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Coming in From the Cold: Improving Cartel Detection and Reporting

Report of the C.D. Howe Institute Competition Policy Council

Cartels, in the form of explicit agreements among competitors to set prices, rig bids, or share markets, for example, may harm Canadian consumers and the economy, and normally constitute practices contrary to the *Competition Act*. That is why Canada's Competition Bureau should improve the incentives for cartel members to abandon cartels, and report their existence to the Bureau.

In the course of its enforcement activities, the Competition Bureau participates in international investigations and settlements, including, for example, the current and high-profile LIBOR case. However, in comparison with actions directed at international cartels, domestic investigations and prosecutions are relatively rare, and the Bureau's policies may create insufficient motivation for members of domestic cartels to self-report, potentially allowing harm to Canadian consumers and the economy. This is the general consensus of the C.D. Howe Institute's Competition Policy Council, which held its fifth meeting on April 30, 2013.

The Competition Policy Council comprises top-ranked academics and practitioners active in the field of competition policy. The Council, chaired by Finn Poschmann, Vice President, Research at the C.D. Howe Institute, provides analysis of emerging competition policy issues. Professor Ed Iacobucci, Osler Chair in Business Law at the University of Toronto and Competition Policy Scholar at the Institute, advises the program, with the assistance of Benjamin Dachis, Senior Policy Analyst. The Council, whose members participate in their personal capacities, convenes a neutral forum to test competing visions and to share views on competition policy with practitioners, policymakers and the public.

At Issue: The Competition Bureau uses self-reporting under its Immunity Program as its principal means of detecting the existence of cartels and cartel-like behaviour. In what situations will the Immunity Program be most effective in revealing cartels? Are there more reliable, accurate or cost-effective means of uncovering potential infringements of the *Competition Act* with economic data? Would using economic evidence to detect collusion enhance the Bureau's Immunity Program by increasing the chance that firms will self-report?

The Council's Verdict: While the Council was sceptical about the capacity of publicly available economic data or statistical methods to identify the existence of cartels liable to a successful

prosecution, there was a consensus that the Bureau could do more to improve the incentives for cartel members to defect from cartels and to report their existence. The Council recommends that the Bureau revise its Immunity and Leniency Programs to ensure they are not at cross-purposes by, for example, ensuring that the net benefit to a first-mover – the first defector from a cartel – is significantly greater than the leniency granted to subsequent self-reporters or other cartel members. The Council also thought that the Bureau should assign more resources than are currently deployed to active prosecution of domestic anticompetitive behaviour. A greater focus on domestic policy, practice and case law would complement the Bureau's participation in international cartel enforcement.

Cartel Detection in Canada

Cartels that fix prices or rig bids to allocate market share, among members, harm economies and consumers. In Canada, the *Competition Act* renders private cartels illegal, and participation in them may attract a maximum fine of \$25 million and 14 years in prison.

The Competition Bureau relies on two programs to encourage firms to report the existence of cartels: the Immunity Program and the Leniency Program. Cartels are inherently unstable: cartel members normally have an incentive to undercut their colluding partners, to gain market share and to profit at the expense of other cartel members. The Bureau's programs seek to aggravate the inherent instability of cartels by eliminating or reducing the punishment that a reporting firm – or individual – might otherwise suffer if the Bureau uncovered the cartel. The promise of lower expected penalties creates a temptation for each cartel member to defect from the cartel and report it to the authorities.

The greater the probability that the Bureau will uncover the existence of a cartel, without its being reported by a conspirator, the more attractive will be the carrot, reduced punishment, to a cartel member contemplating self-reporting. The incentive that each firm has to report the existence of a cartel to the Bureau hinges on the relative profitability associated with the fines likely if the cartel was detected, versus the profit to the firm if the cartel remained undetected. Increasing the chances of the cartel being detected, or increasing the possible fines, reduces the potential profitability of participating in or perpetuating a cartel. Increasing the chances that a cartel will be detected – either through the Bureau's investigative programs or self-reporting programs – increases the chances that cartels members will see that their reporting the existence of a cartel first, and earning immunity from fines, would be in their own interest. However, if it is in the best interest of cartel members to wait until other cartel members self-report, then none will.

Immunity Program: The Immunity Program allows the first member of a cartel that informs the Bureau of the existence of a cartel, and cooperates with the subsequent investigation, immunity from the fines and prison terms their illegal behaviour might otherwise merit.¹ The Bureau states that the Immunity Program “has proven to be the Bureau's single most powerful means of detecting criminal activity.”

Leniency Program: Subsequent members of a cartel that come forward to Bureau are eligible for the Leniency Program.² The first, non-immune, cartel member that applies for leniency is eligible for a 50 percent reduction

1 For details, see the Competition Bureau's Bulletin on the Immunity Program under the Competition Act, available online at: [http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/vwapj/Immunity-Program-2010.pdf/\\$FILE/Immunity-Program-2010.pdf](http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/vwapj/Immunity-Program-2010.pdf/$FILE/Immunity-Program-2010.pdf)

2 For details, see the Competition Bureau's Bulletin on the Leniency Program, available online at [http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/vwapj/LeniencyProgram-sept-2010-e.pdf/\\$FILE/LeniencyProgram-sept-2010-e.pdf](http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/vwapj/LeniencyProgram-sept-2010-e.pdf/$FILE/LeniencyProgram-sept-2010-e.pdf)

in the potential fine that the Bureau otherwise would have recommended. The second cartel member to come forward is able to reduce its potential fine by 30 percent, and subsequent cartel defectors also are eligible for reduced fines.

Issues with Cartel Detection in Canada

Although the Council is sceptical about the application of economic data in detecting cartels in practice, Council members felt that the Bureau should consider changing how it approaches the task of investigating, detecting and prosecuting cartels.

Application of Data

There was consensus among the Council that the Bureau should not adopt policies that would direct significant resources pursuing economic data or statistical approaches as a means of enhancing cartel detection. The group thought that, in practice, such methods would only rarely help the Bureau identify instances where successful prosecutions would follow from its actions. Moreover, economic data are not well suited to distinguishing tacit but perhaps legal practices from explicit illegal agreements to fix prices or share markets.

International Cartels

The Council agreed that the Bureau's pursuit of international cartels has appeared to be a prominent part of its enforcement program. In general, these cases have arisen following prosecution efforts abroad. On the one hand, some members of the Council thought that this has been an effective means of leveraging the Bureau's limited resources to address cartels that harm Canadian consumers. However, some members of the Council were of the view that the international cartel members that report to the Bureau under the Immunity and Leniency Programs do not contest Canadian fines, creating a gap in case law development in Canada.

Domestic Cartels

The Council expressed concern that the Bureau has been involved in relatively fewer domestic cartel cases compared to international cartel cases. The Council believed that the reason may be that domestic cartels may face incentives to report that differ from those facing international cartels, and that the Bureau's Immunity and Leniency Programs are less effective than they could be in domestic cases. The Council is generally of the view that international cartel members may make their self-reporting decisions based on potential penalties in other countries, and subsequently seek immunity or leniency in Canada only to minimize global legal exposure.

While there was consensus that it is sensible for the Bureau to rely on foreign enforcement efforts in respect of international cartels that have an effect in Canada, some Council members stated that the Bureau needs to do more with respect to the suite of incentives that a domestic cartel participant faces. A number of Council members were concerned that the Leniency Program's staged mitigation of potential fines reduces the incentive for a firm to be "first-in" to disclose the existence of the cartel under the Immunity Program. On this view, to the extent that being the second to disclose also significantly reduces potential punishment, each cartel member might find it worthwhile to wait for someone else to disclose first, leading to a situation in which no one discloses at all. The Council believes that the Leniency Program may be blunting the Immunity Program.

In more formal terms, if the net costs relative to benefits of being the second or subsequent applicant for leniency are low compared to being the first, and the likelihood of subsequent detection and successful prosecution without an informant is low or uncertain, then each cartel member has otherwise less incentive to be an early informant. Each cartel member might sensibly wait until others report, which, if all reason similarly, may create a situation whereby no member comes forward.

Reforming Cartel Detection in Canada

The Council believes that the Bureau and the federal government should ensure that sufficient resources and policy emphasis are placed on investigation, detection and prosecution of domestic cartel-like activity and the Council reached the following conclusions:

The Council believes in general that the Bureau's cartel detection policies and programs should aim to increase the likelihood of a successful and thorough prosecution, even if there is only one defector from a cartel.

Successful immunity and leniency programs, accompanied by other cartel detection programs would amplify cartel instability. In theory, this militates for supplements, such as sector studies conducted by the Bureau, to augment traditional means of detection, which often rely on buyers or other market participants to inform the Bureau of their suspicions of a cartel's existence. Yet, economic studies or reliance on like methods cannot prove the existence of illegal cartels, and will not predict which sectors are worth prosecuting – they may, however, increase the chances that any cartel member will perceive being the first defector as the best option.

The Council thought that public awareness about the potential criminality of cartel-like behaviour, and the existence of the Immunity and Leniency Programs, was lacking. Greater awareness would be beneficial in increasing both the likelihood, and the perception within cartels, that a cartel member will defect or that a customer or buyer of a cartel will inform the Bureau of its suspicions. Sectoral market studies and economic approaches to cartel detection might be useful in this process.

There was a consensus among the Council that, to encourage firms to be the first defector from a cartel, the Bureau should ensure that there are clear differences in how Immunity Program participants are treated versus how the first and subsequent Leniency Program members are treated. This would create a stronger incentive for members of domestic cartels to report on the existence of a cartel. However, at least one member of the Council argued that the Leniency Program could be misused by firms, were they to falsely report the existence of a cartel in an effort to direct scrutiny to their competitors.

Lastly, some members of the Council expressed concern that the efficacy of the Immunity and Leniency Programs are undermined by the emergence of class-action lawsuits, in which the potential damages a firm could incur as a result of self-reporting may be larger than the reduction in statutory fines that would result from self-reporting. However, the group reached no consensus on the appropriate path forward on this emerging issue.

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Members of the Council participate in their personal capacities, and the views collectively expressed do not represent those of any institution or client.

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