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Detection and Compliance in Cartel Policy

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In the past few years, companies around the world have spent an increasing amount of resources addressing issues broadly classified as compliance. In the area of bribery there has been significant enforcement with strong financial and behavioral penalties under the U.S. Foreign Corrupt Practices Act (“FCPA”). The United Kingdom has introduced a new anti-bribery regime this year, which has increased companies’ awareness of the possible negative impact from breaking the law. Similarly, corporate governance legislative initiatives, such as Sarbanes-Oxley and Dodd-Frank, have transformed the compliance landscape for many companies.

During this same period, there have been significant theoretical and empirical contributions as to the effects on a firm’s performance of various corporate governance measures designed to reduce criminal behavior on the part of firms and individual managers. Quite a bit of this literature has focused on improved detection of wrong-doing. Given these changes, it is surprising that U.S. antitrust has not been on the cutting edge of compliance and detection. Antitrust’s primary contribution has been the introduction of leniency programs around the world. In many ways leniency is effective in destabilizing existing cartels. However, it may be, in some cases, that leniency may actually strengthen certain cartels.² Moreover, leniency may not be going after the right kinds of cartels—the worst offenders in terms of overcharges—and may instead be going after the cartels that are easy to find.³ Recent work suggests that the U.S. leniency program has not led to optimal deterrence.⁴

If we take these critiques of leniency and cartel detection seriously (especially relative to detection of other types of corporate crimes) antitrust needs to come up with additional ways to promote cartel detection. One way to improve detection is to increase the penalties for senior management and the board of directors. If the most important executives face the possibility of jail time, they will be more likely to implement compliance problems and take pro-active steps to ensure that such programs are effective. To create more substantive compliance, the Chief Executive Officer (“CEO”) of a firm that reaches a certain U.S.\$ turnover should be required to certify that the firm has an adequate antitrust compliance program, similar to Sarbanes-Oxley certification.

The involvement by top management in criminal activities may merit tougher penalties since senior management involvement signals compliance weakness and a corrupt culture overall. Regarding individual sanctions, one possibility is the U.S. practice of debarring directors,

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² Daniel Leliefeld & Evgenia Motchenkova, *Adverse Effects of Corporate Leniency Programs In View Of Industry Asymmetry*, 2 J. APPLIED ECON. SCI. 114 (2010).

³ Joseph E. Harrington & Myong-Hun Chang, *Modeling the Birth and Death of Cartels with an Application to Evaluating Antitrust Policy*, 7 J. EURO. ECON. ASSOC. 1 (2009).

⁴ Robert H. Lande & John M. Connor, *Optimal Cartel Deterrence: An Empirical Comparison of Sanctions to Overcharges* (August 24, 2011), available at SSRN: <http://ssrn.com/abstract=1917657>.

managers, and other employees from an industry.⁵ The United Kingdom has introduced the possibility of director debarment for firms that participate in cartels.⁶

There also need to be positive incentives. Most importantly, this means creating incentives to report wrongdoers rather than turning a blind eye because of the risk of retribution for internal whistle-blowing.

Just as penalties may need to be increased for senior management, additional benefits need to be introduced to create benefits for firms and individuals to come forward with information regarding cartels. In a forthcoming article, I outline a number of different options.⁷ Below, I wish to focus on one area that the article does not cover—whistle-blowing bounties for antitrust.

Whistle-blowing is not foreign to the U.S. enforcement scheme outside of antitrust. The *qui tam* statute enables whistle-blowers to receive between fifteen to thirty percent of the money recovered by the government.⁸ Without a bounty, whistle-blowers need to come forward individually. To do so presents significant risks. As Dyck, Morse and Zingales note:

[E]mployee whistleblowers face significant costs. In 45 percent of the cases, the employee blowing the whistle does not identify him or herself individually to avoid the penalties associated with bringing bad news to light. In 82 percent of cases with named employees, the individual alleges that they were fired, quit under duress, or had significantly altered responsibilities as a result of bringing the fraud to light. Many of them are quoted saying, “If I had to do it over again, I wouldn’t.”⁹

This suggests that employee incentives are not aligned with the firm in terms of compliance because an employee or mid-level manager risks losing his/her job if he/she comes forward with information of illegal activity.¹⁰ The cost of informing outweighs the benefit of remaining silent. The misalignment of incentives between employees and firm replicate

⁵ There would need to be some sort of guidance on the part of DOJ as to what constitutes an “industry.” Perhaps industry might be by SIC code or it might be defined by other criteria. The exact definition is beyond the scope of this article.

⁶ Enterprise Act § 204.

⁷ D. Daniel Sokol, Cartels, *Corporate Compliance and What Practitioners Really Think About Enforcement*, 78 ANTITRUST L.J. [__] (forthcoming 2012).

⁸ 31 U.S.C. § 3729(a); William E. Kovacic, *Private Monitoring and Antitrust Enforcement: Paying Informants to Reveal Cartels*, 69 GEO. WASH. L. REV. 766 (2001). Though Kovacic has called for an antitrust bounty in the United States, to date only South Korea and the United Kingdom have instituted such policies. Giancarlo Spagnolo, *Leniency and Whistleblowers in Antitrust*, in HANDBOOK OF ANTITRUST ECONOMICS 290 (Paolo Buccirossi ed., 2008) (discussing the Korean reward scheme).

⁹ Alexander Dyck, Adair Morse, & Luigi Zingales, *Who Blows the Whistle on Corporate Fraud?* 65 J. FIN. 2213 (2010).

¹⁰ Robert M. Bowen et al., *Whistle-Blowing: Target Firm Characteristics and Economic Consequences*, [__] ACCOUNTING REV. (forthcoming) (correlating whistle-blowing to situations where: (i) firms tend to be large companies with significant goodwill but that have poor governance; (ii) firms tend to have blurry lines of communication within the firm, in part because of personnel changes; and (iii) tend to be concentrated in industries in which there are significant government purchases).

themselves in the cartel context.¹¹ There is little incentive for employees to come forward without a reward since cartel compliance cultures at many firms are weak.¹²

Creating an ethical compliance environment suggests that individuals have internalized the pro-compliance social norm.¹³ This means that an individual will factor the social cost of non-compliance into their risk-reward calculation of cartel participation because non-compliance will be internalized as deviant behavior. This cultural shift toward ethical compliance aids in whistle-blowing.

A reward system for cartels would change this dynamic. In this sense, the *qui tam* experience is instructive to what cartel compliance might resemble. Under *qui tam*, there are incentives to report employer illegality. One study showed that whistle-blowing was concentrated in healthcare and defense industries, both of which have significant government procurement; hence the possibility of *qui tam* rewards.¹⁴ In healthcare, employees uncover nearly half of all corporate fraud.¹⁵ No doubt, the *qui tam* statute that allows for personal windfalls for any recovery may explain a higher internal detection rate by employees. The average employee windfall cited in one recent paper on successful *qui tam* suits was \$46.7 million.¹⁶ At a number that high, the incentive for detection within companies is particularly strong. Though the time to ultimately collect *qui tam* proceeds is somewhat lengthy, the expected long-term return of significant financial rewards may be a significant factor in getting employees to report illegal activity.

The *qui tam* experience is similar but not identical to cartel compliance. Compared to other industries, healthcare possesses a greater culture of compliance. Moreover, because healthcare companies are more accustomed to regulation and litigation,¹⁷ in-house attorneys are more heavily valued and often treated as part of the senior management team. Heavy regulation and the high stakes associated with legal decisions (e.g., FDA approval of a new drug or a patent ruling) fundamentally shape business strategy more in healthcare than in less regulated industries. Healthcare firms have very significant compliance programs, not just because of *qui tam* litigation but also because of the risks arising from fraud and abuse rules, privacy laws, and malpractice claims. Thus, because of the risks of punishment, healthcare companies tend to invest more in compliance and treat it more seriously than in less regulated sectors.

A number of critiques suggest potential limitations to the introduction of a bounty for whistle-blowing on cartels. Cartel “bounties” may create high administrative costs because employees may over-report information. Business may become paralyzed if managers fear that every possible decision might subject them to discipline internally or from antitrust authorities.

¹¹ Donald C. Klawiter & Jennifer M. Driscoll, *A New Approach. To Compliance: True Corporate Leniency for Executives*, 22-SUM ANTITRUST 77, 77 (2009).

¹² Sokol *supra* note 7.

¹³ Charles O'Reilly III & Jennifer Chatman, *Organizational Commitment and Psychological Attachment: The Effects of Compliance, Identification, and Internalization on Prosocial Behavior*, 71 J. APPLIED PSYCHOL. 492 (1986); Donald Lange, *A Multidimensional Conceptualization of Organizational Corruption Control*, 33 ACAD. MGMT REV. 710, 720-21 (2008).

¹⁴ Bowen et al., *supra* note 11.

¹⁵ Dyck et al., *supra* note 10.

¹⁶ *Id.*

¹⁷ See e.g., Bernard Black et al., *Defense Costs and Insurer Reserves in Medical Malpractice and Other Personal Injury Cases: Evidence from Texas, 1988-2004*, 10 AMER. LAW & ECON. REV. 185; but see Lars Noah, *Assisted Reproductive Technologies and the Pitfalls of Unregulated Biomedical Innovation*, 55 FLA. L. REV. 603 (2003)(suggesting apart from medical technologies, healthcare quality and delivery are largely unregulated).

However, based upon the South Korean cartel bounty experience, such concerns seem unfounded. South Korea introduced its antitrust bounty fairly recently. In the short time of using the bounty, the South Korean experience suggests that it is possible to change company culture in a country-wide context with increased fines and visibility of large payouts.

The Korean Fair Trade Commission (“KFTC”) offers a reward of up to 1 billion KRW (approximately \$850 million) to informants based on a percentage of the cartel overcharge.¹⁸ By providing such a high bounty, the KFTC wanted to convey a message that, in extreme cases, even the most senior of executives could leave their job to receive a reward for information. To date, most rewards have not approached the upper limit. The lack of major bounties has limited the appeal of viewing the bounty as nothing more than playing the lottery (in the sense that a worker might make excessive numbers of unfounded claims with the hope of retiring based on a big reward). The highest amount awarded has been 210 million KRW (approximately \$187,000), which the KFTC gave to informants on a sugar cartel in 2007. In most cases, the reward has been only a few million KRW. However, even this relatively small payout is enough for all but senior executives to think about informing on a cartel to the KFTC.

Through 2008, there were fifteen cases in which the KFTC granted rewards to cartel informants. The amount of rewards totaled 333 million KRW. In 2008 alone, the number of cases in which the KFTC granted rewards increased to six compared to what had been a rate of one-to-two awards up through 2007.

Cartel detection in the United States can be increased with better incentives within the firm that mix greater penalties and greater rewards. DOJ Antitrust seems to be behind the times relative to other areas of economic regulation (securities regulation, procurement, etc.) in understanding how better incentives for compliance can improve cartel detection.

¹⁸ The United Kingdom offers a £100,000 bounty, which seems too low of an incentive to produce additional information of cartel violations. To date no individual has been given the bounty in the United Kingdom.