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Introduction of Leniency Programs for Cartel Participants: The Russian Case

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I. INTRODUCTION

Collusion of market participants is one of the most dangerous forms of restriction of competition, adversely affecting incentives and, as a consequence, allocation and production efficiencies. According to some estimates, the average price rise under price-fixing is 10 percent²; several studies give even higher estimates. For example, according to Connor & Bolotova, the median cartel overcharge over the competitive price is 25 percent, and for an international cartel—32 percent. A similar premium set by a cartel operating on the domestic market is 18 percent. In their heyday cartels set bonuses twice the median value.³ Authors of a study covering about 395 cases of cartelization in the period from the 18th to the early 21st century, report an average price bonus of 19 percent, and a median of 16 percent.⁴

It is no accident that a price-fixing agreement qualifies as one of the most serious violations of antitrust laws and is prohibited *per se*. One of the important prerequisites for a price-fixing agreement is trust among the parties;⁵ that is why trust-busting is not a bad thing in this case. Leniency programs are a way to destroy and prevent cartel agreements through the trust-busting among their participants—existing or potential. Similar programs exist in many countries.

The Russian practice of introducing a leniency program is of interest because it reflects experiences of other countries as well as the mistakes made while designing the program. Evaluating the program is complicated by the fact that, in Russia, its introduction coincided with the fundamental restructuring of antitrust legislation, substantial tightening of penalties for the

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² U.S. Sentencing Guidelines (2R1.1, Application note 3) - www.ussc.gov/2006guid/gl2006.pdf.

³ J.M. Connor & C.G. Helmers, *Statistics on Modern Private International Cartels, 1990-2005*, AAI (www.antitrustinstitute.org/recent2/567.pdf); J. M. Connor & R. Lande, *How High Do Cartel Raise Prices? Implications for Reforms of Sentencing Guidelines*, American Antitrust Institute Working Paper 04-01, (April, 2005) (www.antitrustinstitute.org/recent2/342.pdf); J. M. Connor, *Price-fixing Overcharges: Legal and Economic Evidence*, Staff Paper 04-17, Purdue University, (2005). (http://www.agecon.purdue.edu/staff/connor/papers/PRICE%20FIXING_OVERCHARGES_FULL_TEXT_8-20-05.pdf).

⁴ Y. Bolotova & J.M. Connor, *Factors influencing the magnitude of cartel overcharges: an empirical analysis of food-industry cartels*, 23(1) AGRIBUSINESS, pp. 17-33 (2007).

⁵ Harrington, *How do cartels operate*, Foundations and Trends in Microeconomics 2(1), pp. 1-105 (2006).

violations, and emergence of new norms. In this article we examine the history of changes to the norms governing the exemption from liability for participating in cartel agreements (Section 2) and the characteristics of competition policy in Russia, which objectively hinder the effectiveness of the program (Section 3).

II. TWO LENIENCY PROGRAM MODELS

Federal Law № 45 "On Amendments to the Russian Federation Code of Administrative Offences," which came into force in May 2007, introduced a substantial tightening of penalties for violation of antitrust law.

First, turnover penalties were introduced for abuse of dominance and participation in collusion and concerted practices. The former administrative penalties had a maximum amount corresponding to about EUR 12-13,000, or U.S. \$18,000, and did not provide a sufficient level of deterrence for potential offenders. With the change, offenders can now be charged with turnover fines ranging from 1 to 15 percent of their annual turnover in the market. All other things being equal, this change significantly increases the expected costs of restricting competition.

Simultaneously, an item concerning the conditions of exemption from administrative liability for participation in the agreements restricting competition and concerted practice (the leniency program) was introduced into the article of the Russian Federation Code of Administrative Offences, which regulates punishment of offenders of antimonopoly legislation.

The resulting wording has established a broader scope for the leniency program, as compared with international practices. First, the program was extended, not only for agreements representing a form of overt collusion, but also for concerted practices, defined in the legislation as pure tacit collusion. Second, the participants of more than just horizontal agreements became objects of the program; the program now covers both vertical and conglomerate agreements. Finally, the program was designed not only for price-fixing agreements but also for other agreements that restrict or may restrict competition (including agreements those are treated by applying rule of reason).

These features have played a significant role in shaping the demand of companies for participation in the program. In situations where the standards for detecting unlawful agreements remain imperfect (often due to the relatively modest experience of the governing competition authority), the news about the introduction of turnover fines and, at the same time, about the possibility of avoiding them, could lead vendors to participate in the program, even if on the merits of their agreements they would not be found guilty in a Court of Law.

In the original leniency program, three main conditions for exemption from the liability were defined:

1. reporting collusion and its participants or concerted practices to the Federal Antimonopoly Service of the Russian Federation (FAS);
2. providing information about collusions and concerted practices; and
3. refusal to participate in collusions or concerted practices.

Table 1 compares the original version of the leniency program in Russia with similar programs in the United States and the European Union. There is no perfect model of a leniency program, which, strictly speaking, is a consequence of a more general thesis about the

inadequacy of any existing institutions. Every version has some advantages and shortcomings that may have different significances for different countries. Theoretical analysis shows that even the classic examples of the program may be accompanied by negative externalities; not only failing to affect the incentives of participants of collusion, but even increasing the stability of the collusion. Indeed, some studies demonstrate the stabilizing effects of leniency program for surviving cartels.⁶ That is why the issue of the balance of pros and cons of national leniency program is not easy. But even a cursory analysis shows that the original version of the Russian program created interest in seeking exemption, but did not reduce the incentives for creation of new collusions.

Table 17: *Corporate leniency programs: United States, EU, and Russia compared*

	United States	EU	Russia 2007
1	The first cartel participant who reports its existence will automatically receive 100 percent discount from the amount of the fine.	The first member reporting the cartel is automatically granted partial amnesty, although complete amnesty is also not excluded (but is not automatic).	There is no limit to the number of exempted participants.
2	The scale of the amnesty does not depend on the value of the information about the cartel.	The extent of the discount rate is heavily dependent on the amount of evidence provided.	It is possible to provide a full exemption from administrative liability, discount may not depend on evidence provided.
3	The cartel participants who reported their participation later do not get the right to a discount (partial amnesty).	The cartel participants who reported their participation later may be eligible for reduction of fines.	There are no clear instructions for the case of successively received applications for exemption from administrative liability.
4	If an investigation is initiated, complete amnesty is possible, but cannot be guaranteed.	If an investigation is initiated, maximum discount for the first participant who reported the cartel is 50 percent.	Participation in the leniency program is possible at any stage of the review of the administrative case by competition authority, discount does not depend on the state of review of the case by competition authority.

It should also be noted that the authority and regulations of the FAS are such that it is quite limited in conducting secret investigations. Accordingly, companies suspected of involvement in an illegal agreement learn about the investigation long before FAS can make even

⁶ P. Buccirossi & G. Spagnolo, *Leniency policies and illegal transactions*, 90 (6-7) J. PUBLIC ECON. pp. 1281-1297, (2006); M. Maria Bigoni, S.O. Fridolfsson, C. Le Coq, & G. Spagnolo, *Fines, Leniency and Rewards in Antitrust: A Match*, Research Institute of Industrial Economics, Working Paper No. 738, (August, 2009).

⁷ Compiled on the basis of E. Feess & M. Walzl, *Corporate Leniency programs in the EU and the USA*, German Working Papers in Law and Economics. V.2003, Paper 24, p.2-3, as well as materials from the site of FAS and comments of A. Kinev.

a preliminary internal decision. Since, in most cases, seizures of documents and data (including those on magnetic media) to be used as evidence are conducted in accordance with administrative procedures, the companies are aware of the evidence composition. And, since the original version of the program did not put a time limit on reporting or on the number of those who reported, potential participants in a cartel agreement could stop worrying about possible sanctions even while forming the agreement. All of them could escape punishment by submitting statements to the competition authority simultaneously (or even with a certain interval). Plans for collective use of the leniency program became part of the joint decisions of the cartel.

This original design successfully addressed two purposes: providing a significant demand for participation in the program and reduce the costs of investigating and proving the existence of cartel agreements. However, such a program could not achieve the main goal—preventing the formation of cartels. In its traditional form a leniency program increases the likelihood of sanctions due to possible opportunism of one of the participants in price-fixing. The original version of the program in Russia, however, operated in the opposite direction; it didn't increase, but rather decreased the likelihood of sanctions against the companies in the cartel; not destroying but supporting the trust among them.

There existed an additional problem: the program increased the number of Type 1 errors (recognition of practices that were not restricting competition as illegal) in the decisions of the competition authority. In many cases the companies under investigation preferred to accept the fact that their actions were illegal, report breaking the agreements, and obtain exemption from liability. In those cases FAS made an indictment that the companies did not dispute. This posed a real threat of reducing the standard of proof in the cases of agreements.

Indeed, the experience of using this standard in 2007-2008 demonstrated that companies started to report their participation collectively, simultaneously applying to FAS. The shortcomings in the program brought to life a very interesting phenomenon—collusion in applying for the right to be exempted from punishment. According to the deputy head of FAS, Andrey Tsyganov, in the first year of the program operation FAS received approximately 500 applications from companies.⁸ The demand for participating in the program was high; however, this number should be assessed taking into account the fact of filing applications by all suspected in the competition-restricting agreement.

One of the first cases of the program application was the agreement between Rosbank and several dozen insurance companies. In 2007, Rosbank voluntarily reported to FAS entering into agreements with insurance companies. The agreements introduced special conditions provided by the insurance companies under car, home, and liability insurance contracts to the Rosbank customers, who received the corresponding services (car loans, mortgages, and consumer loans). Rosbank initiated these agreements, and it also was one of the first applying for participation in the leniency program. The insurance companies applied to the competition authority at least in two waves—the first group applied with Rosbank, the second applied six weeks later.

FAS, in its decision, indicated that such agreements led or may lead to the fixing of prices for insurance services, which is a direct violation of Article 11 of the Federal Law "On Protection

⁸ A. Tsyganov, *They came to surrender*, VEDOMOSTI, 16.09. (2009).

of Competition."⁹ The decision gives rise to reasonable doubts. It is not clear how the agreements could restrict competition. Insurance markets in Russia are highly competitive, with lots of alternative proposals. The same applies to credit markets. Insurance conditions for the Rosbank clients who did not constitute a significant share of all the buyers of insurance services were unlikely to affect insurance rates on the market as a whole. Moreover, there was no indication in the case materials that the Rosbank agreements included any exclusionary notes limiting the ability of the clients to enter into contracts with other insurance companies. If the case was tried on the merits, it is possible that the competition authority would not have been able to prove the accusation. However, the companies preferred to accept the decision and reduce the costs of proceedings.

Among the 500 applications for participation in the program could have been those related to the vertical or even conglomerate agreements. It is possible that part of the agreements did not and could not restrict competition. However, the companies that were unable to separate illegal agreements from legitimate ones (sometimes not even the competition authority is able to separate them) decided to file an application “just in case.” That is why in 2009 the conditions for participation in the program were modified so as to restore competition to get leniency and reduce the number of “false positive” applications:

First, only the company which has submitted the application first becomes eligible for exemption from administrative responsibility.

Second, the application filed simultaneously on behalf of several persons wouldn't be subjected to review by competition authority.

Among the first and most obvious results of the introduction of the new version of the leniency program was a sharp decline in the number of applications. In 2010 and in the first half of 2011, there were only 30 such applications. Thus the demand for participation in the program dropped. However, in our view, the changes should be evaluated favorably not just because they bring the design of the program closer to the ones adopted in international practice, but primarily because they reduce the extent of negative externalities of the leniency program. (It should be noted that we cannot yet evaluate the results the new program on individual cases because most of these cases are at an early stage of competition authorities' or the courts' proceedings.)

Not all issues of the application of the leniency program in Russia are resolved. There is still incomplete clarity about the possibility of exemption from administrative liability of the initiator of collusion. Also remaining open is an issue about using a system of markers¹⁰ which defines the sequence of information disclosure and assessment of information provided. Another key issue—the issue of witness protection—is not resolved. And there is still no clear understanding of the difference between a corporate program of exemption from administrative penalty and an individual program (tailored for company managers).

The latter issue is very important, because in 2009 Russia introduced criminal penalties for violating antimonopoly laws. According to Article 178 of the Criminal Code of the Russian

⁹ http://www.fas.gov.ru/fas-news/fas-news_14660.html

¹⁰ See, for example, *Commission Notice on Immunity from fines and reduction of fines in cartel cases*, OFFICIAL J. EUR. UNION, p. 19 / C 298/11 (2006). The system of markers is designed to not only prioritize but also to preserve competitiveness among companies for providing information to the antimonopoly authority

Federation preventing, restricting, or eliminating competition by entering into competition-restricting agreements is subject to criminal prosecution. Three offenses admitted in the cases eligible for administrative liability serve as a basis for criminal liability. Fines, disqualification or deprivation of liberty (for a term of up to seven years) are stipulated as an individual responsibility.

However, the Criminal Code provides for the possibility of exemption from punishment (including imprisonment) if the offender has contributed to the disclosure of this crime, compensated for the damage, or transferred to the federal s the income gained from illegal activities. In contrast to the Code of Administrative Offences, this rule is also extended to those guilty of abuse of dominant position in the market.

A simultaneous existence of norms of both administrative and criminal law governing the exemption from liability increases legal uncertainty. An exemption from administrative liability does not mean exemption from criminal liability for at least two reasons:

1. Grounds for exempting from criminal and administrative liability are different.
2. A decision on exemption from administrative liability may be made by the competition authority, but only the Ministry for Internal Affairs may decide whether to criminally prosecute or not.

As a result, the model of leniency program in Russia is not completely defined. But at least the version of the program envisaged in the framework of administrative responsibility is free of the shortcomings of the original norm.

III. PERFORMANCE FACTORS OF LENIENCY PROGRAM: BUDGET AND POWER OF THE COMPETITION AUTHORITY

If we assume that about 20 applications for exemption from liability annually out of 400 cases initiated by FAS central and regional offices on the fact of collusions and concerted practices represent a moderate impact of the program, then such a statement requires explanation.

The main goal of reducing (or exemption from) penalties for infringement of antitrust law is to improve compliance with its norms.¹¹ Such programs exist in both developed and emerging market economies (Australia, Brazil, the United Kingdom, Hungary, Canada, Cyprus, Latvia, the United States, Japan, etc.). Not only the size of the fines, but also the possibility of their targeted uses, are the characteristics of the system of sanctions. The higher the probability of sanctions at a given size of fine (which must also be noticeable), the greater the incentive to use the program. At low fines and/or low probability of their use, economic entities would generally not consider the expected costs of violation of the rules of competition in their decisions.

That is why the leniency program is used only as a complement to the capabilities of the competition authorities on their own to preclude collusion by identifying its participants and collecting sufficient evidence to present in court. Why is this so? In accordance with the approach

¹¹ See, for example: International Competition Network, *Anti-cartel Enforcement Manual*, (Cartel Working Group, Subgroup 2), Ch. 2, Enforcement Techniques (April 2006) on Drafting and Implementing an Effective Leniency Program Workbook (*.P 3).

to determining the optimal level of cost of law enforcement by public authorities, in contrast to individuals,¹² there are the following four main reasons for this kind of coercion:

1. high cost of identifying the violator by the victim;
2. high cost of abuse of law by those whose rights are protected;
3. economies of scale in the case of state coercion; and
4. preference on the exclusive use of force by the state.

The designated factors are fully applicable to the explanation of the role of competition authority as an organization, specialized on antitrust law enforcement.

The desired effect of leniency programs is in its weakening of the incentives to form new collusions and creating the incentives for the destruction of the existing ones through increasing the likelihood of their disclosure. These tasks should be solved without dramatically increasing state budget expenditures on financing the activities of competition authorities in conducting investigations and gathering information on the facts of collusion among market participants that could be used as evidence in legal proceedings.¹³

A leniency program may decrease enforcement cost of competition authorities in a country where the likelihood of detecting offenses and applying sanctions is high enough. But in a country where the likelihood of detection and punishment of members of collusion has always been low, the program will only work if it is complemented by an independent gathering of evidence. That is why the issue of available resources of competition authority is important for an explanation of the expected results of leniency program, other things being equal.

While a leniency program can be successful if competition authorities have limited resources and imperfect technology for obtaining sufficient evidence of the existence of collusion in the commodity markets, these limited resources still need to provide a significant level of probability of disclosing collusion by competition authorities on their own. Currently it is difficult to define the threshold level of budget and powers of competition authorities which would make the program efficient.

However, no matter what this threshold is, if there are competition authorities that do not reach the threshold or are in the danger zone, FAS must be one of them. FAS is one of the largest competition authorities in the world, with a staff of about 3,000 people¹⁴ (including its regional divisions). However, it has relatively modest financial resources, an extremely wide area of responsibility, and limited powers for detecting and proving the existence of illegal collusions.

Table 2 provides information on the budget of competition authorities in 2006 normalized by GDP. In the first approximation GDP can be considered as an indicator, which can be used to estimate the size of the economy. In the sample the gap between the highest and lowest budget is considerably more than one order of magnitude (or more accurately—more than 28 times).

¹² A.M. Polinsky & S. Shavell, *The Economic Theory of Public Enforcement of Law*. (XXXIII) J. ECON. LITERATURE, pp.45-76, (March 2000)

¹³ Peculiarities of design of the Russian system of the antitrust law application can be seen in using the mechanism of interagency cooperation for search operations (FAS and the Ministry of Internal Affairs).

¹⁴ Report on the results and main activities of the Federal Antimonopoly Service for 2012-2014.

Table 2: *Budgets of competition authorities: international comparisons*

Nº	Country	Thousandths of a percent of GDP in 2006
1	Argentina	3,5
2	Brazil	7,0
3	Germany	7,2
4	France	14,3
5	Russian Federation	20,1
6	United States	26,2
7	Canada	33,0
8	Czech Republic	40,4
9	Estonia	54,8
10	Ukraine	57,7
11	United Kingdom	58,6
12	Denmark	66,1
13	Australia	99,1

Source: World Competition Review (http://www.globalcompetitionreview.com/sr/hcea.cfm?master_id=1#), Calculations: A. Shastitko

Figures presented are not sufficient to make conclusions on the resources of antitrust enforcement in a given country since, in order to ensure comparability, we still need to clarify a number of items, including the responsibilities of the authorities, the availability of specialized controls that perform specific functions of the antimonopoly regulator in individual markets, etc. However, one observation can be made and is very important, and is illustrated by comparing the Federal Antimonopoly Service of Russia and the Antimonopoly Committee of Ukraine. These are two economies with a similar history and competition authorities with generally comparable competence (although the competence of the FAS of Russia is somewhat wider due to its responsibilities for monitoring compliance with legislation on public procurement as well as the control of foreign investment in strategic sectors of the economy). Nevertheless, the cost of operation of the Russian competition authority normalized by GDP is almost three times lower!

The results for Germany are also somewhat surprising. However, it is important to take into account the narrower scope of the German competition authority compared with the Russian (only the "hard core of antitrust"—abuse of dominance, collusions and concerted practices, monitoring economic concentration deals) as well as the existence of the European Commission as a supranational competition authority whose jurisdiction extends also to the German economy. In addition in Germany there are special controls that monitor the conditions of competition in selected industries.

In assessing the budget of competition authority in Russia one also needs to remember the very broad scope of responsibility of FAS. In addition to preventing competition-restricting agreements and concerted practices, abuse of dominant position, as well as exercising preliminary merger control, FAS provides a variety of functions that are often not included in the scope of global competition authorities. It prevents unfair competition, monitors competition in the provision of state aid, controls investments in strategic industries, prevents restrictions of competition by the authorities, and carries out sector-specific regulation in some industries. Such wide scope of functions leads to an increase in the number of the FAS staff.

That is why a quantitative assessment of the budget of competition authorities per employee is also very important (see Table 3).

Table 3: *Resources available for competition authority staff (2006)*

Nº	Country	Total staff (persons)	GDP in national currency / GDP in USD by PPP	Budget in million USD by PPP, IMF estimate	Resources available for competition authority staff (thousand USD per employee)
1	Russian Federation	2200	15,41	34,79	16
2	Ukraine	904	1,5	20,55	23
3	Brazil	400	1,37	11,86	27
4	Estonia	37	8,3	51,34	36
5	Argentina	48	1,05	2,18	45
6	Germany	280	0,9	18,52	67
7	Czech Republic	114	13,55	9,55	84
8	Canada	399	1,24	38,17	96
9	Australia	598	1,47	67,4	110
10	France	240	0,92	27,65	115
11	United States	1874	1,02	251,75	134
12	Denmark	92	8,26	13,12	143
13	United Kingdom	823	0,61	124,35	150

Source: World Competition Review (http://www.globalcompetitionreview.com/sr/hcea.cfm?master_id=1#),
Calculations: A. Shastitko

To evaluate the available resources for each country's competition authorities' staff in monetary terms we normalized the budgets of competition authorities by the ratio of GDP in national currency to GDP calculated with PPP, as estimated by the IMF. The resulting data shows that the United Kingdom is the most "financially endowed" of all the countries under consideration, demonstrating about \$150 thousand per person per year. Moreover, where the relative values of the budgets of the competition authorities showed a significant gap between Australia and the other countries (Table 2); in this case, the gap between the three leaders—the United Kingdom, Denmark, and the United States—is about 10 percent (Table 3). We understand that the estimates given in the table are in need of a more adequate methodological basis; still one should not miss a significant gap between the leaders and outsiders, Russia among the latter. According to the data obtained, the budget of the Russian competition authorities' staff is of an order of magnitude smaller than that in the United Kingdom.

At the same time, the number of initiated cases of restriction of competition is steadily increasing. In 2006, according to FAS of Russia, 1,200 cases were initiated under Art. 10 of the Law "On Protection of Competition," which prohibits abuse of dominant position; in 2010 there were more than 1,600 such cases. On collusions and concerted practices (Art. 11 of the Law "On Protection of Competition") there were about 150 cases in 2006, and about 400 in 2010.

All things being equal the budget of the competition authorities affects their ability to curb infringements of the antitrust legislation. At the same time, if the probability of detection and disclosure of collusion by the competition authorities is negligibly small, the use of leniency program will not reach its goal, for the same reason as in the case of soft penalties.¹⁵ In this

¹⁵ International Competition Network, *Anti-cartel Enforcement Manual*, Cartel Working Group, *supra* note 11.

context, the question arises about the adequacy of the level of resource endowment of FAS staff, which is almost of an order of magnitude lower than that in the United Kingdom and almost one-third lower than that in Ukraine. Clearly, while there is not enough information for a more substantive answer to this question, it is still sufficient for putting the question.

In addition to the modest resources of the Russian competition authority (given the wide scope of responsibility and the number of initiated cases) its own achievements in suppressing and preventing cartel agreements are constrained by its limited powers to collect evidence. FAS has no authority to implement the operative-search activity. It can use methods of covert investigation only in co-operation with the Ministry of Internal Affairs. There are examples of fruitful co-operation of the agencies. For example, at the end of 2010, FAS obtained evidence in the case of collusion in the market of coking coal thanks to the co-operation. However, the difficulties of interagency co-operation are obvious.

IV. CONCLUSIONS

1. A leniency program is an important antitrust policy tool aimed at improving effectiveness of measures to combat cartels and achieving the goals of antitrust policy in general.
2. Not every leniency program leads to the desired results because its design can create adverse incentives for market participants. Such, in our opinion, was the original design of the program in Russia. It was characterized by two problems: reduction of restraining force of penalties for collusion and increase of likelihood of errors of Type I appearance in cases of agreements. During that period not every application submitted actually testified to the fact of collusion prohibited by antitrust law.
3. Changing the design of the program in 2009 formally reduced the demand for it among market participants but eliminated the sources of negative externalities.
4. Necessary conditions for the effectiveness of leniency programs are not only high penalties for violating antitrust law, but also the ability of competition authority to disclose collusion.
5. The probability of disclosing collusions by competition authority on its own depends on its resource endowment and scope of authority. Currently, these factors still constrain the effectiveness of both prevention of cartel agreements and application of leniency programs in Russia.