanism for the two suppliers;
- an in-depth analysis of the cost structures of the two firms, showing significant differences between them in terms of sources of imports, refinery costs, transportation costs, capacity utilisation, and others.

The FTC also apparently employed game theory in its analysis of the conduct, concluding that the results were consistent with a form of agreement.⁶⁷

The Commission concluded that the conduct constituted a violation of Chinese Taipei’s Fair Trade Law, and it fined each of the two respondents NT\$6 500 000 (about USD 200 000).

5.2. Cartels as crimes

A minority – but a growing one – of countries prosecute cartels as crimes. The standard of proof in criminal cases is the highest, and this would translate into stricter standards for the use of circumstantial evidence. Still, such

evidence can be used in these cases. The experience in two countries where cartel conduct is a crime is described below.

5.2.1. United States

The US has a relatively long history in prosecuting cartels as crimes.⁶⁸ There were some early criminal cases under the Sherman Act that were built on circumstantial evidence.⁶⁹ In the past several years, however, all criminal convictions under the Sherman Act have been based on direct evidence. Since the mid-1990s, the US' leniency programme has become its most important tool in its anti-cartel arsenal, and most cases result from an application under the programme. Most are also resolved without trial, on the basis of guilty pleas.

Of course, circumstantial evidence can also be useful and important. The *Art Auctions* case noted in the introduction above was one case in which it was. The case involved an agreement between the two leading art auction houses, Sotheby's and Christie's, fixing their commission rates. The trial involved Sotheby's Chairman, A. Alfred Taubman; the other parties had either pled guilty or were not prosecuted because they had entered the US' leniency programme. There was direct evidence resulting from the leniency application proving the existence of the cartel agreement. The evidence linking Taubman to the agreement was more tenuous, however. It consisted of communication evidence, much of it written, showing that Taubman had met with his counterpart at Christie's and discussed prices, and that he had supervised discussions between his subordinate and a Christie's executive on the subject.⁷⁰ The jury convicted Taubman on the basis of this evidence, and he was sentenced to one year and a day in jail and a fine of \$7.5 million.

5.2.2. Canada

Canada has also long classified cartels as crimes. Like the US, there were some early cases in which convictions were based only on circumstantial evidence, and in which the sanctions – fines – were minimal.⁷¹ In 1980 an important case in the evolution of the use of circumstantial evidence in criminal cases was decided by the Supreme Court of Canada.

5.2.3. Atlantic sugar⁷²

The defendants, three sugar refiners, were accused of, among other things, entering into an agreement to maintain traditional market shares over a period of several years. There was no evidence of communication between the defendants on this subject, however. The evidence, as characterised by the court, was entirely "circumstantial". It included the rigid stability of the defendants' shares over a long period and at least one facilitating practice – basing point pricing. In addition, there was documentary evidence showing

that the defendants deliberately – but apparently independently – chose not to initiate price cuts that would destabilise this environment.

The trial judge concluded that the circumstances were “the result of a tacit agreement between the accused”, brought about by the desire of each defendant to avoid a destructive price war.⁷³ The judge held, however, that such conduct did not constitute a violation of the applicable criminal law. The Supreme Court upheld the trial court (an intermediate appellate court had overturned it). It emphasised the apparent lack of communication between the defendants on this point. Then:

In those circumstances did the “tacit agreement” resulting from the expected adoption by the competitors amount to a conspiracy? I have great difficulty agreeing that it did because the author of Redpath’s [the pricing leader] policy was conscious that its competitors would inevitably after some time become aware of it in a general way and also expected them to adopt a similar policy which would also become apparent.⁷⁴

The *Atlantic Sugar* decision engendered concern that “tacit agreements” were no longer subject to the criminal conspiracy provisions of the Competition Act. The Act was amended in 1986, adding (among other things) the following provision:

Evidence of conspiracy – In a prosecution under subsection (1), the court may infer the existence of a conspiracy, combination, agreement or arrangement from circumstantial evidence, with or without direct evidence of communication between or among the alleged parties thereto, but for greater certainty, the conspiracy, combination, agreement or arrangement must be proved beyond a reasonable doubt.⁷⁵

The following interpretation of the amendment is provided in a comment to the law:

The new subsection makes clear that tacit agreements, in the sense of agreements proved by circumstantial evidence alone, fall within the scope of s. 45(2.1). However, the section does nothing to clarify the more difficult questions of what in law constitutes an agreement, what sort of communication among the alleged conspirators is necessary and how to distinguish agreements from mere “conscious parallelism”.⁷⁶

In any case, it seems that the trend in Canada, like that in the US, is toward an increasing number of cartel cases generated by its immunity programme.⁷⁷

6. Conclusion

In prosecuting cartel cases, competition officials prefer to have direct evidence of the cartel agreement, and they are getting better at acquiring it.

Circumstantial evidence continues to play an important role in cartel cases, however, either alone or, more commonly, together with direct evidence. Circumstantial evidence may be relatively more important in early cartel cases in countries just beginning an anti-cartel effort, as those new agencies may not have perfected their ability to develop direct evidence.

There are various types of circumstantial evidence, and it is difficult to generalise about them, because each case is highly fact specific. However, communication evidence and conduct evidence that tend to show that the parties' actions were not consistent with each party's unilateral self-interest are widely considered most important. Other economic evidence typically will be relevant as well to establish a persuasive case.

The great challenge in establishing a circumstantial evidence case is that such evidence typically is ambiguous and subject to more than one interpretation. There is a risk that enforcers will too readily condemn parallel conduct even though it is simply the result of independent action by market participants, each acting according to its own judgment as to its best interests. As demonstrated above, application of sound economic principles plays an important role in interpreting the conduct of firms to distinguish lawful, unilateral acts from joint action that results from an unlawful agreement.

Notes

1. Available on the website of the American Bar Association, at: www.abanet.org/antitrust/committees/criminal/taubman.doc.
2. It should be noted that the United States, well along on the virtuous circle, would not normally bring a criminal cartel case on indirect evidence alone. Even in the Sotheby's case, there was direct evidence of the agreement, and there was some direct evidence linking Sotheby's Chairman to it. Much of the evidence against him, however, was circumstantial.
3. Sherman Act § 1.
4. Article 9.
5. Articles 7 and 14.
6. Articles 2 and 8.
7. *Esco Corp. v. United States*, 340 F.2d 1000, 1007 (9th Cir. 1965).
8. The reader should be careful, though, and not put too much emphasis on these definitions. As other observers have noted, trying to come up with common definitions of "agreement" is not a useful exercise in cases where circumstantial evidence is used to identify a cartel. It is better to describe agreement in terms of what courts in circumstantial evidence cases actually require in terms of firm behaviour that supports the inference of agreement. See, e.g., Jonathan B. Baker, *Identifying Horizontal Price Fixing in the Electronic Market Place*, 65 *Antitrust L. J.* 41 (1996) (arguing that this approach emphasises the (forbidden) process of reaching

supracompetitive market outcomes, rather than the outcome itself, which in turn ensures that remedies focus on forbidden acts that can be enjoined.).

9. In a recent article Greg Werden notes the confusion in terminology that is employed in this field. The terms express, explicit, tacit and co-ordinated are often found, but users do not always ascribe the same meaning to them. For example, the term tacit collusion has been used to describe an alleged cartel agreement for which only indirect evidence is available, but also to describe cases of parallel, interdependent conduct that does not amount to an unlawful conspiracy. Werden uses the term spoken agreement to refer to an unlawful conspiracy. Gregory J. Werden, *Economic Evidence on the Existence of Collusion: Reconciling Antitrust Law with Oligopoly Theory*, 71 Antitrust L. J. 719, 735-36 (2004). This paper will generally use the terms agreement or cartel agreement to refer to an unlawful conspiracy.
10. The secret video tapes generated in the *Lysine* investigation certainly qualify; they continue to represent the gold standard in cartel evidence. Unfortunately, obtaining such “real time” evidence of agreement is usually not possible.
11. Section 3, *infra* at p. 24.
12. Market shares, of course, are also an element of market structure. Stable market shares are classified as conduct for purposes of this discussion because they could be the result of a conscious agreement among competitors not to compete.
13. Consider, for example, the French case against the mobile phone operators, discussed *infra* at p. 376. The market was concentrated, but mobile phone services would normally not be considered a homogenous product.
14. Sometimes, however, and depending on the circumstances, facilitating practices have been condemned in their own right as competition law violations, without the need for showing an underlying anticompetitive agreement. See, e.g., Donald S. Clark, *Price-Fixing Without Collusion: An Antitrust Analysis of Facilitating Practices After Ethyl Corp.*, 1983 Wisconsin Law Review 887.
15. Problematic information exchanges include those containing information about current prices, costs, business plans, capacity utilisation, or other non public, business sensitive information. The use of this information in facilitating a cartel is obvious – it aids both in setting the terms of agreement and in monitoring compliance with it.
16. Price signalling is a form of information exchange, usually conducted by means of public announcements of future prices or pricing policy. This information obviously can assist rivals in reaching agreement.
17. Freight equalisation schemes, whereby products are sold on a delivered basis (freight is absorbed by the seller), or by using a “basing point” system in which freight is charged by all sellers as though their products were shipped from a single location, eliminate a variable component of prices, making it easier for rivals to define the cartel price and to monitor it.
18. Price protection (meeting competition) and most favoured nation clauses, whereby buyers are guaranteed the lowest price offered either by a seller’s rivals (price protection) or by a seller to other buyers (MFN), are by no means always anticompetitive, but in the right circumstances they can serve as enforcement or punishment mechanisms in a cartel agreement.
19. Agreement on unnecessarily restrictive product standards operates to exclude new entry, which could destabilise a cartel.
20. See the press announcement of the case on the Competition Authority’s website, at www.agcm.it/eng/index.htm.

21. See, e.g., Andrew I. Gavil et al., *Antitrust Law in Perspective: Cases, Concepts, and Problems in Competition Policy* 283 (2002).
22. These two factors are discussed in greater detail below. See *infra*, at p. 29.
23. In 1838 Cournot proposed that firms choose their optimal output level given their rivals' outputs and 1883 Bertrand proposed instead that firms choose the optimal price given their rivals' prices. Both the Cournot and Bertrand models are examples of one shot games. In such games, participants expect that the game will last only for one period. In repeated games (for example, models associated with the Folk Theorem), the players play the one shot game repeated. Repeated games typically identify multiple equilibria and there appears to be a widely held view among economists that the actual outcomes in an oligopoly are determined by factors outside those models. Such factors can include, in particular, agreements among competitors. As a result, the usefulness of in particular infinitely repeated game models to explain firm conduct in circumstantial evidence cases has been questioned, and they are not discussed in greater detail in the text. For an analysis of this issue see Gregory J. Werden, *supra* note 9, at 759-765. Whatever model the parties propose as lawful explanation of their conduct, competition authorities must check that the model's underlying assumptions are a good description of the industry in question.
24. Following up on these developments, competition authorities have made extensive use of unilateral effects theories and today many legal complaints are brought primarily based on a unilateral effects concern.
25. This reasoning has been the basis of numerous complaints by competition authorities in a variety of merger cases when they speak of a coordinated effects concern.
26. Certain economically minded students of antitrust policy have argued that coordinated or accommodating behaviour by firms should be treated as a violation of competition law. See Richard A. Posner, *Antitrust Law* 94 (2nd ed. 2001). The prevailing view is, however, that cases where competitors have not reached an agreement should not be held to violate competition laws as it would be difficult or next to impossible to design an appropriate remedy. See, e.g., Jonathan B. Baker, *Identifying Horizontal Price Fixing in the Electronic Market Place*, 65 *Antitrust L. J.* 41, 48 (1996). See also Gregory J. Werden, *supra* note 9, at 773-77, for a discussion of Posner's view.
27. See *United States v. Omnipoint Corporation*, No. 1:98CV02751 (D.D.C. 10 November 1998); *United States v. Mercury PCS II, L.L.C.*, No. 1:98CV02751 (D.D.C. 10 November 1998); *United States v. 21st Century Bidding Corporation*, No. 198CV02752 (D.D.C. 10 November 1998).
28. The following table identifies two competitors: firm 1 and firm 2 and defines the profits that correspond to the sets of actions that are available to firm 1 and 2, respectively.

Prisoner's dilemma

		Firm 2	
		Price high	Price low
Firm 1	Price high	10, 10	3, 15
	Price low	15, 3	4, 4

For example, if firm 1 prices high and firm 2 prices low then firm 1 earns 3 and firm 2 earns 15. To find the Nash equilibrium and to highlight how unilateral

incentives determine the Nash equilibrium let's begin in the box where both firm 1 and firm 2 are pricing high. This box indicates that both firm 1 and firm 2 each earn 10 in profits. Call these the profits that each would earn if they explicitly agreed to fix prices. In order to understand the incentives facing each firm ask what firm 1 should do if it thinks that firm 2 will price high. If firm 2 prices high then firm 1's profit can be 10 if it also prices high or 15 if instead it defects on the cartel and prices low. Because 15 is more than 10 it is in firm 1's unilateral interest to price low. Now, firm 2 knows that if firm 1 prices low that it could earn 4 if it also priced low or 3 if it continues to price high. Because 4 is more than 3, firm 2 will choose to price low as well. This is, as it turns out, is the Nash equilibrium because each firm's best response to the other firm's best response is for both to price low.

29. George J. Stigler, *A Theory of Oligopoly*, 72 J. Pol. Econ. 44-61 (1964).
30. For a good hypothetical, using numerical examples, of the problems faced by firms considering a cartel see Andrew I. Gavil et al., *supra* note 21, at 228-35.
31. Stigler's description of the problems faced in the formation and operation of a cartel can provide useful guidance to a competition authority which attempts to build a cartel case using circumstantial evidence since attempts by cartel members to overcome these problems may have created an evidence trail. When seeking to establish that the companies' behaviour was not consistent with unilateral self interest, a competition authority can strengthen its "conspiracy story" if it has evidence that explains how the cartel solved the problems of formation, detection, and/or punishment. For example, the competition authority may be able to explain that certain facilitating practices were used by the cartel member to monitor their compliance with the agreement and provide for the possibility to punish defectors. The Italian baby milk case, discussed *supra*, at p. 22, provides a nice illustration of this point (facilitating practices included measures to create price transparency, and use of sales channels where price discounts were unlikely). On "facilitating practices", see *supra* at p. 21 Note, however, that evidence concerning the solution of the three cartel problems will not always be available.
32. *Reserve Supply Corporation v. Owens-Corning Fiberglas Corporation*, 971 F. 2d 37 (7th Circuit 1992).
33. For further examples on the use of the concept of actions against unilateral self interest see *infra* at p. 31.
34. *American Tobacco Co. v. United States*, 328 US 781 (1946).
35. Gregory J. Werden, *supra* note 9, at 779-80.
36. See, e.g., 6 Phillip E. Areeda and Herbert Hovenkamp, *Fundamentals of Antitrust Law* (3d ed. 2004), §1433a, at 236: The courts are nearly unanimous in saying that mere interdependent parallelism does not establish the contract, combination or conspiracy required by Sherman Act §1; Ivo Van Bael and Jean-François Bellis, *Competition Law of the European Community* (4th ed. 2005), at 55: Parallel behaviour between two or more undertakings as such does not constitute sufficient evidence to establish the existence of a concerted practice. The EC Treaty does not deprive economic operators of the right to adapt themselves intelligently to the existing and anticipated conduct of their competitors. (Quoting from Case 48/69, *ICI v. Commission*, [1972] ECR 619, para. 118.)
37. *In re Flat Glass Antitrust Litigation*, 385 F 3d 350, 359-60 (3d Cir. 2004).
38. For discussions of the EU jurisprudence on the topic of circumstantial evidence in cartel cases, see, e.g., Mark Jephcott, *Horizontal Agreements and EU Competition Law*

- (2005); Sigrid Stroux, *US and EC Oligopoly Control* (2004); Lennart Ritter and David Braun, *European Competition Law: A Practitioner's Guide*, 100-110 (3d ed. 2004) ; Richard Whish, *Competition Law*, 514-16 (5th ed. 2003).
39. *In re Flat Glass Litigation*, *supra* note 37.
 40. Most of the recent US civil cases dealing with this topic have been presented to US appellate courts upon appeal from a dismissal of the case by the trial court before a complete factual record had been made. Under US "summary judgment" procedures the court can grant judgment in advance of a full trial if the moving party can show that all necessary factual issues are settled or so one-sided they need not be tried. A different, more lenient (to the proponent) legal standard applies to summary judgment motions than to a final judgment. In these cases the appellate court is not deciding finally whether an agreement has been proved, but only whether there is sufficient evidence of agreement to permit that question to be submitted to the fact finder (judge or jury). Nevertheless, these cases are instructive on the issue of proof of agreement in horizontal cases.
 41. *Id.*, at 361.
 42. *Ibid*, quoting from an opinion by Judge Richard Posner in *In re High Fructose Corn Syrup Antitrust Litig.*, 295 F.3d 651 (7th Cir. 2002).
 43. *In re High Fructose Corn Syrup Antitrust Litig.*, *supra* note 422.
 44. *Id.*, at 655.
 45. Price discrimination is not always anticompetitive, and the existence of it does not always indicate collusion. Judge Posner discusses at some length in the decision why it is relevant in this case. *Id.* at 658.
 46. *See supra*, at p. 24.
 47. *See Petruzzi's IGA v. Darling-Deleware*, 998 F.2d 1224, 1243-45 (3d Cir. 1993).
 48. *Blomkest Fertilizer v. Potash Corp. of Sask.*, 203 F. 3d 1028 (8th Cir. 2000) (en banc).
 49. Most appeal cases in the US Federal system are heard by a panel of only three judges, chosen at random.
 50. *Id.*, at 1034-35.
 51. *Id.*, at 1047.
 52. *In re Brand name Prescription Drugs Antitrust Litig.*, 186 F3rd 781 (7th Cir. 1999).
 53. *Id.*, at 661.
 54. *Id.*, at 655-56.
 55. *See Williamson Oil Co. v. Philip Morris USA*, 346 F.3rd 1287 11th Cir. 2003).
 56. *Cases C-89/85 etc., Ahlstrom Oy v. Commission*, [1992] ECR I-1307.
 57. *Id.* at para. 81. *See also*, *Suiker Unie v. Commission (Sugar Cartel)*, OJ [1973] L 140/17.
 58. *See, e.g., PVC II*: OJ [1994] 239/14, substantially upheld on appeal, *Cases T-305/94 etc., Limburgse Vinyl Maatschappij v. Commission* [1999] ECR II-931 (CFI confirming that "... items of evidence should be regarded not in isolation but in their entirety [...] and individual items of evidence cannot be divorced from their context"); *Plasterboard*, OJ [2005] L. 166/8.
 59. Although, as suggested above, there might be differences even within one and the same country.

60. Based upon a review of Commission press releases during the period, available on the Commission's website.
61. OECD, *Implementation of the Council Recommendation Concerning Effective Action Against Hard Core Cartels: Third Report by the Competition Committee* (2005), available on the OECD website at www.oecd.org/competition.
62. Of course, in many of these cases there was circumstantial evidence as well. As noted above, the different types of evidence may be used together in a case.
63. For example, between 2001 and 2005 the European Commission imposed fines totaling almost €4 billion for cartel conduct in violation of Article 81. See, speech by European Commissioner Neelie Kroes before the International Forum on Competition Law, April 7, 2005, available on the European Commission website, at <http://europa.eu.int/comm/competition>. As noted above, all of these cases apparently were based, at least in part, on direct evidence.
64. The press release by the Conseil de la concurrence is available on the Conseil's website at www.conseil-concurrence.fr/user/standard.php?id_rub=149&id_article=501. The complete decision is available at www.conseil-concurrence.fr/user/avis.php?avis=05-D-65. The defendants have announced their intention to appeal the decision.
65. For further discussion of this case, see, Paulo Corrêa and Frederico G. de Aguiar, *Circumstantial Evidence and Plus Factors in Cartel Cases*, available on the SEAE website, at www.fazenda.gov.br/seae/english/index_english.html.
66. See, OECD, *Competition Law and Policy in Brazil: A Peer Review*, at 50-54 (2005), available at the OECD website, at www.oecd.org/dataoecd/12/45/35445196.pdf.
67. A more complete description of this case is available on the APEC website, at www.apec.org.tw/doc/Taipei/Case/D094q108.htm.
68. The Sherman Act provides for both criminal and civil sanctions, but for many years after its enactment in 1890 most of the cases brought under it were civil. Also, for many years, a Sherman Act violation was classified as a misdemeanor – a lesser crime. In the 1970s, however, the act was amended to make a violation of it a felony, and the maximum penalties were increased. There were further increases in the maximum penalties, so that today a corporation can be sentenced to pay a fine of up to \$100 million (and even more, pursuant to an alternative sentencing provision in US law), and a natural person can be sentenced to a jail term of up to 10 years and a fine of up to \$1 million. Sentences actually imposed have kept pace with the increasing authorisations; corporations have paid fines of hundreds of millions of dollars, and individuals are regularly sentenced to jail terms of three years or more. See, Scott D. Hammond, "An Overview Of Recent Developments In The Antitrust Division's Criminal Enforcement Program", speech before the America Bar Ass'n, 10 January 2005, available at www.usdoj.gov/atr/public/speeches/207226.htm.
69. One of these was *American Tobacco*, *supra* note 34, decided in 1946. It was an appeal from a criminal conviction of three leading tobacco companies and some of their executives. Each defendant was convicted on three counts of violating the act and each was fined a total of \$15 000, which was then the maximum fine. There was apparently no direct evidence of an agreement between the defendants, but as outlined in Part III above, the Supreme Court upheld the convictions on the basis of patterns of price changes, which it found to be "circumstantial evidence of the existence of a conspiracy".
70. There was also oral testimony offered by Taubman's subordinate, however, which the US government considered to be direct evidence. A good description of the

evidence introduced by the government can be found in a government filing in the appeal from the conviction (which was upheld), available at www.usdoj.gov/atr/cases/f11300/11329.htm.

71. One of these was *McGavin Bakeries*, a case decided in 1951 by the Supreme Court of Alberta. *Rex v. McGavin Bakeries, Ltd.*, 3 W.W.R. (N.S.) 289, at p. 10 (1951). The court noted that ... the crown's case here is based almost entirely on circumstantial evidence, but it concluded that the massive amount of factual material relating to conduct over a 17 year period by bakers in three western provinces resulted in the inescapable inference... that there was the conspiracy charged. The maximum fine that could be applied to the conduct, however, was CAD 10 000. Six defendants were fined a total of CAD 30 000.
72. *Atl. Sugar Refineries Co. v. A.G.Can.*, [1980], 2 S.C.R.644.
73. *Id.*, at p. 7.
74. *Id.*, at p. 15.
75. Competition Act, §45(2.1).
76. Robert S. Nozick, *The 2004 Annotated Competition Act* (Toronto: Thomson Carswell, 2004), at 87.
77. See, e.g., Sheridan Scott, *Cartel Enforcement: International and Canadian Developments*, a paper presented before the Fordham Corporate Law Institute, 7 October 2004, available on the Competition Bureau's website at www.competitionbureau.gc.ca.

Prosecuting Cartels without Direct Evidence of Agreement

3. Summary of the Discussion

Summary of the Discussion

The Chairman, Daniel Goldberg of Brazil, invited the Secretariat to summarise the background paper that it prepared for the roundtable.

The subject is more complex than it might first appear to be. Competition laws apply both to explicit agreements and to agreements of a less formal kind, such as “concerted actions”, “understandings” and so forth. Moreover, proving cartel agreements can pose special challenges, as cartel participants usually do not willingly co-operate with investigators. The competition agency will seek to acquire all types of relevant evidence, including “direct” and “indirect”, or “circumstantial” evidence.

Direct evidence includes “smoking gun” documents or e-mails, and statements by cartel participants describing the agreement. Circumstantial evidence can be classified into two types: 1) “communication” evidence, or evidence that the suspected cartel participants did communicate about the subject of their agreement, and 2) “economic” evidence. Economic evidence can be further classified as a) “conduct” evidence and b) “structural” evidence. Conduct evidence includes such things as parallel pricing or other parallel behaviour and practices that facilitate a cartel agreement (*e.g.*, price signalling). Structural evidence includes such factors as high market concentration and homogeneous products. Of the two types of economic evidence, conduct evidence is the more important.

The discipline of economics can provide valuable insights into how to evaluate economic evidence. In general, the conduct must be inconsistent with that which would occur if the enterprises were acting unilaterally. The paper describes various economic models in which competitors make decisions based upon their judgments on what their rivals are doing. Only one of these is considered to be a cartel and unlawful, and economics provides guidelines on how to make that judgment.

The paper discusses how different treatment of cartels across countries – prosecuted as crimes or as administrative violations, for example – can affect how circumstantial evidence is employed. The paper also notes two general points: 1) all types of evidence – direct and circumstantial – can be used together; and 2) circumstantial evidence should be considered holistically – that is, cumulatively, and not item by item.

The paper relies heavily on case descriptions as an effective way to illustrate the use of circumstantial evidence in cartel cases.

1. Definition of agreement and the applicable legal standard

The Chairman indicated that the discussion would be divided into blocks, or subtopics. The first would deal with the type of agreement that can arise in a cartel case – for example, explicit or tacit agreements – and standards that apply to proving these different types of agreements. He noted that the EU Treaty specifically identified two concepts: agreement and concerted action, and he asked the delegate from the European Commission whether there were different standards of proof that applied to these concepts, and specifically whether circumstantial evidence was more important in proving one than the other.

The EC delegate stated that the two concepts are indeed different. An agreement embodies a communion of will – an agreement that the parties will adopt a certain practice or behaviour. A concerted practice is less formal, and may simply be the observed result of a set of communications. In either case, however, the standard of proof is the same, and circumstantial evidence can be equally relevant in both. Admittedly, the exclusive use of circumstantial evidence is more risky, as it is necessary to exclude other plausible explanations for the conduct that is observed.

The Chairman noted that Chinese Taipei's competition law also employed the term "concerted action", and also that the competition agency sometimes, but not always, applies a *per se* rule to cartels. Did the application of the *per se* rule depend on whether direct or circumstantial evidence was predominant?

The Chinese Taipei delegate noted that its agency employed a kind of minimum standard when evaluating cartel cases, and it would decline to prosecute conduct that had a truly *de minimus* effect. The applicable standard of proof, however, is not dependant on the type of evidence that is available.

2. The difficult distinction between direct and circumstantial evidence

The Chairman moved to the second sub-topic, the sometimes difficult distinction between direct and circumstantial evidence. He noted that BIAC's written submission urged that cartel cases should not be based solely on indirect evidence. The paper also criticised the EC's policy of using corporate statements, which technically are direct evidence. He asked for an elaboration of BIAC's position on these points, and particularly how BIAC would differentiate between direct and indirect evidence.

BIAC expressed its support for vigorous prosecution of cartel conduct. It noted, however, that such prosecutions result in significant pecuniary and reputational harm to businesses that are found liable, and it urges, therefore, that cartel cases not be based solely on circumstantial evidence. Direct evidence can take the form either of documents or of testimony by individuals who were involved in the cartel activity. The latter is becoming increasingly available by means of leniency programmes. Other types of communication evidence are relevant, but sometimes they are ambiguous. Economic evidence, such as parallel pricing, is even more ambiguous, and it should not be sufficient by itself in a cartel case.

Regarding the Chair's question about the use of corporate statements in Europe, these are technically direct evidence, but they cannot be adequately tested because the European Commission procedure is administrative not judicial and there is no mechanism for either the Commission or the parties to cross examine witnesses on statements given in furtherance of a leniency application.

3. Communication evidence

The Chairman then turned to the subject of communication evidence – evidence that the parties communicated about the subject of their alleged agreement, but not containing the substance of an agreement itself. The Chair noted that the *Toshiba* case in Japan set forth an apparently precise standard for the use of circumstantial communication evidence. Must the evidence always meet this standard in Japan?

The delegate from Japan replied that if the evidence satisfies the test set out in the *Toshiba* decision it is sufficient to prove a cartel agreement, but it is not required that this test always be met. The *Toshiba* court understood that direct evidence of a cartel case can be difficult to obtain and that circumstantial evidence could be sufficient in appropriate circumstances. The court took a holistic approach toward circumstantial evidence, and using the three elements described in its decision it found that the evidence was sufficient. While these elements need not be satisfied in every case, it is important that there be some form of communication evidence presented.

The Chairman noted that Korea's competition law creates a "presumption of agreement" in the absence of direct evidence when there is "conformity of outward conduct" and "competition restrictiveness". The KFTC has also created a set of internal guidelines that provide standards for proving agreements in the absence of direct evidence. Is it necessary that the evidence always include some form of communication evidence?

The Korean competition law is somewhat unique in that it specifically provides for a presumption of agreement when the two elements noted by the

Chairman are present. Strictly speaking, an agreement could be proved in the absence of communication evidence, but in practice this would be difficult. The KFTC always strives to acquire communication evidence, but if it is not present, it would be possible to prove agreement using a sufficient amount of economic evidence.

The Chairman referred to the submission of the Czech Republic, which described a case in which some interesting and unusual circumstantial evidence was generated. He asked the Czech delegation to describe this evidence for the delegates.

There were three important pieces of evidence in this case, which involved a cartel among bread producers in the Czech Republic. First, there was very suspicious parallel conduct, in which the producers announced identical price increases in parallel fashion. Second, the Antimonopoly Office obtained e-mail messages between several of the cartel operators discussing customer allocations. One of these messages ended with “I am deleting this message now because the Antimonopoly Office and the Devil never sleep”. Third, the investigators obtained some unusual photographic evidence: they photographed the automobiles of the cartel operators parked outside a pub, where they were meeting to discuss the operation of the cartel.

4. Quasi-communication: facilitating practices

The Chairman moved to the subject of “quasi-communication” evidence, which includes facilitating practices. He referred to a successful case from Argentina, involving a cement cartel and which resulted in the imposition of record fines. The circumstantial evidence in the case was quite strong, and included regular exchanges of sensitive information, regular audits to confirm the operation of the cartel and one instance of predatory conduct serving as punishment of one member for cheating. Did the evidence also include evidence of parallel conduct and other economic evidence?

The delegate from Argentina explained that there was not much evidence of parallel conduct because cement markets in Argentina are local. The terms of the conspiracy mostly involved customer/market allocation. The circumstantial evidence of that agreement was strong, however.

5. Economic evidence

A second type of circumstantial evidence is economic evidence. The Chairman noted that economic evidence should be evaluated as to whether or not the conduct would be rational but for the existence of an agreement. The Chair noted that Turkey’s competition law creates a rebuttable presumption of agreement when the observed conduct is inconsistent with competition. The Turkish submission described a cement case in which the price increases

apparently were not justified by cost factors. The evidence also included, however, two documents that were considered as “plus factors”. Would the economic evidence in this case have been sufficient without these two documents?

The delegate from Turkey explained that while transportation costs are a significant factor in the price of cement, the cartel operators seemed to be willing to supply some customers more distant from their plants and unwilling to supply others located more close by. This evidence would have been enough to invoke the statutory presumption, but a successful case based on economic evidence usually requires more than just the presumption itself.

The Chairman turned to France, which had described a case involving public transportation in its submission. The case seemed to involve both direct and indirect evidence, and the Chair asked how the French authorities used both types of evidence and how they reinforced each other.

The French case involved urban public passenger transport. There were three providers of this service, and the evidence disclosed that they had allocated various local contracts among themselves. Thus, while the effects of the agreement were local, the cartel was national in scope. The *Conseil de la Concurrence* applied the “classic” technique, establishing the existence of the cartel from indirect evidence that was serious, specific and corroborative. The circumstantial evidence indicated that the customer allocation was both stable and persistent. The technique of evaluating circumstantial evidence is not unlike that of an impressionist painting, in which many small points make up a complete picture. The technique in this case permitted a finding of an agreement.

The Chairman asked Brazil to describe how it uses economic evidence as a screening device in the many complaints that it receives regarding retail prices of petrol.

The Brazilian agencies must consider all complaints that they receive. In order to avoid spending too many resources on the many complaints of price fixing in petrol that it receives, it evaluates them preliminarily using economic evidence. Profit margins in the market in question are analysed according to several criteria as to whether they are increasing, and if so whether the increases are consistent with a hypothesis of collusion. If not, the complaint is dismissed. If further inquiry is indicated, the prices in the market in question are compared with prices at the state level, on the hypothesis that the local agreement, if any, might not exist in a broader geographic area. If after passing through these filters the possibility of collusion cannot be dismissed, a more detailed inquiry is begun.

The Chairman noted that in some cases the fact that competitors’ prices are the same even though their costs differ is evidence of collusion. But isn’t

this situation also consistent with a competitive market? The taxi operators case from Lithuania appeared to have this situation of identical prices and differing costs.

The delegate from Lithuania stated that Article 5 of the Lithuanian competition law resembles and is intended to be interpreted similarly to Article 81 of the EC Treaty. In the taxi case there did exist this apparent disparity between costs and prices, but it was not a major factor in the case. There existed a substantial body of other evidence indicating that the abrupt, simultaneous and identical change in prices charged by the taxi operators was the result of an agreement.

The Chairman observed that in the Russian Federation many markets are highly concentrated and susceptible to collusion. Moreover, it is difficult for the Russian competition authority to acquire direct evidence of agreement in these circumstances. The Russian submission notes that it is important that the competition agency be able to prove the existence of cartel agreements by means of circumstantial evidence. In this regard, how do the Russian authorities use economic evidence to distinguish oligopolistic interdependence from collusion?

A new draft competition law is being prepared in Russia that will address these issues, among others. In general, the Russian authorities take a holistic approach when evaluating economic evidence. They consider market concentration, parallel conduct, facilitating practices, capacity reductions, information exchanges, and so forth. The authorities are also giving increased emphasis to the concept of collective dominance in dealing with this issue.

The Chairman turned to Switzerland, whose law seemingly requires that there be proved some harmful economic effect. Does this mean that in every case there is some economic analysis that must be provided?

The Swiss delegate explained that economic effects can come into play in two ways: first, in the proof of an anticompetitive act, and second, in the case of an attempt by the parties to show that the conduct, even if facially anticompetitive, is justified on the grounds of economic efficiency. In the case of cartels, however, the efficiency defence is not available, as it is considered that cartels are always harmful. Further, if a cartel agreement is proved, the harmful economic effects are presumed, unless the parties rebut this presumption through economic evidence, in which case a more complete economic analysis of the conduct is necessary.

6. Criminal vs. administrative or civil prosecution and the treatment of circumstantial evidence

The Chairman turned to the issue of different treatment of cartels across countries, notably the fact that in some countries they are prosecuted as crimes,

while in others – the majority – they are considered as administrative or civil violations. The question is whether these differences have an effect on the way that circumstantial evidence is used. The Chair noted that the United States has long been known for its aggressive use of the criminal process to fight cartels. The US states that it almost always bases its cases on direct evidence, often acquired through its leniency programme. But what advice would the US have for countries that are just beginning to prosecute cartels as crimes, or considering doing so, and in particular, is there a place for circumstantial evidence in these cases?

The delegate from the United States reviewed his country's procedures in investigating and prosecuting cartels, and acknowledged that the US' leniency programme has a critical function in developing the necessary direct evidence to permit the criminal prosecution of this conduct. He noted that it is important to avoid errors in this process, particularly those that would result in the prosecution of conduct that is not a cartel. Heavy use of circumstantial evidence could result in such errors, and while one could not completely rule out using circumstantial evidence in cartel cases, it is preferable to use direct evidence, and this means developing an effective leniency programme.

The Chairman noted that cartels can be prosecuted in Romania either administratively or criminally, and he asked whether the decision to use either process was based on the nature of the evidence.

In Romania, administrative fines cannot be imposed upon individuals. Individuals can be prosecuted criminally for cartel conduct if it can be shown that they participated in a cartel with fraudulent intent and in a decisive way. In this way the administrative and criminal processes in Romania are complementary. It is possible to use evidence developed in the administrative process in a criminal prosecution.

7. Sanctions

The Chairman observed that it is accepted everywhere that cartels should be sanctioned heavily, most often with high fines, so as to deter future conduct of that kind. The issue presented here is whether in order to justify such high fines it becomes more necessary to develop direct evidence of the unlawful agreement. The Chair noted that the European Commission is now imposing very large fines in its cartel cases, and he noted also the standard of proof that the Commission must meet is also high – not much different than that which exists in criminal cases. Is this standard related to the fact that large fines are now common, and in particular, does it mean that the Commission must rely more heavily on direct evidence in its cases?

The delegate from the Commission responded that the high standard of proof confronting it results from the close scrutiny that the European courts

give to Commission decisions. Regarding circumstantial evidence it means that the evidence must be credible, and that the only plausible explanation for the conduct is that of an agreement. On the other hand, there is no direct link between the type of evidence in a case and the level of fines. All cartels are considered as very serious infringements and all must be sanctioned accordingly.

The submission by Chile described a case involving a cartel of milk processors, in which the evidence was apparently entirely circumstantial. It took a period of nine years to complete the case, after which the sanctions applied were minimal. The Chairman inquired of Chile whether the mild sanctions were a result of there being no direct evidence of agreement in the case.

The Chilean delegate stated that the case was the first under a new system in which a Competition Court would decide appeals from decisions of the competition agency. The court decided in fact that the evidence, which was entirely circumstantial, was not sufficient to prove a cartel agreement. Therefore the court did not impose any significant sanctions. The result has highlighted for the competition agency the importance of acquiring direct evidence when possible. In this regard the agency is considering adopting a leniency programme.

8. Countries beginning anti-cartel enforcement

The Chairman noted that a few countries that provided submissions for the discussion had not previously been actively prosecuting cartels. It would be useful to hear from these countries as to issues facing them at this first stage, including their use of both direct and indirect evidence in their investigations.

Croatia has not yet completed a cartel case, though it currently has one investigation underway. It is difficult to acquire direct evidence in these cases, especially after the competition law has been in effect for a period of time, because businesses learn to conceal evidence of their wrongdoing. In an economy as small as Croatia's even circumstantial evidence may not exist, as it is easy for enterprises to monitor one another's conduct and to act in parallel fashion. In the current investigation the competition agency is studying various contract clauses employed by the parties for a pattern that may suggest collusion.

In Zambia cartels are prosecuted as crimes, and the higher burden of proof associated with criminal cases is proving difficult to satisfy for the Zambian competition agency. Zambia does not have a leniency programme in place, for example, and circumstantial evidence is usually not sufficient by itself. There is growing momentum in the country for changing the

classification of this conduct to an administrative violation. Another constraint facing the agency is a lack of effective investigative skills. Zambia urges that there be more effective international co-operation in cartel matters. It is having some success in informal co-operation with its neighbouring developing countries. Zambia also finds useful the seminars on developing investigational skills sponsored by UNCTAD in its region twice each year.

Jamaica's written submission contained a candid assessment of the JFTC's current inactivity in cartel prosecution. The problems include inadequate investigative tools and inadequate sanctions, insufficient resources for the Commission and a lack of competition culture in the country. The submission noted that competition advocacy was an important tool in remedying these shortcomings. The Jamaican delegate agreed that specific cases can be useful in competition advocacy, and that it was currently engaged in an investigation in the banking sector that might be appropriate for this purpose. The Commission may also focus on government procurement in another effort toward raising public consciousness about cartels.

The Chairman observed that several of the written submissions described cases involving collusion in the wholesale and retail petrol sector. It seems that cases in this sector are especially common across countries, and many of them are constructed with mostly circumstantial evidence. Japan described such a case in its submission, and the Chairman asked their delegation to discuss its use of circumstantial evidence in the case.

The Japanese case included the usual episodes of parallel pricing, but there were also two items of communication evidence that proved to be important. One was evidence of an "emergency" meeting of petrol retailers called by their trade association. It was clear that this was not a routine meeting of the association. Second, while records of the meeting did not describe the terms of an agreement, they did disclose that the members were instructed not to keep notes of the meeting in order to keep knowledge of it from the JFTC. This evidence, taken together with the economic evidence produced in the case, was sufficient for the JFTC to find that an agreement had been reached.

The Chairman invited the European Commission to comment further on point raised by BIAC regarding the Commission's use of corporate statements submitted under its leniency programme.

The corporate statements themselves are not necessarily direct evidence, as that term is commonly used. They may be of two types: 1) a general story, which must be corroborated by evidence developed in traditional ways, and 2) a more detailed specific disclosure accompanied by strong evidence.

9. Open discussion

The Chairman declared that the floor was open for discussion.

Competition Committee Chairman Frederic Jenny described two cases recently decided by the French *Conseil de la Concurrence* that involved issues of circumstantial evidence and agreement. The first was a petrol case, involving petrol stations on the French *autoroutes*. Each morning the several concessionaires along a route would exchange by telephone their current prices. This information was analysed by the individual networks, forming the basis for their prices the following day. The *Conseil* found that the conduct was an anticompetitive facilitating practice. The appeals court ruled, however, that while there had been an exchange of information, the evidence did not prove that the parties had reached an agreement. A second case was in fertiliser, in which the parties had adopted most favoured nation and meeting competition clauses, the result of which was a tendency not to reduce prices. Again, the decision was that an unlawful agreement had not been reached. These cases present the difficult question of what one means by an agreement under competition laws.

Indonesia described its experience in early cases prosecuted by the competition agency, in which it applied the rule of reason to cases in which there was circumstantial evidence. The agency had difficulty convincing the courts to accept its decisions in these cases. As time progressed the agency had more success in the courts, but the Indonesian delegate expressed interest in learning from other countries how they dealt with this issue of educating courts in competition analysis.

Israel, which prosecutes cartels criminally, finds it difficult to succeed in a case in which there is no direct evidence. The agency often finds, however, that circumstantial evidence, for example parallel pricing, provides a good basis for initiating an investigation, in the course of which direct evidence may later be developed. The Israeli delegate also responded to a comment that had been made earlier that countries new to anti-cartel enforcement may find it more necessary to build cases on circumstantial evidence, because they have not yet developed effective tools for acquiring direct evidence. Israel's experience was the opposite, because there existed many "naïve cartels" – cartels in which the members are unaware that their conduct is unlawful and who do not conceal their activity – when these prosecutions first began. Later, cartel operators became more sophisticated, and acquiring direct evidence became more difficult.

Australia currently prosecutes cartels civilly, although a criminal regime is due to start soon. Even under the civil process, however, the competition agency's burden of proof is high – "quasi-criminal" – because the respondents are subject to very high fines. In this context the ACCC has encountered two

problems in proving cases on the basis of circumstantial evidence. The first is the courts' receptivity to the "passive recipient defence", in which a party claims merely to have received in some way an invitation to raise price and then, without any affirmative response, merely does so. A second is the reluctance of courts to accept "inferential evidence". Such evidence might consist of, for example, a series of phone calls, perhaps hundreds, which correspond in time to parallel changes in price. Australian courts have required something more – that a particular communication be specifically linked to subsequent action by one or more parties. Both of these issues are under appeal in the Australian courts system, but a final resolution may be some time in the future.

The United States referred to the intervention by Frederic Jenny, in which he described cases involving facilitating practices but lacking evidence of a specific agreement among the parties. In the US two lines of cases have developed, one involving traditional cartel agreements and a second involving only the facilitating practice itself. Perhaps the most famous facilitating practice case was the *Container* case in the 1960s, which involved an extensive pattern of price verification among manufacturers of cardboard containers. This conduct was held in a civil case to be unlawful in itself, without there having been an explicit agreement on prices. The beneficial effect of the decision was later revealed in a document obtained from an oil company, in which the *Container* case was cited as causing businesses in the oil industry to cease similar practices, the result of which, in the words of the document, was to make it easier for "disturbers in the marketplace to discount without a commitment to verify prices".

The delegate from Italy described a case from that country in which insurance companies had engaged in regular, detailed exchanges of pricing information. It was argued that transparency in prices can be procompetitive, which it can be, but it can also have anticompetitive effects. The Italian authorities considered the arguments on this issue and concluded in this case that the conduct was anticompetitive, and ordered that it be stopped. Contributing to their decision was the fact that prices in this sector in Italy were the highest in Europe. The Italian delegate provided another observation about evidence of this kind, which is that when it becomes necessary to fashion an effective remedial order against a cartel it is important to forbid these kinds of practices. One cannot merely forbid parallel pricing; one must prevent specific conduct which makes the parallel pricing possible.

The delegate from the United Kingdom expressed his agreement with the point made by the United States, that competition agencies should focus on cases in which there is direct evidence. Too much emphasis on circumstantial evidence could waste resources and could jeopardise long-run success in the fight against cartels. Having recently come from the private sector, the

delegate noted that direct evidence of cartel conduct does exist; it is up to the investigators to find it. The delegate also expressed his disagreement with BIAC's position on corporate statements in European cases, saying that there is a place for such statements in these cases, especially when they are corroborated by other evidence.

The United States noted the importance of educating both the public and the courts about the nature of cartels and of the need to sanction them severely. In this regard, the quality of the cases initiated by the competition agency is important. A straightforward price fixing or market allocation case, proved by direct evidence, is the most effective for this purpose.

The delegate from Finland described that country's experience in its initial efforts against cartels. When its competition law was first enacted 50 years ago cartels were subject to criminal sanctions, but because such conduct was not generally thought of as a crime and because the standards of proof were high, there were few successful cases. In 1992 the law was changed to provide for an administrative process, and enforcement has become more vigorous. Criminalising the conduct might be more successful today. The lesson is that available sanctions and legal tool kits must be tailored to each country's situation, including whether there exists a strong competition culture. A second point regarding circumstantial evidence is that a case may resemble a jigsaw puzzle, in which the evidence must be considered as a whole. An important part of the puzzle can be evidence supplied by customers, or those affected by a cartel.

The Chairman asked Chinese Taipei about a case described in its presentation, in which it appeared to apply game theory in its evaluation of economic evidence.

The case was another in the petrol sector, in which there was a duopoly. The leading firm was a former state owned enterprise, with a 70% market share. The evidence was entirely circumstantial. It consisted of a pattern of simultaneous prices increases by the two sellers, many of them preceded by announcements in the newspapers. The parties also employed a facilitating practice – meeting competition clauses. The competition agency considered the evidence in a holistic fashion and concluded that it was sufficient to prove an agreement. It was acknowledged that the evidence was not particularly strong, however. The competition agency did not use game theory in the course of making its decision, but subsequently the case has been analysed using game theory in scholarly journals.

10. Conclusion

The Chairman thanked the delegates for their participation in this highly useful discussion. He noted that prosecuting cartels is becoming ever more

difficult, as cartel operators react to the threat of increasing sanctions by being more secretive. In this environment, circumstantial evidence may become more important to the competition agency. It can help in differentiating between, on the one hand a mere facilitating practice, and on the other a full blown, hard core cartel agreement.

Prosecuting Cartels without Direct Evidence of Agreement

4. Country Contributions

Further information from the following jurisdictions on Prosecuting Cartels without Direct Evidence of Agreement is available at: www.oecd.org/competition under the topic “Best Practice Roundtables”.

Country contributions

Algeria	Japan
Argentina	Korea
Brazil	Lithuania
Chile	Romania
Croatia	Russian Federation
Czech Republic	Switzerland
Estonia	Chinese Taipei
Canada	Turkey
European Commission	United States
France	Zambia
Jamaica	

Monitoring Review of Korea

This report reviews the achievements of the Korean 3-Year Market Reform Road Map. This assessment is carried out in light of the OECD's previous recommendations to shift KFTC priorities and resources toward core competition problems related to efficiency goals and away from its historic focus on conglomerate financial structure and governance; the need for further improvements in investigative powers and a clearer rule against hard-core cartels; implementation of recommendations to repeal exemptions for "small" business and exclusions of professional services and co-ordination with sectoral regulators about competition problems; and recent institutional changes to join the KFTC with the system for applying consumer protection law. This report was the basis for a monitoring review in the October 2006 session of the Competition Committee.

Box 1. **Summary**

Commitment to market principles at the highest political levels in Korea has provided strong support for competition policies, for reforms of the financial sector and corporate governance and for opening markets to trade and lowering barriers to foreign investment. That conclusion of the 2000 *OECD Report on Regulatory Reform in Korea* is confirmed in the experience since then. The 2000 Report noted the prominence of Korea's determined and pro-active competition policy institutions to underpin the consistency and sustainability of market-oriented policies. It described how the KFTC had become stronger and more active, imposing higher sanctions and turning to more sophisticated and difficult competition enforcement problems. The KFTC has exemplified strong independence in vigorously pursuing its reform plan despite opposition from the *chaebols*.

In line with OECD recommendations, the KFTC has been shifting its priorities and resources toward core competition problems related to efficiency goals and away from its historic focus on conglomerate financial structure and governance. In 2006 the KFTC is examining the results of the 3-Year Market Reform Roadmap that it announced in 2003, to decide what, if any, new structure might be needed when those reforms are completed. The KFTC's other announced goals confirm that it is concentrating on more effective application of competition laws to improve efficiency and promote consumer interests.

To make the enforcement process more effective and transparent, the KFTC is reviewing its procedures. Stronger KFTC investigative powers have been implemented only in part, and the KFTC still lacks a "dawn raid" power to enter premises and take possession of evidence. The recent doubling of the level of the basic administrative fine shows support for stronger sanctions. The broader sanction powers are now being tested, and it remains to be seen whether they will be strong enough to deter. To strengthen enforcement against hard-core horizontal cartels further, the competition law should be amended to make it clear that these cartels are prohibited without regard to claims about their supposed lack of effects in particular cases. Private suits have been facilitated, and further steps in that area are under consideration.

Box 1. **Summary** (cont.)

Commitment to pro-competitive reform was not equally strong everywhere in 2000, and recent experience with competition law enforcement against restrictive agreements in telecommunications reveals that there may still be some differences in appreciation about the roles of government direction and competitive initiative. Eliminating constraints in professions remains a challenge, with some reforms in the legal profession underway. Korea is implementing the principal recommendation from 2000 about the coverage of competition law, by repealing most of the special programs that protect small businesses from competition. Repealing all of them, including an anomalous, never-used presumption against acquisitions of small firms by large ones, would send a clear signal that Korea's law supports open competition on the merits of efficiency. Joining the KFTC with the system for applying consumer law, a logical and valuable evolution of its role, can make consumer policy more consistent with market competition and make competition policy more sensitive to effects on consumers.

1. Background, developments

This report is part of the monitoring review of developments since the 2000 *OECD Report on Regulatory Reform* ("2000 Report"), particularly of the implementation of its recommendations. It follows the same outline as the chapter on competition law and policy of the 2000 Report, dealing with substantive law and application, institutions, coverage and policy issues. The recommendations of the 2000 Report are highlighted in boxes. It deals mainly with recent developments; further detail and analysis about other aspects of the law and policy can be found in the 2000 Report. Developments related to competition policy were also covered in a special chapter on product market competition in the OECD's annual economic survey of Korea, published in June 2004 ("Annual Survey"). The Competition Committee considered developments in Korea since 2000 in its October 2004 retrospective examination of 10 member regimes, focusing at that time on implementation of recommendations about competition law enforcement.

Application of the Monopoly Regulation and Fair Trade Act (MRFTA), originally adopted in 1980, by the independent Korea Fair Trade Commission (KFTC) concentrates on horizontal constraints and unfair practices. The KFTC also applies laws to protect small businesses and consumer rights. Historically, it has been deeply involved in direct regulation of the structure, governance and operations of the *chaebol* conglomerate business groups. A

series of priority-setting projects has increasingly targeted competition problems in services, choosing sectors for attention that have a direct and visible impact on consumers or that have been significantly deregulated. The KFTC emphasises a law-enforcement approach along with its important advocacy and reform roles. It is perceived as an aggressive prosecutor, and recent amendments to the law have strengthened some enforcement tools.

The KFTC's conception of its role is broad. Its goal, set out in a January 2004 policy announcement, is "to nurture growth potential by enhancing efficiency in resource allocation through transparent business management and fair competition, thereby distributing the value-added in an effective and reasonable way". The KFTC holds that improving market confidence by supporting these core values of transparency and fairness will encourage human and physical capital to flow into more productive and healthy sectors. To implement this general competition policy of stimulating dynamic efficiency to facilitate adaptation and improve efficiency and consumer welfare, the KFTC's specific targets are preventing monopoly and oligopoly market structures through merger enforcement, removing regulations that hinder competition, deterring cartels and vertical restraints, improving conglomerate ownership structure and transparency, promoting fairness in transactions with consumers, and strengthening private enforcement against unfair practices. The goal of promoting "balanced development" of the economy responded to a longstanding concern the economy has been "overwhelmingly" dominated by conglomerate investment groups, whose influence has distorted competition and concentrated economic power. This priority was reinforced by a belief that in this respect Korea's situation was unique. Thus, although enforcing law about cartels and mergers and eliminating regulations that constrain market competition are important, the KFTC has placed equal importance on improving the machinery of capitalism, that is, on reforming the ownership and investment structures of the *chaebol* so that resources respond better to market signals. The KFTC has considered these functions to be as important as competition law enforcement, and it has been just as strict in enforcing these rules, through enforcement campaigns to check for undue transactions and other violations.

The policy options proposed in the 2000 Report dealt with the KFTC's *chaebol* responsibilities and with competition law enforcement. The principal recommendation was that attention and resources should move toward more emphasis on measures related to efficiency goals. This theme was echoed in the Annual Survey, which made what amounted to the same recommendation, from another perspective: that regulatory functions related to financial structure and corporate governance should be concentrated in regulators that are responsible for financial and securities matters, while transactions that have an exclusionary or distorting effect on product market

competition in particular cases should remain subject to competition-law control. Both reviews also called for strengthening the KFTC's investigative powers and tools. Other subjects of recommendations included individual sanctions, private remedies, substantive standards applied to abuse of dominance and mergers, and protectionist measures favouring "small" businesses. Regulatory reforms recommended in the Annual Survey included improving competition in retailing and professional services and strengthening competition and regulatory structure in network industries. These recommendations follow measures that had been set out in other chapters of the 2000 Report.

Steps taken since the 2000 Report have moved toward implementation of many of these recommendations. In 2001, easing the strictures on holding companies invited the *chaebol* to shift toward this more transparent structure. In 2002, the KFTC ended the system of designating the top 30 business groups for special attention, moving instead toward a system of general regulation of business group conduct. Most significantly, in 2003 the KFTC set up a comprehensive "Three year market reform roadmap" that included measures to resolve remaining problems with the corporate groups' structure and governance. The plan was embodied in legislation that took effect in April 2005.

Enforcement improvements include expanding the leniency program in 2001, adding an informant-reward feature in 2002 and strengthening both in 2005. The financial penalty against cartel violations was doubled under the legislation to implement the "three year market reform road map". These amendments also revised the merger review system, to require pre-notification of major mergers and set deadlines for KFTC action on them, while exempting acquisitions of small firms from the notification requirement. The law now explicitly reaches anticompetitive conduct outside Korea that affect the domestic market, and it tries to make it easier for private plaintiffs to claim and prove their damages due to violations. The KFTC staff structure was reorganised at the end of 2005 in order to underscore its reorientation toward better economic analysis and stronger enforcement against horizontal violations. The principal special-protection programs for small business are set to expire by 2007.

The KFTC's current priorities and ambitions are set out in its January 2006 statement of "policy goals and implementation tasks". The first general goal, to improve institutions, is to be implemented through a new approach to issues of corporate structure, encouraging voluntary resolutions of disputes, adopting more formal, transparent case decision procedures at the KFTC and strengthening international co-operation. The second general goal is to promote market competition, through anti-cartel enforcement focused on markets with direct consumer impact, more efficient merger reviews, focused

attention to potential abuses of dominance and unfair marketing practices and continued oversight of regulatory constraints on competition. The third general goal recognises the KFTC's historic concern about the situation of small businesses, encouraging both greater fairness and greater transparency in subcontracting and franchisee relationships. The last general goal highlights the new importance of consumer issues, by proposing to enhance consumer sovereignty by empowering consumers through better information and linking the dispute settlement process of the Consumer Protection Board with the KFTC's enforcement tools.

2. Substantive law

The core competition rules about restrictive agreements, dominant firms and mergers remain basically unchanged since the 2000 Report. There are some new procedures for applying them, and the KFTC's priorities are shifting. The most important changes have been in the most unusual aspect of Korea's competition jurisprudence, the oversight of conglomerates. That topic was also the subject of the most important recommendation of the 2000 Report, and the changes are generally consistent with that recommendation.

Historically, the *chaebol* regulations have taken many forms. The KFTC has designated the groups that are subject to special regulation because of their size, enforced rules governing the structure of holding companies, limited total shareholdings of other domestic companies, limited loan guarantees within a group, restricted how financial affiliates in a group could vote shares, and policed "undue" transactions within a group. The KFTC refined its approach in 2002, in part because reforms since 1997 changed *chaebol* structure and conduct. Provisions about the debt-equity ratio were dropped, while the KFTC's powers were extended to demand financial information from financial institutions concerning their customers' "undue transactions".

The ambitious "Three Year Market Reform Road Map" ("Road Map") that the KFTC issued at the end of 2003 demonstrates the continued high priority of the *chaebol* regulation function, while underscoring the progress made and the likelihood of major changes soon. A foundation of the plan is an index developed for the KFTC by the Korea Development Institute to measure transparency, fairness and competition of firms and markets in Korea. Transparency and fairness are assessed based on systems for monitoring management and corporate performance and on the gap between the "cash flow" rights and the voting rights of controlling shareholders. Competition is assessed based on industry concentration. Of the three principal sets of policy measures set out in the Road Map, the first two are devoted to issues of corporate structure and governance.

The first part of the Road Map is about changes to general corporate laws, to strengthen transparent and accountable business management by authorising class action suits about corporate and securities misconduct, strengthening auditor independence and accountability and minority shareholder rights, disclosing insiders' efforts to preserve their powers and preventing insiders from using financial affiliates to extend control. The second set of measures in the Road Map addresses the KFTC's own regulations of corporate structure, announcing changes intended to encourage the *chaebol* to adopt more transparent structures. In addition to requiring more disclosures about insider holdings and transactions, the Road Map announced revisions to the system of policing circular intra-group shareholdings while making it easier for the groups to reorganise into conventional holding companies. The KFTC's regulation of total shareholding by the *chaebol* had been introduced first in 1987, to prevent insiders from extending control and inflating capital via complicated holdings among affiliates. The regulation prohibits affiliates of large business conglomerates (those with assets over KRW 6 trillion) from acquiring shares of other domestic companies in excess of 25% of the affiliate's net assets. The Road Map promises that firms could avoid this limit by improving their corporate ownership and governance structures. One measure of improvement is adopting sound systems for shareholder voting and director oversight. Alternative criteria for earning an exemption from the shareholding limit are transforming the group structure into a holding company, simplifying its ownership (to fewer than five affiliates) or reducing the gap between voting rights and cash flow rights. The last set of proposals in the Road Map is about more familiar competition policy topics, of eliminating anti-competitive regulations, doubling sanctions against cartels, streamlining merger review, facilitating private suits in competition cases and improving consumer protection oversight.

The KFTC's plan envisioned that simpler and more transparent structures would evolve from the *chaebols'* tangled webs of intra-affiliate shareholdings. The Road Map anticipates that the ownership structures would be holding companies, although the particular form would depend on each group's characteristics. For some, loose relationships might be maintained among more independent affiliated businesses sharing the same brand name, while others might be divided into smaller business groups or even dissolved completely into independent businesses. A justification offered for the plan was that improving transparency and fairness in corporate governance and ownership would make Korea a more attractive destination for investment. In announcing it, the KFTC indicated that part of the plan was to evaluate its implementation at the end of the three year period, with a view to revising or even ending this program of direct regulation.

The promised review of the regulation of total shareholdings is underway. The KFTC and the Ministry of Finance and Economy are expected to report their findings and recommendations by the end of 2006, 3 years after the Road Map plan was proposed. The need for further KFTC oversight would depend, in part, on the capacity of corporate law and financial and securities regulators to deal with the problems that these regulations have addressed. Those capacities have expanded greatly since the crisis of the late 1990s. The KFTC notes that stronger securities market regulation and stricter observance of accounting standards might still miss some issues arising in non-listed companies, a category that includes a substantial proportion of the holdings in the principal business groups. Nonetheless, the KFTC is moving to withdraw from these responsibilities as Korea's corporate governance structure improves. The change is evident in the allocation of KFTC staff resources, where the staff that administers the regulation of cross-holdings among affiliates has been reduced to one 9-member team.

Another aspect of the KFTC's historic agenda of *chaebol* oversight, the investigation of "undue" intra-group transactions, is more closely related to conventional conceptions of competition law. It is also handled by different KFTC staff than the team that applies the regulation of cross-holdings. Subsidies in the form of transactions within a group on more favourable terms are conceived to present competition problems analogous to state aid subsidies. For example, the KFTC contends that if a firm should be liquidated according to market standards but an affiliated firm props it up, the result is anti-competitive because entrenching inefficient large firms bars entry of potentially more competitive small ones. The Supreme Court has recently underlined this connection, by requiring that KFTC enforcement decisions demonstrate how the undue transactions had an anticompetitive or unfair effect.

Horizontal cartels are now the top enforcement priority, despite the lack of a clear *per se* rule against horizontal price fixing. Changing the relevant language in Article 19 of the MRFTA in 1999, from whether a restriction is "substantial" to whether it restricts competition "unfairly", was intended to achieve a *per se* approach. The FTC's *Guidelines* about cartels contend that no market analysis of effects is needed in particular cartel cases, since cartels reduce competition inherently. Agreement is all that is needed to establish a cartel. But the Supreme Court, in a January 2005 ruling, rejected a strict *per se* rule and suggested that courts consider factors that could mitigate anticompetitive effects. The KFTC is pursuing amendments to the MRFTA to clear up this uncertainty about the scope of proof that is needed. Despite those uncertainties, the KFTC has scored several successes in price fixing and boycott cases. In two investigations in 2003, 7 major cement firms and their trade association were assessed surcharges of KRW 26 billion for conspiracy,

Box 2. The *chaebol* issue

“Competition policy attention and resources should move, over time, toward emphasising measures that are clearly related to ‘efficiency’ goals”

The 2000 Report recognised the KFTC’s longstanding position, that reducing the power of the *chaebol* and correcting the distortions of competition that have been caused by their group structures must be a high priority and that this task cannot be understood solely in terms of conventional competition policy categories. To link the *chaebol* policies with the usual conceptions of competition policy, the KFTC has contended that greater transparency will lead to broader, more stable capital and factor markets, supporting innovations in those markets that will encourage entry and adaptability in other markets. That is, correcting the problems of corporate and financial structure will lead to market behaviour that increases competition, even if the problems themselves are not usually conceived as results of particular constraints on competitive conduct.

The 2000 Report noted that it would be appropriate to continue to focus attention on intra-group transactions that may have effects on competition in markets. The KFTC observed then that close supervision of “undue” transactions was a temporary, transition tactic, to help ensure that capital markets develop and function. The 2000 Report argued that reforms of corporate governance and prudential supervision, as well as market openness, are the better means in the long run to deal with major *chaebol* issues. The analogy between “undue” intra-group transactions and anti-competitive state aid was more apt when it appeared that the *chaebol*, or some of them, would be treated as too big to fail. In the absence of implied government support for the supposed subsidies, there should be a stronger presumption that transactions will be subject to the discipline of market forces, even within a group, although controlling shareholders may nonetheless try to escape that discipline. KFTC monitoring in the absence of any such implicit guarantee is reminiscent of older styles of regulatory intervention, such as control over firms’ investment decisions and adherence to consensus price levels. Suspicious intra-group transactions may involve unfairness or something like predation, but more often the real problem is misappropriation, breach of fiduciary duty or embezzlement. KFTC enforcement actions against clearly identifiable threats to market competition are of course necessary, but actions may fail where they aim at corporate misconduct that is not actually anticompetitive.

The KFTC contends that the other aspects of its unusual enforcement agenda are consistent with reliance on markets for growth and efficiency, because transparent structures and fair competition support confidence in market transactions, thus encouraging the flow of resources into productive uses. That general “dynamic efficiency” motivation is undermined by some of the rules’ constraining effects. For example, concerns have been expressed that the ceiling on *chaebol* shareholdings (a rule that is aimed principally at curbing “circular” shareholding structures) may make

Box 2. *The chaebol issue* (cont.)

it more difficult to set up large-scale projects that require teaming substantial Korean firms as strategic investors with substantial foreign investors; however, the KFTC has not found any instances of projects that could not be done for this reason. The KFTC has also defended its attention to corporate governance and shareholding matters on the grounds that corporate, financial and securities laws and regulatory institutions were not established well enough to do the job adequately.

Opaque corporate structures needed to be cleared up, because they allowed financial leverage at a scale that undermined stability. To do that task, the KFTC was more independent and effective than the existing financial regulators. But there have been numerous reforms to improve corporate governance, financial soundness, and transparency since 1997. Other enforcement agencies, notably the Financial Supervisory Commission and the Financial Supervisory Service, which were created in 1998, are in place to deal with problems related to corporate financing. Supervisory functions related to shareholdings and guarantees and intra-group transactions that amount to misuse of corporate assets should be concentrated in regulators responsible for financial and securities matters, while transactions that have an exclusionary or distorting effect on product market competition in particular cases should still be subject to competition-law control.

Changes in the KFTC's policies and in the financial situations of the *chaebol* themselves suggest that the long run will arrive soon. Measures of financial balance have improved significantly. The KFTC is evidently stepping back from its strategy of broad dragnet investigations. The "Three-Year Market Reform Roadmap" has offered the *chaebol* incentives to improve their corporate governance practices and ownership structure. Specific criteria allow companies to graduate from the regulations on total shareholdings, and firms that improve their governance and structure will no longer be subject to special regulations.

group boycott and price fixing, and manufacturers of iron bar were assessed surcharges of KRW 79 billion for agreeing to boycott tenders in 2001 and 2002 and for price increases in early 2003. In both cases, several of the parties were also referred for criminal prosecution. In 2002, the first international cartel was caught under the MRFTA, as the KFTC imposed surcharges of KRW 9 billion on six manufacturers of graphite electrodes. These sanctions were affirmed on appeal in August 2003. Important cases in 2004 targeted prices for car batteries and apartments. In 2005, the KFTC imposed the highest surcharge to date on a single firm, KRW 115 billion, against an agreement to limit price competition between telephone companies.

The telecoms case shows the KFTC's stern view of claims about "administrative guidance". The KFTC's *Guidelines* about collective action warn

that conduct which is not legitimately taken pursuant to the authority of statutes or secondary legislation risks violating the MRFTA. The KFTC had previously taken corrective measures against agreements in beer, pesticides and property insurance that the parties had claimed were authorised by administrative guidance. A KFTC case in the 1990s, involving bathroom tissues, challenged several sequences of parallel price changes that followed administrative guidance admonishing the industry to cut prices. In the recent telecoms case, the firms claimed that guidance from the Ministry of Communications had supported their limits on price competition when reforms introduced number portability. But the KFTC rejected that excuse, finding that whatever guidance the Ministry gave was not related to their restraint. The Ministry confirmed during the KFTC's proceeding that it did not issue an instruction such as the companies were claiming. The MRFTA provides for the possibility of exemption, for agreements about industry rationalisation, research and development, restructuring, rationalisation of trading terms, responding to economic depression or enhancing competitiveness of small enterprises. But since 1999, the KFTC has not approved (that is, exempted) any cartels under this authority; some arrangements that favour small businesses are based on other legislation, discussed below. A 20% market-share threshold in the KFTC *Guidelines* provides a "rule of reason" safe-harbour for non-hard core agreements.

Resale price maintenance is generally prohibited, although limits on maximum resale prices are allowed for "justifiable reasons". The law still includes a provision for setting resale prices for publications and some other products, but this provision depends upon prior designations by the KFTC. The KFTC has designated literary works that are eligible for resale price maintenance, but it has not made the required prior designations for any other products. Most other competition issues arising in distribution are covered by the KFTC's application of MRFA Article 23 on "unfair business practices", as elaborated by enforcement guidelines issued in 2005. Those guidelines treat some kinds of conduct covered by Article 23 as restrictions on competition, and provide that such conduct will not be considered to violate the law if the party setting the restraint has a market share below 10%. This rule of thumb shows the connection between these rules and principles about abuse of market dominance. In addition, Article 23 also addresses unfair competition and taking advantage of bargaining power, that is, economic dependence.

In dealing with dominant firms and mergers, the traditional structural approach is shifting toward greater emphasis on economic analysis of particular market situations. The definition of a market dominant enterprise is general, that is, one that has the power to determine prices or terms, individually or jointly with others. Whether a firm is dominant is determined

by examining market features such as entry barriers and market share. A *de minimis* threshold prevents finding dominance for a firm with turnover in a market below KRW 1 billion. The law also includes a structural test, presuming dominance from a market share of 50% or a combined share of 75% or more for the top three firms (not including any firm whose share is below 10%). The KFTC's criteria for assessing dominance also include entry barriers, the relative sizes of firms and the possibility of collusion among them, differentiation from other products and markets, foreclosure, financial capacity and technological prospects. In cases about abuse of dominance, the KFTC has always found dominance where the market share presumptions were met. Some mergers, however, have been permitted to proceed even though the firms' market shares exceeded the threshold for dominance. In several cases, the KFTC has found joint dominance where the industry concentration fell below the level of the statutory presumption. In a step away from an overtly structural enforcement approach, though, the KFTC no longer maintains a listing of dominant firms subject to particular scrutiny. Claims about predatory low pricing are subjected to the sceptical "recoupment" test, that the predator be able to recover its losses by raising prices free from the challenge of competitive re-entry. Since 2001, denial of network access has been defined in the law as an abuse of dominance.

Box 3. Dominance and mergers

"The use of essentially the same structural standards for abuse of dominance and for mergers should be reconsidered"

The 2000 Report observed that essentially the same structural standards were used for cases of abuse of dominance and for merger analysis. But correcting an existing situation may present different issues than preventing new problems. In addition, over-reliance on market-share criteria in both settings may inhibit sensitive application of policies motivated by efficiency.

The same basic structural test is still used for cases of dominance and for mergers. The structural test for presuming a market dominant position, in Article 2(7), also supports a presumption that a merger will restrain competition. [Article 7(4)(1)(a)]. The merger control part of the law has an alternative structural criterion, presuming an adverse effect if the merging parties would have the highest share in the market and that share would be 25% greater than the next largest firm. The differences between cases about abuse and review of mergers are evidently not considered significant enough to warrant more discriminating treatment, and the KFTC finds that examining other economic characteristics of the markets at issue can support appropriate differences in dealing with these situations.

The KFTC has taken enforcement action against abuse of dominance on only a few occasions. Activity may increase in the future, as priorities shift toward greater emphasis on standard antitrust matters. A notable recent example is the 2005 decision against Microsoft for tying its media player, media service and messaging to its operating systems. The KFTC decision noted the “tipping” effect that followed from the positive network externality due to Microsoft’s very high market shares in PC and server operating systems. In addition to paying an administrative fine of KRW 32.5 billion, Microsoft must offer versions of its operating system from which the tied products are unbundled. A special team to keep abreast of emerging issues involving competition and intellectual property rights was set up in late 2005 in the wake of this complex proceeding.

Merger control is moving beyond structural presumptions. The substantive standard for merger control is whether the transaction would substantially lessen competition. The statute backs up this standard with presumptions based on market share. In practice, the structural standards are not conclusive, for the KFTC also considers the likelihood of entry and particular aspects of the market situation that affect the likelihood of a reduction of competition, either through unilateral conduct or co-ordination. The KFTC has declined to take action despite market shares above the threshold level in a market for intermediate technology components because overcapacity and the threat of foreign entry reduced the risk to competition; conversely, the KFTC has required corrective measures where shares were below the thresholds but where the circumstances and the enforcement record of the industry, steel, showed a propensity to collusion or single-firm market power. There is no provision for overriding KFTC decisions on mergers, or on anything else, based on other policies, and policies other than competition are not considered at the KFTC. Remedies may be both behavioural and structural. Responding to a combination in late 2005 that eliminated potential competition between the top brand names in beer and soju (rice wine), the KFTC imposed a hold-separate order and price controls.

The merger review system has been updated to bring Korea’s system more closely into line with merger review systems in most other member countries. Pre-notification is now required for mergers or acquisitions by a firm with assets or annual turnover in excess of KRW 2 trillion. Notification must be made within 30 days after the firms reach agreement, and the deal may not close before the KFTC finishes its review. The normal review period of 30 days can be extended up to 90 days. Post-transaction notification is required for mergers or acquisitions by a firm with total assets or annual turnover in excess of KRW 100 billion. But no notification is needed in either case if the acquired firm’s assets and or turnover are below KRW 3 billion. As of June 2003, rules about the notification of foreign acquisitions were

modified, by setting a test based on sales in Korea (of KRW 3 billion for each party) in order to distinguish those that are less likely to have effects in Korea.

Rules that protect small businesses from unfair practices, particularly in relationships with suppliers and between contractors and subcontractors, still represent a significant component of the KFTC's workload. Some of these rules are in the MRFTA itself, and some are in separate legislation, such as the Fair Franchise Transactions Act and the Fair Subcontract Transactions Act. The Subcontract Act prohibits unreasonable delays or reductions in payments and other unreasonable practices. There is a *de minimis* standard, which confirms that the principal motivation of these rules is protection of equality of bargaining positions: the rules do not apply if the contractor is no more than twice the size of the subcontractor (in terms of turnover or employees). It also does not apply to small businesses, which are defined for these purposes in terms of turnover: below KRW 1 billion for services, KRW 2 billion for manufacturing and repairs, and KRW 3 billion for construction.

The KFTC also defends consumers' interests in marketplace integrity by applying rules against unfair marketing practices and misrepresentation. That role may soon become more important. Here too, some rules are found in separate legislation, such as the Fair Labelling and Advertising Act and other statutes about door-to-door sales, instalment transactions, contracts of adhesion and electronic commerce. The 2002 law about e-commerce followed the OECD's 1999 guidelines on the subject. The KFTC is encouraging a shift away from the traditional emphasis that treats consumers as in need of government protection, toward a view that the direction of the market is determined by informed consumer choice. In addition to its own enforcement functions, the KFTC has other opportunities to advance this integration of competition and consumer policies. The KFTC is a member of the Consumer Policy Deliberative Committee, set up under the Consumer Protection Act to co-ordinate policies about consumer interests that are implemented in sectoral laws and regulations. Historically, the KFTC has collaborated with the Consumer Protection Board and NGO consumer organisations. The relationships will become even closer with the implementation of a restructuring plan that was under consideration in mid-2006. Under this plan, the KFTC would have the authority to manage and supervise the Consumer Protection Board, and it would share the "executive secretary" function for the Consumer Policy Deliberative Committee with the Ministry of Finance and Economy. The Consumer Protection Board would thus become an affiliated organisation with the KFTC. This could lead to co-ordination of both policies and enforcement tools. Claims about consumer injury, now often resolved by non-binding settlement agreements, could be backed up by KFTC sanctioning powers against violations of labelling laws or the MRFTA's provisions about unfair competition, while the Consumer Protection Board's work about

product safety could follow the KFTC's emphasis on consumer information. The Consumer Protection Board will remain a separate, independent agency, and the basic enforcement tools and responsibilities would remain in place. Smaller cases will still be handled by mediation, while the KFTC might take an initiative on larger matters with market-wide effect.

3. Institutions and enforcement processes

The KFTC is one of only a few independent agencies in the Korean government. Independent regulatory bodies deal with broadcasting and the financial sector, while the bodies responsible for energy and telecoms regulation have less autonomy from their ministries. The KFTC tends to reinforce its independence through long-term autonomy in the choice of personnel. The five full-time "standing" commissioners have usually been KFTC veterans, while the four "non-standing" commissioners have often been law or economics professors. In a variation from the traditional pattern, the current chair and his predecessor have been professors from outside the government. The overall staff level has increased substantially, from 413 in 2000 to 484 in 2005. About 25% of the staff and budget are devoted to enforcement of laws about subcontract rights, unfair contract terms and consumer protection.

The KFTC staff was reorganised in 2005 to address new priorities. As the KFTC de-emphasises *chaebol* regulation and wide-ranging investigations of their internal transactions, the antitrust, competition and investigation bureaus have been restructured into the Competition Law Enforcement Bureau and the Cartel Investigation Bureau. The needs for consistency and specialised legal and economic expertise in enforcement are addressed by the newly reinforced Litigation Team and the newly created Economic Analysis Team. Two other teams were set up for emerging competition issues and advocacy. The OECD Regional Centre for Competition in Seoul, operated in conjunction with the KFTC, could be a resource for improving staff analytic skills.

Most competition complaints to the KFTC are about abuse of dominance and refusal to deal (although the largest share of total complaints is about unfair practices), but most of the enforcement attention has gone to collusion and, until recently, to *chaebol* issues. The targets of the KFTC's priority-setting "clean markets" project have been mostly in services. In 2001, the industries chosen were telecoms and broadband internet service, medical services and pharmaceuticals, wedding and funeral services, construction materials and apartment and office rents, media, and school uniforms and private institutions. In 2002, they were LNG-LPG, credit cards and insurance (other than life insurance), internet shopping, real estate agents and home

maintenance services, job referral, and private instruction institutions. And in 2003, similarly, the targets were electric power, instalment finance and banking, internet shopping, real estate services, advertising, and professional certification. The “clean markets” campaigns produced a surge in complaints, which tripled between 2000 and 2001, from 1 576 to 4 791. The number of matters resulting in financial sanctions also increased, although not as dramatically. The total sanctions imposed has varied greatly, from KRW 225 billion in 2000 to KRW 36 billion in 2004 and then back up to KRW 249 billion in 2005. One reason for the lower total in 2004 was that the KFTC shifted enforcement attention toward firms that deal directly with consumers, which are often smaller, while the telecoms price fixing case explains much of the higher total in 2005. Over the period 2000-2004, about 10% of the KFTC’s enforcement actions stronger than a warning were against concerted practices, that is, on average about 40 out of an annual total of about 420. A much larger proportion, over 180 annually, dealt with “unfair business practices”, which can include refusal to deal, elimination of competitors, coercion and resale price maintenance, as well as “undue” support. But in the aggregate, the financial penalties have usually been concentrated on cartels. Surcharges against concerted practices in this period averaged about KRW 83 billion annually, about twice the total against “unfair business practices” at about KRW 42 billion. In 2001, though, the total against unfair practices and undue support, of KRW 121 billion, was substantially more than the total against cartels, of KRW 24 billion. The number of cases about labelling, advertising, contracts and subcontracting is nearly 6 times greater, averaging about 2 350 per year, but the sanctions imposed are usually insignificant. In 2002, though, sanctions against advertising and labelling violations totalled KRW 5 billion.

Notices and guidelines explain the KFTC’s policies and analytic methods. Subjects addressed include abuse of dominance, cartels, approval of concerted actions, unfair practices generally, undue supportive behaviour, unfair practices concerning gifts and large retail stores and newspaper business. They are published and posted on the KFTC website. Most are available only in Korean. Decision documents are to be issued within 20 days, and they are posted on the KFTC website. The KFTC is moving toward a more transparent process for preparing decisions. A “deliberation preparation process” has been instituted, to give staff and the respondents the opportunity to contest each others’ arguments and evidence (in writing) in advance of any formal hearing at the Commission.

The KFTC’s investigative powers still need to be strengthened, to target conduct that parties would prefer to conceal. Difficulties have been encountered in investigations of cartels and of compliance with *chaebol* regulations. The sanction for non-compliance with investigation is an

administrative fine. Although stronger sanctions can now be applied to discipline non-compliance with orders and investigations, the basic information gathering powers remain ones that were originally designed for voluntary processes. The KFTC cannot perform a “dawn raid” to search premises and take possession of evidence. Administrative law enforcement bodies that deal with labour, tariff, environment, and tax compliance have such powers, as does the prosecutor. To make the KFTC’s administrative enforcement more effective and obviate the need to resort to criminal processes for inappropriate reasons, the KFTC needs such compulsory investigative powers.

Box 4. Investigation powers

“The KFTC’s powers to obtain information in investigations may need to be strengthened, so there is less need to refer small matters for criminal prosecution”

The 2000 Report noted that measures that might be considered could include the power to seek a court order for access to documents or information.

So far, the only concrete step was to authorise higher fines to punish non-compliance with administrative orders and processes. The amendments to the MRFTA in 2001 raised the maximum fine for this from KRW 10 million to KRW 50 million for an individual, and from KRW 100 million to KRW 200 million for a corporation. It is not clear that this step has made very much difference yet in practice, though. On 3 occasions in 2003, after this increase, firms decided to pay the fine rather than comply with the process.

A leniency program has been in place since 1997. The leniency program was refined in 2005, to make clear the promise of complete leniency for the first party to come in (and 30% off the surcharge for the second). A regulation assures applicants of confidential treatment. The program now includes “amnesty plus”, an additional benefit for revealing another cartel, and a “marker” system to encourage rapid action. The improvements produced immediate results. The KFTC had received 7 applications between 1999 and 2004 under the previous programs, but 11 cases were treated with leniency in 2005 after the changes became effective. The recent telecoms case followed a leniency application, which led to a 49% reduction in the surcharge that would have applied. So far, the leniency program has promised reductions in administrative fines and corrective measures. Proposed amendments to the MRFTA would offer a reduction of criminal penalty as an additional incentive. In addition to the prospect of a lower surcharge for the corporation, the KFTC program has a “whistleblower” component, offering a positive inducement to

encourage individuals to come forward. Similar rewards to informants are found in other areas of law enforcement in Korea. An informant can be paid a proportion of the surcharges that are eventually assessed. This program too was not very successful when it was first launched in 2002. With a low reward and little protection of the informant's identity, it produced only about one lead per year. In November 2003, the ceiling on the bounty was increased to KRW 100 million, and up to KRW 1 billion for information about cartels. Measures were also introduced to protect informants' identities. These changes led to a record reward in case about welding rods, another case about internet cafes and several matters that are still under investigation. These "whistleblower" rewards are available not just for cartel cases, but also for other parts of the KFTC enforcement agenda, including unfair competition issues involving department stores and newspaper discounts.

Another innovative detection tool is the Bid Rigging Indicator Analysis System, which the KFTC set up at the end of 2005 to uncover cases of collusion in procurement. The KFTC obtains information about public bidding processes from the national procurement office's electronic bidding systems. The KFTC focuses on tenders for construction contracts worth over KRW 5 billion and tenders for products or services worth over KRW 2.5 billion. It analyses six criteria, including the ratio of the winning bid to the estimate, the number of bids, any pattern of unsuccessful bids and the number of failed bids transferred to private contracts. Some cases are already under investigation. To introduce the BRIAS system, the KFTC presented a briefing about the program to about 100 procurement office officials.

A program to encourage firms to adopt formal compliance programs was introduced in 2001. The KFTC enlisted a Committee on Compliance for Fair Trade, led by the chairman of the Korea Chamber of Commerce and composed of business and academic representatives, to help plan and publicise this program. As an inducement and incentive for firms to establish compliance programs, the KFTC promises that their surcharges will be reduced by up to 20% (and up to 40% if they also correct the violation themselves) and that complaints against them will not be filed with the prosecutor; however, having a compliance program is not considered a mitigating factor in hard-core cases. Over 250 firms set up programs by the end of 2005.

Corrective measures can include orders to take specified actions, such as to initiate a transaction or terminate an agreement, as well as orders to cease violations. Orders can also require notification to the public or customers and reporting to the KFTC. The KFTC issued a guideline in November 2005 setting out its policies for employing these corrective measures. An obvious application of an order for specific performance would be in a dispute about denial of access to a network or essential facility.

The basis for computing administrative fines, or “surcharges”, was expanded in 1999. That change, combined with stepped up enforcement, greatly increased the sanctions actually imposed against competition violations. Yet provisions for financial sanctions were still less stringent than in most other member countries. The ceiling on the administrative fine was 5% of turnover (the annual average total turnover over the previous 3 years) or a minimum of KRW 1 billion, and the level actually imposed was typically about 2.5% to 3.5% of turnover. The amendments that took effect in 2005 doubled the ceiling for cartel fines, while changing the basis to the turnover affected by the violation. The basic surcharge level against cartels in Korea, 10% of turnover affected by the violation, is now similar to the newly revised basic surcharge level in Japan; however, in Korea the KFTC has some discretion in setting the actual surcharge imposed. That discretion is subject to guidelines that make the computation transparent. The 10% multiplier is comparable now to that used in most of Europe, but the resulting sanction may not be as stringent because the base could be smaller. Thus even the new level in Korea could still result in fines that are effectively lower than those in countries where sanctions are a percentage of total firm turnover, not just the turnover related to the violation. The surcharge can be increased up to 50% for repeat offences. Repeat offences are an increasing problem, as half of the complaints to the KFTC in 2004 were about non-compliance with KFTC corrective measures. The KFTC is finding it necessary to follow up, evidently because sanctions have not been fully effective.

Criminal sanctions are available but are still rarely applied. Individual executives may face criminal punishment in Korea for antitrust violations. In case of a violation by a trade association, surcharges can be imposed on the members who participated in them. Individuals who are managing directors or executives can be held criminally responsible for violations by their firms. A recommendation from the KFTC is generally required to initiate a prosecution. The Ministry of Justice has proposed that its prosecutors have the power to initiate competition cases on their own. The KFTC has been concerned that prosecutions applying a purely criminal law perspective, without its economic input, could impair competition. The Ministry of Justice, on the other hand, has resisted giving the KFTC stronger investigative powers as long as the KFTC has a monopoly on initiating prosecutions.

The courts’ reluctance to support stiff sanctions against business violations and white-collar crimes may be changing. Since 2000, sentences of imprisonment have been imposed in 6 competition cases, but in 5 of these cases the sentence was suspended, and in the other, the court suspended service of the imprisonment. No one has yet spent any time in jail for violating the competition law. The prosecutors, conceiving of cartels as economic crimes, did not demand high fines. That history has become an issue of public debate. The Minister of Justice and the Chief Justice of the Supreme Court both

called attention to the lower courts' unwillingness to impose heavy white-collar sentences. In the judiciary's non-binding guidelines about sentencing, the ceiling on penalties for white-collar crimes has been raised.

Judicial familiarity with economic issues is improving, but a proposed procedural reform may interrupt that progress. Appeal from decisions of

Box 5. Private actions and lawyer quotas

"Strengthening rights of private action should be considered"

To apply more resources and expand the base of support for competition policy, the 2000 Report concluded that strengthening rights of private action should be considered, taking into account the characteristics of Korea's legal system. Measures could include easing the proof of damages in competition cases or facilitating consumer and customer recoveries in price-fixing cases. The quota on new lawyers should be eliminated.

Private suits for damages, following KFTC enforcement, were already possible under the MRFTA. Plaintiffs can also claim damages under the general provisions of the Civil Code, but in Civil Code suits the plaintiffs have the burden of showing intent or negligence. In private cases following KFTC action under the MRFTA, the defendants have the burden of showing the absence of intent or negligence. In 2004, the MRFTA was amended to permit private actions for damages without waiting for the KFTC's final decision. Another aspect of the amendment's effort to make private actions more attractive was to overcome the courts' insistence on detailed proof of the amount of damage. As of 2004, there had been about 30 private cases claiming damages, and the plaintiffs had apparently gotten some relief in about half of them. A recent and prominent example followed the KFTC's case imposing surcharges of KRW 11.5 billion for fixing prices of school uniforms, and recommending prosecution as well. About 3 500 customers filed lawsuits, and damages were awarded in June 2005. Outside of the area of competition violations, some big private suits have been filed to recover consumer damages in e-commerce.

Private actions for injunctive relief are not yet provided, but the KFTC is considering amendments to the MRFTA that would do so. Another, indirect avenue for relief is available, at least in theory: if the KFTC has declined to initiate a case or has decided there was no violation, this can be the subject of a complaint in the Constitutional Court. The 2000 Report observed that creating a general right to challenge KFTC inaction in the ordinary courts, though, could require a more significant change in Korean law.

The legal profession is being allowed to expand. The ceiling on the number of new lawyers admitted each year was raised from 300 to 1 000, and a plan is under consideration to open a law school in 2008 to provide an alternative means of entering the profession.

the KFTC can be taken to the Seoul Regional High Court, with a further appeal possible to the Supreme Court. (There is also a provision for an internal appeal at the KFTC, which results in re-examination by the General Counsel and a consideration by the full Commission, but that step is not a prerequisite to an appeal to the courts.) Two special 3-judge panels of the Seoul High Court specialise in KFTC cases. Judicial capacity to deal with economic issues is improving as the subject is becoming more familiar, in practice and in legal education. The Seoul High Court can retain its own economic expert, and it has done so on occasion. The Supreme Court has added an antitrust expert as a research counsel. Pending legislation would change the process for appeal from KFTC decisions to make it conform more closely to the usual steps for judicial review of government agency decisions. Under the usual system, the first judicial step is the administrative division of the district court, as a court of first instance. Under the proposed legislation, the first step for appeals from KFTC decisions would be to the separate Seoul Administrative Court as a court of first instance, with further appeal to the Seoul High Court. The proposed change, although consistent with the usual administrative appeal process, would give up the concentration of expertise that has developed at the Seoul High Court. The usual review process is reasonably efficient. The administrative division of the district court finishes half of its cases in 6 months. The High Court handles most appeals in 6 months to a year. At the Supreme Court, most administrative cases are completed within 6 months, but competition cases often take up to 2 years. That period is expected to decline as the Supreme Court strengthens its capacity for these cases. The rules provide for a “fast track” for some important matters. The number of administrative cases increased 30%, to 12 000, between 1998 and 2004, but the greater workload did not slow down the process significantly.

4. Coverage, sector regulation and policy advocacy

The scope of exemptions from competition law is now limited. Government entities are subject to the same rules as private enterprises. This equal treatment applies to *chaebol* regulation too, as large government-related entities have been designated as groups whose transactions are regulated, and the KFTC fined several of them for undue transactions and abuse in relationships with contractors. Claims that anti-competitive conduct is authorised by official action are treated sceptically. Conduct following discretionary administrative guidance that is not backed explicitly by statute is not exempted from the MRFTA.

Some sectors are still protected or controlled to some extent. Liner shipping conferences are exempted by special legislation on the grounds that they are “internationally recognised” cartels. Minimum resale price maintenance, which is normally prohibited *per se*, is permitted for literary works. Collaboration is permitted through producer co-operatives in agriculture and forestry, and through contracts between ginseng farmers and processors, in order to strengthen the negotiating position of atomised producers. Other protections have been eased. Tobacco production is subject to a permit system, which replaced the state monopoly in 2001, and prices are no longer subject to government approval, although they must be reported to the government in advance. Some agreements that are exempted from the MRFTA, because they have little competitive impact or even a net economic benefit, include joint establishment of telecoms facilities by key providers and joint purchase and allocation of equipment in maritime transport.

Most remaining exemptions were eliminated by the Omnibus Cartel Repeal Act of 1999. For example, this law revised a provision allowing premium-fixing by insurance companies, limited co-ordination directives to cases of compliance with inter-governmental agreements or export of military equipment, and abolished government co-ordination of bidding competition for overseas construction projects and territorial allocation of unsterilised rice wine. The law ended fee-setting arrangements for a number of professional services: lawyers, certified public accountants, architects, certified tax accountants, patent attorneys, customs brokers, certified labour services, administrative recorders and veterinarians. Previously, professional associations would set fees, which would then be approved by the relevant ministries. After this practice became illegal, the KFTC reported that fees declined significantly in the affected sectors. But some professions resisted the changes and even succeeded in having them reversed. The restriction on fee-setting for architects was reintroduced in 2001, although it takes the form of direct notification by the government rather than delegation of the power to the professional association. For notaries and engineers, too, fees are set by regulation rather than by market competition. In 2003, five professional services (lawyers, certified public accountants, architects, certified tax accountants, and judicial recorders) were included in the KFTC’s Clean Market Project for close scrutiny, following enforcement action against some associations, including the certified public accountants, and a KFTC inquiry into professional fees which revealed that liberalisation had not reduced overall fee levels, though it had led to more differentiation based on the type of service.

Eliminating competition constraints in professions and services remains a challenge. The number of new lawyers permitted to enter each year has risen from 300 to 1 000. New forms of practice are now authorised, for

domestic lawyers. Restraints on lawyers' advertising were relaxed. A law school is planned, but it will not open until 2008 or 2009. Decisions yet to be made by the Ministry of Justice about the size of the eventual graduating class from that school will have an effect on any decisions to lift further the ceiling on the number of new lawyers. Proposals to make it easier for foreign lawyers to provide services to clients in Korea, by setting up branch offices, forming joint ventures with Korean firms or employing Korean or foreign lawyers, remain under study. The law restricting operation of pharmacies to pharmacists operating as natural persons was struck down by the Constitutional Court, so the legislature is considering permitting pharmacies in corporate form; however, permitting a pharmacist to operate more than one pharmacy and permitting corporations not composed of pharmacists to operate pharmacies are not being considered.

Other regulators are involved in the network industries, where the KFTC also can apply the competition law. About some subjects, including mergers, business transfers, and access to essential facilities, the relevant ministry and the KFTC are required to consult in order to avoid potential conflicts. The KFTC has not invoked the "essential facilities" doctrine to decide access disputes. In practice, the KFTC and ministries have shared responsibility, with the KFTC accountable for competition issues and the ministries accountable for technology issues. The Financial Supervisory Commission shares responsibility for handling mergers in the industries it covers. It would normally heed any KFTC objections on competition grounds, but it not required to accept the KFTC's views. Although relations among the regulators have generally been smooth, there have been some tensions, which can expose companies to uncertainty. For example, in insurance, where the Financial Supervisory Commission was concerned that excess competition would undermine financial soundness, the KFTC warned that co-ordinating marketing of offers of free services would amount to an illegal cartel. In cable television, the Korean Broadcasting Commission encourages mergers to monopoly within service territories to achieve economies of scale, but the KFTC, concerned about regional market power, has imposed conditions such as information disclosures and limits on price increases.

In telecoms, the most prominent competition matter was the 2005 price fixing cases. Much of the KFTC's other enforcement action in the telecom sector has been *chaebol* regulation. Among the 36 enforcement actions that the KFTC took here between 2003 to 2005 were surcharges of KRW 640 million against LG Telecom for coercing or inducing customers of competitors, KRW 5.1 billion against SK Telecom for undue support for its affiliates, and KRW 740 million against KT for violating the limit on shareholding in other domestic companies. The KFTC and the Ministry of Communications entered a Memorandum of Understanding in March 2001, to ensure that overlapping

jurisdiction would not lead to dual penalties. That is, if the Ministry imposes a fine in applying telecoms regulation, the KFTC cannot act in the same matter. For example, in 2005 the KFTC investigated whether mobile carriers had prevented their subscribers from accessing competing portal sites over wireless internet, but ultimately it took no action because the Korea Communications Commission had already determined this to be a violation of the anti-discrimination rules in the telecoms law. The memorandum of understanding focuses on access to essential facilities, recognising that for this issue the telecommunications legislation takes precedence over the competition law and providing that the authorities will consult to prevent overlapping regulation. For other issues, the memorandum of understanding calls for discussion. In the price fixing cases, the KFTC rejected the firms' claims that the Ministry's guidance excused their conduct.

In electric power and gas, regulation has had less to do with competition law, though, because there is still little competition in these sectors. A 9-member regulatory commission for electric power was established in 2001, but because the extent of liberalisation remains limited, it is occupied principally with standard issues of public utility regulation of prices in a market that is still dominated by the historic monopoly, KEPCO. The generation function has been separated, but further reform in distribution and sales has stalled, partly because of concerns raised by events such as the California crisis. KEPCO divided itself into independent business units. These six KEPCO parts compete in the wholesale market, accounting for 90% of it. In addition, there are 59 other power generation companies, most of them co-generators or relying on new or renewable energy sources. Their production is mostly sold to KEPCO for transmission and retail sale, although there are some sales into the wholesale pool, and local sales have been possible in some districts since 2004. In theory, customers could purchase directly from generators, but only in excess of a high threshold, and there have been no such purchases yet. Thus the regulator has had no occasion to set a transmission tariff or handle disputes about access to the network. There is no retail price competition. A reduction in the outage rate over the last 3 years is some indication that these modest structural reforms have improved productivity and efficiency. The Ministry of Commerce, Industry and Energy is studying the post-separation performance to identify improvements in competitiveness and financial health. But a consultant's study of further structural reform in distribution, carried out pursuant to a joint labour-management-government consultation, concluded that the risks outweighed the likely benefits, so further reforms are likely to be limited. A privatisation proposal 3 years ago did not proceed because of adverse market conditions. Continued delay in privatisation is probably due chiefly to commercial factors.

Box 6. Small business protections

“Eliminate protectionist measures that prevent potentially efficient competition in sectors reserved for ‘small’ business”

Such measures include rules that prevent entry, that reserve some aspects of government procurement to cartels of small businesses and that apply stricter structural tests to discourage large firms from acquisitions in the protected “small business” sectors.

The most significant of these prevents entry by larger firms in as many as 88 business lines. The Regulatory Reform Council decided in 2000 to reduce the number of protected small business sectors to 45 in 2001 and to 0 by 2004. The government’s target now, under legislation adopted at the end of 2004, is to complete that process by 2007. Of the reserved sectors, 27 out of the remaining 45 were opened as of the end of 2005, and the remaining 18 are to be opened by the end of 2006.

The procurement cartel system may have a more limited effect on competition, since it does not prevent buyers from seeking sources other than the cartel, and permitting a degree of co-ordination among very small firms could help them achieve some efficiencies. The 1999 Omnibus Cartel Repeal Act as drafted planned to reduce the “collective free contract” system by 40% in 2000 and another 20% thereafter. But the legislature intervened and by an overwhelming vote eliminated the second stage. Nonetheless, the government still intends to eliminate this program by 2007, and the necessary legislation to do so was adopted in 2004.

The rule discouraging large-firm acquisitions in sectors dominated by small businesses is still in the MRFTA, and there is evidently no plan to eliminate it. An acquisition by a large company of a firm with more than a 5% share of a market that is otherwise dominated by small businesses (that is, one in which small businesses account for more than two-thirds of the market) is presumed to restrict competition. This provision has never actually been invoked, but the KFTC believes that it retains some symbolic value as a protection of small firms against economic power.

Some special subcontracting requirements were not identified in the 2000 Report. For about 22 sectors and about 800 items, in the shipbuilding, automotive and electric equipment industries, large firms are required to outsource. This regulation dates from the heavy industry era, when it represented a deliberate effort to build up a parts business. It may not be significant any more. The government wants to repeal these rules, while the small business association wants the repeal period to be stretched out.

The government would like to privatise at least some parts of KEPCO to create a yardstick and encourage private participation in the market.

Natural gas monopolies are being phased out gradually. Most gas supply is imported LNG, and most demand (60%) is for households. There are

four terminals, three of them owned by the historic monopolist, KOGAS, and one by POSCO. Legislation is in preparation to provide for third party access. In the meantime, POSCO has negotiated pipeline access to transport gas it has imported for its own account. Competition issues in this industry would be covered by the MRFTA.

The KFTC continues to be vigilant against anti-competitive regulation, reviewing about 400 items per year and submitting opinions concerning about 40 of them. The framework legislation about regulatory quality mandates competition review as part of regulatory impact analysis. The KFTC chairman is a member of the Regulatory Reform Committee, and senior staff are on its subcommittees. This process has been reasonably successful, but the KFTC continues to identify items for improvement. The 2003 round of review identified 174 regulations requiring attention, of which about half ended up being eliminated or significantly improved, through consultations with the agencies involved. In 2005, the KFTC reports agreements to eliminate or improve another 48 regulations.

5. Assessment

The 2000 Report concluded that commitment to market principles at the highest political levels in Korea provided strong support for competition policies, for reforms of the financial sector and corporate governance and for opening markets to trade and lowering barriers to foreign investment. Korea had shown it was willing to rely on the market rather than the government to correct business failures. But the commitment was not equally strong everywhere. Policy implementation sometimes appeared still to resort to central controls, while industry reportedly received instructions through administrative guidance, which was typically unwritten.

The 2000 Report noted the prominence of Korea's determined and proactive competition policy institutions to underpin the consistency and sustainability of market-oriented policies. It described how the KFTC had become stronger and more active, imposing higher sanctions and turning to more sophisticated and difficult competition enforcement problems. Further experience has confirmed these basic strengths and directions. The KFTC has exemplified strong independence in vigorously pursuing its reform plan despite opposition from the *chaebols*. Expert observers in Korea give the KFTC high marks for intensity and commitment. The recent reorganisation, with performance and results oriented management, encourages vigorous enforcement action.

The principal recommendation of the 2000 Report was for the KFTC to shift its priorities and resources toward core competition problems related to efficiency goals and away from its historic focus on conglomerate

financial structure and governance. The Annual Survey repeated this recommendation, emphasising more explicitly that financial and corporate affairs which do not have clear competition impacts should be handled by other laws and regulators. The KFTC's 2006 Policy Goals show that this shift is well underway. The KFTC's first goal for 2006 is to examine the results of its 3-Year Market Reform Roadmap and decide what, if any, new structure might be needed when those reforms are completed. This wrap-up is likely to conclude with a substantial retrenchment in this area of KFTC activity. The KFTC's other announced goals confirm that it is concentrating on more effective application of competition laws to improve efficiency and promote consumer interests.

The KFTC is examining its case handling and "hearing" procedures, to make its enforcement process more effective and also more transparent. Doubling the level of the basic administrative fine against cartels shows support for stronger sanctions. The broader sanction powers are now being tested, and it remains to be seen whether they will be strong enough to deter. The Annual Survey also called for better deterrence through such measures as credible sanctions against individuals.

To encourage the courts to support stronger enforcement against hard-core horizontal cartels, it should be clear that they are prohibited without regard to claims about their supposed lack of significant effect in particular cases. The courts' reluctance to support a *per se* rule against horizontal cartels may be related to the increasing sanctions that would apply to them, and their reluctance to impose significant criminal sanctions may be related to uncertainty about how to characterise and treat this conduct. The amendment in 1999, which was intended to specify the *per se* treatment of horizontal price fixing, did not achieve that result. In law enforcement, the competition authority and the courts need to establish clearly a *per se* rule against hard-core horizontal cartels.

As economic analysis of markets has become a more important element of KFTC decisions, the recommendation in the 2000 Report about uncritically using the same structural tests for mergers and abuse of dominance cases may no longer be very relevant. KFTC decisions often refer to analytical factors other than market share, and some merger decisions have declined to follow the usual market share presumptions. Some remedies in merger cases appear analytically awkward, though. Where sectoral regulation uses market share to identify something akin to "dominance", it is too tempting to use the same market share level as a benchmark for a merger order, without analysing whether capping shares might actually inhibit desirable competition rather than promote it. Requiring merged parties to maintain or limit their post-merger prices sends a confusing signal, too. Regulators may see nothing wrong with telling

competitors to constrain their pricing if the KFTC's orders themselves constrain pricing freedom. It is important that the KFTC explain clearly how such rulings are expected actually to improve post-merger competitive conditions in the markets affected. The KFTC's encouragement of company "compliance" programs also sends a confusing signal about incentives. A firm should expect lower penalties, not because the KFTC will hold off when it is nonetheless caught violating the law, but through the reduced likelihood that there will be any violation to catch. The KFTC does not extend this promise to hard-core matters, and perhaps the inducement is intended to soften the edge of the remaining regulation about *chaebol* issues and to provide a margin of flexibility about complex monopolisation problems.

Stronger KFTC investigative powers, as recommended in the 2000 Report, have been implemented only in part. Raising the administrative fine turned out not to be enough to get firms to provide sensitive information. Even after the increase, firms on several occasions decided that it was cost-effective from their perspective to pay the fine instead of comply. The KFTC needs the power to examine and copy evidence about possible MRFTA violations, that is, to conduct a so-called "dawn raid". More use of criminal sanctions in hard-core cartel cases, to make the threat of individual liability more realistic, depends on co-operation with the prosecutors. The terms of the MRFTA do not limit the application of criminal sanctions to hard-core cartel behaviour. Thus, to avoid excessive and inappropriate extension of criminal sanctions to other anti-competitive practices, the KFTC decides which cases to refer for prosecution. Refinement of the MRFTA provisions about criminal violations could facilitate co-operation with the prosecutors and thus strengthen enforcement against hard-core cartels.

The recommendation from the 2000 Report to consider means of strengthening private suits has borne fruit, in measures to permit suits before KFTC action is completed and to facilitate proof of damages. Permitting private litigants to sue to obtain orders, as well as damages, is under study. Whether this will be a sound idea could depend on the capacities of the courts that will hear these suits. Proposals to change the system of judicial oversight of competition cases, to make it consistent with the administrative court review of ministry actions, could be a setback for sound policy, though. The independent KFTC is more like an adjudicatory body or first-instance court than a Ministry administrator. More importantly, the change would require recreating the Seoul High Court's accumulated experience and perspective about competition matters in the administrative courts.

The Annual Survey examined competition policy and sector regulation, while other chapters of the 2000 Report dealt with telecommunications,

which is also being reviewed in this monitoring process, and electric power, which is not. The Annual Survey noted that the conflict between industrial development and competition, which still exists in the ministries responsible for network industries, should be resolved by the establishment of sectoral regulators that are independent of ministries. This process should continue by removing remaining entry barriers and further increasing openness to international trade and investment. Setting up a sector regulator in telecoms has not ended all controversy, although the Memorandum of Understanding with the Ministry has cleared up many issues. In the most recent high-profile case, what was at stake was not the conceptually complex issue of network access and pricing, but agreements to stabilise prices among competitors vying for market position in new competitive circumstances. The claims, which the KFTC rejected, that ministry guidance should excuse this conduct reveals a continuing gap in appreciation about the roles of government direction, including administrative guidance, and competitive initiative.

Programs to protect small businesses from competition were the principal subject of the recommendations in the 2000 Report about the coverage of competition law. Decisions have been taken, and necessary legislation adopted, to eliminate the most important of these programs by 2007. It is important to follow through. The legislature's intervention to derail the government's repeal plans in the last round demonstrates that it is not over until it is over. One special rule will remain in place, and it too should be repealed. The protectionist presumption against large firm acquisitions in markets dominated by small business has never been used. Justifications offered for this moribund rule include preventing the spread of "monopoly" by the entry of firms that are more efficient than the incumbent small businesses, and preventing the *chaebol* from expanding their business areas "indiscriminately". These explanations are patronising and even anti-competitive. The KFTC may have felt that retaining the presumption had some symbolic value, in preserving the image of protecting the weak against the powerful. It would be better, though, to permit open competition on the merits of efficiency. If large firms would indeed be less efficient in these markets, they would not enter or they would tend to fail if they tried. Meanwhile the prospect of entry could encourage smaller scale firms to adopt more efficient methods and organisation, while the prospect of acquisition by a larger firm could increase their value and improve their access to financing. The KFTC may review this rule in the course of its next project for improving the MRFTA.

Some anti-competitive constraints still apply in some professions. The 2000 Report called for eliminating quantitative limits on entry into the legal profession, in part in order to supply the expertise to make the right of

private action more useful. The cap has been raised but not lifted entirely. In addition, alternative means for entering the profession through law school are being pursued too. These are steps in the right direction, but they have not yet eliminated the reason for concern. It may be years before their effect will be felt in the professional services marketplace.

In assessing the impact of proposed regulations, the Regulatory Reform Commission pays particular attention to those that would explicitly restrain competition. But regulations that do not on their face restrain competition can nonetheless have a net anticompetitive effect. The OECD is preparing a draft manual for the analysis of the competitive impact of regulations, to be used in RIA programmes. The KFTC, which has long been active in advocating reform of anti-competitive regulations, could help establish a stronger foundation for the process of regulatory impact analysis generally in Korea by assisting in the final development of this manual. A “field test” by the KFTC could demonstrate how its methods apply to actual regulatory problems. In the process, other officials responsible for RIA could also learn more about the importance of identifying and correcting competition problems in regulatory proposals.

Joining the KFTC to the system for applying consumer law is a logical and valuable evolution of its role. Business representatives support stronger consumer protection; however, they have expressed some anxiety that the KFTC could use this role as a new outlet for attacking big business, now that its *chaebol*-regulation function may be winding down. Integration can make consumer policy more consistent with market competition and make competition policy more sensitive to effects on consumers. Competition and consumer policies are each concerned with making markets work well, not only to support competitiveness and efficiency but also to promote economic justice by securing opportunities for both producers and consumers.

Implementation of Recommendations from 2000 Report

Recommendation of 2000 Report	Actions taken	Assessment and recommendations
<i>Competition policy attention and resources should move, over time, toward emphasising measures that are clearly related to "efficiency" goals.</i>	Reorganisation of the KFTC staff targets horizontal cartels and expands economic analysis capacity; the "three-year market reform road map" promises to reduce the priority of the non-competition aspects of <i>chaebol</i> regulation.	The KFTC is shifting priorities as recommended.
<i>The use of essentially the same structural standards for abuse of dominance and for mergers should be reconsidered.</i>	The law is unchanged; decisions about mergers show flexibility in use of structural presumptions.	The evolution of more sophisticated analysis and decision practice makes it less important to revise the statutory language.
<i>The KFTC's powers to obtain information in investigations may need to be strengthened, so there is less need to refer small matters for criminal prosecution.</i>	Administrative fines were increased.	"Dawn raid" power is still needed.
<i>[Annual Survey] Make the threat of individual sanctions more credible to ensure that it is an effective deterrent.</i>	Criminal penalties are applied, lightly.	More use of criminal sanctions depends on co-operation with the prosecutors.
<i>Strengthening rights of private action should be considered.</i>	Amendments have permitted suits without waiting for the KFTC action and made proof of damages easier.	Adding private rights to seek injunctions could be considered, provided the courts hearing the cases have the capacity to reject abusive or frivolous suits.
<i>Eliminate protectionist measures that prevent potentially efficient competition in sectors reserved for "small" business.</i>	Most programs are to be repealed by the end of 2006.	The unused presumption that discourages large-firm acquisitions in "small business" sectors should be repealed too.

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