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Settlements in Antitrust Enforcement: A U.S. Economic Perspective

I. Introduction

This paper provides an economic perspective on the use of settlements in the European Union. The paper emphasizes settlements in cartel cases, but also offers comments that are relevant for the analysis of settlements in restraint of trade cases brought under Article 81 and abuse of dominance cases under Article 82 of the EC Treaty.[1] The comments contained in the paper are informed by my personal experiences as an antitrust enforcer (as Deputy Assistant Attorney General for Economics in the Antitrust Division of the Department of Justice in 2007 and 2008), as a consultant in private antitrust matters, and as an active member (and former president) of the American Law and Economics Association. The latter experience is particularly relevant because the policy issues surrounding settlements are informed by the law and economics literature relating to legal process and to deterrence.

The paper is organized as follows. Section I focuses on criminal cartel enforcement. I explain that the U.S. corporate leniency program creates a set of incentives that generally encourage settlements involving single and multiple cartels. I then explain that the law and economics literature relating to legal process and to deterrence can offer useful lessons to the E.U. as it continues to develop its leniency program.

As is well known, the E.U. is in the process of putting into place a system of private antitrust enforcement. The interaction between the cartel settlement procedures and the new system of private enforcement are both important and complex. Therefore, while discussing cartel enforcement, I will offer comments on the relationship between the design of a leniency program and the incentives to bring private enforcement actions. Section II comments on

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[1] Procedures for cartel cases are covered under the proposed new Article 10a of Commission Regulation 773/2004 of 7 April 2004 on the conduct of proceedings by the Commission pursuant to Articles 81 and 82 of the EC Treaty, 2004 OJ L123/18, last amended by Commission Regulation (EC) No 622/2008 of 30 June 2008, 2008 L171/3. Article 81 and 82 settlements are covered by Article 9 of Regulation (EC) No 1/2003 of the Council of 16 December 2002 relating to the implementation of the rules on competition laid down in Articles 81 and 82 of the EC Treaty, 2003 OJ L1/1.

civil public enforcement issues that arise out of Sections 1 and 2 of the Sherman Act and which have relevance for Articles 81 and 82 within the European Union. I describe the range of instruments that can be useful in achieving an appropriate deterrence goal, and I comment briefly on the pros and cons of the available remedies.

II. Criminal Cartel Enforcement

The primary objective of a criminal antitrust enforcement program is and ought to be deterrence of conspiracies to fix prices or to divide markets. Other objectives such as punishment or the disgorgement of wrongful gains are secondary. The U.S. enforcement program is particularly complex; it uses a combination of "carrots" and "sticks" to achieve its deterrence goals. Sticks involve penalties that are harmful to recipients. Carrots are inducements that benefit recipients (although those benefits might include a reduction in harmful penalties).

The U.S. amnesty programs offer a series of benefits to firms that have engaged and/or are engaging in price fixing (or market division) activities. The Amnesty Program offers leniency to the first party that comes in the door (and qualifies); if they do qualify, both the corporation and its employees are free from criminal prosecution (fines and imprisonment). The qualifying company is also assured that it will be subject to single rather than treble damages in any private follow-on cases that are brought. The Amnesty Plus Program allows parties that do not qualify for amnesty with respect to the initial matter to receive amnesty for the second offense and a reduced corporate fine for the first.[2]

The two amnesty programs create a number of important economic incentives that offer lessons for the EU's leniency program. By far the most important is the incentive to be first in the door. There is no doubt that the Amnesty program has been highly successful in encouraging parties to come forward to the Department of Justice. The program has helped to unearth price-fixing conspiracies that either would not have come to light at all, or would only have been become known at a significantly later date.[3]

There are, however, a number of other incentives that are less obvious, but potentially important. Any firm that does come forward faces the risk that through settlement or trial it will pay substantial civil damages (single damages if first; treble otherwise).[4] In recent years, the tendency has been for

[2] Roux and Ungern-Sternberg (2007) offers details and analysis.

[3] See Leslie (2006) for a more extensive discussion of strategic incentives that flow from the Amnesty Program.

[4] This is in accordance with the 2004 amendment to Section 4 of the Clayton Act, 15 U.S.C. § 15.

private class action suits to be filed immediately following the public availability of information relating to criminal investigations, whether or not those investigations lead to prosecutions. Knowledge that pleas in criminal cases can create direct evidence of antitrust violations in civil cases can increase the likelihood that those private suits will be successful.[5]

Parties coming forward to seek amnesty must therefore consider the possibility of settling or litigating private suits. As a matter of economic theory, this will reduce the incentive of parties to come forward in the first place, especially given that firms cannot be assured that they will qualify for leniency.[6] Given the substantial increase in major price fixing cases brought by the U.S. following the introduction of the amnesty program, it appears unlikely that this effect has been large. However, a firm conclusion with respect to this issue awaits empirical study. From the perspective of the EU, it seems reasonable to expect that the development of a system of private litigation that is substantially more limited than the U.S. system (no contingent fees, single damages, opt-in requirements for class actions) will have only a modest discouraging influence on the decision of parties to participate in the leniency program.

The Amnesty Plus Program also creates a potentially significant economic effect. While the program on its face offers a benefit to reporting involvement in a second cartel, it is likely to create mixed incentives with respect to reporting the first cartel. On one hand, there will be an increased incentive to report based on the additional benefit created by the "Plus." On the other hand, there may be a reluctance to come forward, if participation by firms in the Amnesty Program is more likely to lead to the uncovering of a second profitable cartel arrangement.

The U.S. criminal enforcement program of fines and prison sentences for individuals was clearly designed to create a race between companies involved in price fixing and its employees to come forward to disclose improper behavior.[7] While a great deal has been written about the success of this program from an operational point of view, relatively less attention has been given to the generally supportive lessons that flow from the literature on the economic analysis of law.

Deterrence theory views the decision to engage in improper behavior as a function of the probability of being detected and successfully prosecuted and the magnitude of the penalty that is imposed. In his classic analysis of criminal enforcement, Gary Becker emphasized the savings in enforcement costs

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[5] See 15 U.S.C. §16(a).

[6] The incentives with respect to private litigation will be somewhat different in Europe to the extent that the losing party is responsible for covering some or all of the litigation costs of the winning party. For a review of the empirical issues relating to fee-shifting and other related issues, see Kessler and Rubinfeld (2007). For more general commentary on the introduction of private enforcement in Europe, see Rubinfeld (2006).

[7] See, e.g., Hammond (2004).

that arise if one increases the penalty and reduces the probability of detection so as to keep the expected penalty (the probability multiplied by the penalty) constant.[8] It is now well understood that for risk-averse parties (which likely characterizes the behavior of many company individuals) high penalties and a low probability of detection can achieve appropriate deterrence with even lower enforcement costs.[9] The reason is that the uncertainty of detection creates risk, and the risk-premium that individuals would be willing to pay to avoid that risk creates additional deterrence without any enforcement expenditure.

It also now well known that individual prison sentences can offer more effective deterrence than fines.[10] The essential point is that for high-wealth individuals (and arguably for highly profitable corporations) the opportunity cost (i.e., the loss of wealth) associated with a fine may not be sufficient to generate adequate deterrence. However, a prison sentence, which deprives individuals of an opportunity to earn substantial income and offers the disutility of prison conditions, can generate very substantial deterrence.[11]

Now consider the additional complexities that are created with the implementation of the Penalty Plus program. This program offers a strong stick whose purpose is to further deter wrongful behavior. Under Penalty Plus, the failure to report a related second offense can lead to increased penalties beyond those that would naturally be imposed with respect to the first offense. Once again, lessons from the law and economics literature offer some insights into the likely effects of the program. The Penalty Plus program can be seen as a program that offers increased penalties to repeat offenders. As a general rule, economic analysis tells us that under reasonably general conditions the increased penalty design will create additional deterrence beyond what could be achieved if the penalty for the second related offense were not increased. The basic intuition is that by avoiding the first offense, parties eliminate the possibility of the heavy penalty that would flow from engaging in a second offense (which is successfully detected and enforced).[12]

III. Cartel Settlements

The introduction of a program that encourages cartel settlements by the European Union has generated some controversy. A review of the economics

[8] Becker (1968).
[9] See Polinsky and Shavell (1979).
[10] See, e.g., Polinsky and Shavell (2000).
[11] This deterrence benefit will be reduced to the extent that the corporations continue to pay salaries to employees that serve prison sentences.
[12] See Polinsky and Rubinfeld (1991). The authors do point, however, to circumstances in which a reduced penalty for the second offense can be beneficial.

underlying such a program in the U.S. and the EU should help to clarify some of the issues.

Cartel settlement programs generate some clear and significant benefits. First, they reduce enforcement costs.[13] This allows the enforcement authority that is constrained by a limited budget to undertake more investigations and to prosecute more cases. This not only increases enforcement and deterrence, other things the same, it also gives a clearer signal to prospective violators. The clarity of the enforcement signal from the competition authority is important from an economic perspective because a clear signal increases certainty and thereby reduces the company expenditures needed to defend against investigations that may not undercover improper behavior.

I see two potentially significant costs associated with a settlement program. First, the program is likely to introduce certain inequities, since the punishments among cartel members are often highly variable. These inequities may not be as significant an issue in the EU as in the U.S., since the EU (unlike the U.S.) will not grant amnesty to the cartel ringleader.

Second, settlements reduce the expected penalty paid by wrongdoers. (The violator will not settle unless the settlement payment is less than the expected cost of pursuing the investigation through trial and appeal unless a final resolution is reached.) This leads, other things the same, to reduced deterrence.[14] This is a valid concern. However, it should be counterbalanced against the fact the settlement only occurs because it benefits the enforcement authority as well and, as just discussed, those benefits can translate in the end into greater enforcement activity.

While an exact balancing of the costs and benefits of a cartel settlement program is undoubtedly difficult, I have no doubt from my U.S. experience that such a program does generate improved deterrence within the constrained, limited enforcement budget.

IV. Civil Public Enforcement

Civil public enforcement in the U.S. also seeks to achieve deterrence objectives (primarily under Sections 1 and 2 of the Sherman Act and the FTC Act). Despite the fact that two separate agencies are involved in enforcement in the United States, the limited budgets of the enforcement authorities make the management of enforcement costs an important secondary objective. The deterrence objective is achieved in the vast majority of cases through injunctive

[13] See, e.g., Zingales (2008).

[14] Polinsky and Rubinfeld (1989) offer one illustration of this point, using a model in which the injuring party settles only if the settlement leads to a reduction in the expected penalty plus the expected cost of litigation.

remedies, although disgorgement of profits from inappropriate behavior has been an occasional goal.

Settlements play an important role in both U.S. agencies for reasons that are analogous to many of the points made with respect to criminal enforcement. The paragraphs that follow offer some further thoughts with respect to the economic issues underlying settlements at the Department of Justice, whose process is somewhat different from that of the Federal Trade Commission.

The Department of Justice ("DOJ") frequently settles cases through the use of consent decrees. Historically, DOJ tended to enter into decrees that had a long life. Over the years, however, the view that shorter decrees are more appropriate has become dominant. From an economic point of view, this is a sensible rule (although there are always exceptions to the rule). While the threat of longer decrees tends to create greater deterrence, the longer the decree, the greater the risk that competitive behavior will be restricted.[15]

Consent decrees can reasonably be placed into two categories, those that involve behavioral remedies and those that are structural. Structural remedies offer high rewards with higher risks. A remedy that alters the structure of the industry (perhaps by a divestiture of assets or a license of intellectual property to competitors) will change the nature of competition. If the remedy is appropriately chosen, it can beneficially influence the competitive landscape for the foreseeable future. Structural remedies have an important second benefit—once the remedy has been imposed, relatively little if any monitoring is involved. Most commentators would likely agree that the consent decree breaking up AT&T is an example of the successful use of a structural remedy.

Behavioral remedies are lower in risk, but typically lower in reward as well. They are likely to have a less significant impact on the competitive process, but they do avoid the potentially large cost associated with the inappropriate imposition of a structural remedy. Unfortunately, behavioral remedies typically involve substantial continuing monitoring and enforcement costs. Whether in agreement with the settlement in *U.S. v. Microsoft* or not, most commentators would likely agree that the decree has required (indeed imposed) continued and costly monitoring by the Department of Justice and by the Federal District Court in the District of Columbia.

V. Conclusion

The leniency programs in the United States and in other countries have been remarkably successful in unearthing cartels. As the EU and other countries

[15] Epstein (2007) offers a particularly critical historical view of consent decrees.

further develop their own individualized programs, they can learn from the U.S. experience.

Firms and their managers do respond to economic incentives. That is undoubtedly the reason that the Amnesty Program has induced so many participants in cartels that adversely affected U.S. commerce to come forward. When the Amnesty Program is combined with other leniency programs, Amnesty Plus and Penalty Plus, the economic incentives that are created by the mixed use of "carrots" and "sticks" become substantially more complex. Among other things, the U.S. experience tells us that the presence of an extensive system of private civil enforcement mutes the incentives for firms to participate in the Amnesty Program.

There is also much to learn from the literature on the law and economics of legal process about the likely incentives created by a new leniency program. Among other things, both the use of prison sentences for individuals and the addition of the Penalty Plus Program are likely to have a positive influence on the incentives of parties to seek Amnesty.

As the European Union continues to put its cartel settlement program into effect, it is tempting to note and to emphasize the differences between the U.S and the E.U. While convergence is in itself a desirable goal, it is not essential for the two systems to be equivalent for the combination of the two to serve as an effective deterrent against price fixing and other cartel-like behavior.

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