

# Leniency and civil claims

## Should leniency programmes extend to private actions?

by *Jonathan Green and Iona McCall\**

Currently in the European Union, almost all member states have national leniency programmes in place for companies that have been involved in cartels, many of which are now aligned with the European Competition Network model leniency programme. (The only member states still not to have leniency programmes in place are Malta and Slovenia, though Slovenia is in the process of introducing such a policy.) The European Commission (EC) also has a leniency programme that applies at the EU level. Leniency programmes are generally considered to play a significant role both in reducing regulatory costs and in undermining companies' incentives to engage in collusive behaviour. As such, the impact of increased private actions in Europe on the efficiency of leniency programmes is an important issue.

In April 2008, the EC published the white paper on damages actions for breach of the EC antitrust rules. The aim of the white paper is to "address the obstacles to effective antitrust damages actions" that were identified in the green paper published in 2005. One of the proposals set out in the white paper refers to the interaction between leniency programmes and private actions. This raises both the issue of disclosure in private actions for damages and the impact of civil liability on the effectiveness of leniency programmes.

Disclosure in civil cases of corporate statements submitted by applicants for leniency under the public programme has been discussed at length as part of the consultation process. The issue that has been commented on in less detail is the impact of extending leniency to civil cases. Here, we focus on the civil liability issue and assume that leniency applications follow the approach employed in the US of non-disclosure. This assumption is consistent with the position set out by the European Commission in the white paper: "adequate protection against disclosure in private actions for damages must be ensured for corporate statements submitted by a leniency applicant in order to avoid placing the applicant in a less favourable situation than the co-infringers".

### **The options for addressing leniency in the context of civil liability**

The original green paper published in 2005 offered two options for interacting leniency programmes with civil damages cases:

Option 1 was the award of a rebate on any damages claim conditional upon the provision of evidence to claimants in follow-on damages claims.

Option 2 was the removal of joint liability for successful leniency applicants, guaranteeing that their liability would be strictly limited to a certain share in the damage caused.

According to the Commission staff working paper that accompanied the white paper:

"Generally, under the rules of civil liability applicable to antitrust damages actions, undertakings which are parties to anticompetitive agreements are liable for the entire damage caused by these agreements. The co-infringers are jointly and severally liable for the damage caused by their actions. This means ... that a victim having suffered harm ... may claim his entire damage not only against his trading partner(s), but also against any of the other parties to the illicit agreement. However, between the co-infringers, the liability is several. This implies that the infringer who compensated the entire harm then has a right to seek contribution from the other co-infringers."

Responses to the green paper also suggested that Option 2 should not be made conditional upon the co-operation of successful leniency applicants with the victims on the civil side.

In addition to the form of any reduction in a successful applicant's civil liability, the issue of which companies should be candidates for any extension of the leniency programme was also raised. In particular, whether only the first company to come forward under the leniency programme and enjoy full immunity should benefit from a reduction in civil liability, or whether benefits should extend to all successful applicants of leniency programmes.

Based on the discussions of these various issues, the white paper proposed that only the company awarded immunity under the leniency programme should benefit under private actions, limiting its liability to its direct and indirect contractual partners. So, for example, if the claimant only sourced 20% of the affected products from the immunity recipient, the company would only be liable for the damages associated with that 20%. It was also suggested that the immunity recipient bear the burden for proving the extent of its liability under this proposal. We discuss here the potential implications such a policy would have on firms' incentives to apply for leniency and thus the effectiveness of leniency programmes.

### **The economic implications of extending leniency programmes**

First of all, we consider very simply how leniency programmes work. The impact of leniency programmes on a firm's incentives can be broadly represented by the prisoner's dilemma game. By altering the payoffs, under a simple one-period scenario the optimal strategy for a firm acting in collusion with another firm is to "cheat"; that is, the optimal choice for the firm will be to report the behaviour to the authorities and benefit from the lenient treatment. This is true

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whatever the composition of the collusive agreement under this simple static model. This is illustrated in the table below.

### Payoffs under a leniency programme

	Collude	Co-operate with authorities
Collude	$\pi_C, \pi_C$	0, -x
Co-operate with authorities	-x, 0	-x+1, -x+1

If neither company comes forward and they continue to enjoy the benefits of colluding, they each earn profits,  $\pi_C$ . If there is a leniency programme in place, which awards full immunity to the first company that comes forward, the company that comes forward first and applies for leniency receives a fine of zero, while the other company that does not co-operate with the authorities bears the full cost of the fine, -x. If both firms come forward and both benefit from the leniency programme (but not necessarily full immunity), they both receive a reduction in the potential fine of +1.

In a scenario that extends over more than one period (ie a repeated game), however, where there is scope for the collusive firms to punish any deviation from the agreed rules, a firm's optimal strategy may vary. For a collusive agreement spanning a defined amount of time, it will always be optimal for the firm to defect in each period. This is because, given the defined timeframe and the gains from defecting, each firm has an incentive to report the collusive agreement to the authorities towards the end of the contract life. Since only the first to report the misconduct will benefit from full immunity, knowing that the firms have an incentive to defect towards the end of the contract life, they will have an incentive to defect earlier, and so on, undermining collusion.

Even though breaking the agreement and reporting the collusive practices to the authorities is no longer the firm's dominant strategy in a multiperiod model with an undetermined time horizon, it is clear from this discussion that leniency offers a very real incentive for firms to come forward with information. As Spagnolo suggests, this reflects the age-old principle of divide and conquer. Clearly, therefore, if an existing leniency programme is well designed, any increase in the potential size of fines and civil liabilities – for example, through an increase in the number or value of successful private actions – will weaken the leniency programme by reducing the benefits of “cheating”, unless leniency is also extended, in some way, to cover the civil actions.

One way to offset this, from the firm's perspective, would be by extending the programme to limit the successful leniency applicant's civil liability. The lower the expected cost of coming forward, the more likely the company is to do so. That is, the lower the likely fine and civil liability, or the lower the probability of such financial burdens, the more attractive reporting the cartel will be. Consequently, any increase in the expected value of a company's private liability will reduce the

incentives to come forward. This point is particularly relevant when considering the issue of non-disclosure; if corporate statements submitted by leniency applicants are not protected, the probability of their being pursued and penalised through private actions increases, and so does the expected value of the company's civil liability.

The relative size of the expected value of potential public penalties and the expected value of civil liabilities will determine the relative importance of each stage of the process. For example, if public fines tend to represent a large proportion of a company's turnover while the civil liability is likely to be relatively small, the scope for leniency under the public system will be more important in determining the willingness of a company to report collusive behaviour. This will depend not just on the size of fines. The entire package of penalties at the public level will have an impact as well as the likelihood of being caught. For example, in countries where those not covered by leniency programmes can face criminal prosecution, the relative importance of the public penalties is likely to be stronger than in countries where such punishments do not form part of the penalties regime.

The rationale that only the company that benefits from full immunity under the leniency programme should enjoy some form of leniency in private actions follows directly from this. Under leniency programmes, companies effectively benefit from being the first to come forward or “move”. This is known as the first-mover advantage. The remaining cartel members must assume that they have been exposed and the profits they earn from their collusive behaviour will cease. As such, they require less incentive to come forward with evidence once the cartel has been exposed, so smaller reductions in fines are required to incentivise them to co-operate with the investigation.

### What can we learn from the United States?

In the US, the leniency programme only benefits the first firm to come forward with evidence. Prior to an investigation, full amnesty from criminal prosecution is granted to the first company to come forward – subject to a number of conditions – and to all their staff that admit their involvement. These conditions include, for example, the company (1) reacting promptly on initial discovery of the illegal behaviour, both in terms of stopping it and reporting it to the authorities; (2) co-operating fully and honestly with the authorities; and (3) not being the leader of the illegal activities of the cartel.

Immunity may still be granted to that company even if an investigation is already underway, as long as the Department of Justice (DoJ) does not already have sufficient evidence against that company to convict them. Subsequent companies coming forward receive no benefit under the corporate leniency policy, although by co-operating and entering into an agreement with the DoJ they may secure a more lenient sentence under the US sentencing guidelines (on average, a 30% to 35% discount for the second company to co-operate, with the size of the reduction falling with each subsequent firm, although there are no set discount rates for co-operation).

Historically, private actions have been more common in the US than Europe, with private filings accounting for at least 80% of all antitrust filings each year, and penalties can reach as high

as three times the estimated damage. Since 2004, however, as a result of the Antitrust Criminal Penalty Enhancement and Reform Act (ACPERA), companies in the US that are granted immunity under the leniency programme can also benefit from a reduced civil liability. Under the terms of the policy, the company that has successfully applied to the DoJ for leniency in a cartel case, and which co-operates with private claimants in civil actions, is only liable for single damages, and is removed from the joint and several liability rule for co-conspirators. In this way, a successful applicant for immunity can cap not only the criminal penalties but also the scope of the civil claims, in that it can only be sued by its own customers.

Following revisions to the corporate leniency programme in 1993, the DoJ estimated the application rate for leniency increased from around one amnesty application per year to approximately two per month. A similar increase has not been noted following the introduction of ACPERA, even though the number of private actions is thought to have risen steadily between 2004 and 2007.

According to Connor, given the relative infrequency of civil actions in cartel cases in the EU and the size of the EU market, the total potential liabilities of cartelists in the EU are, in practice, much lower than in an equivalent case in the US. Comparing the size of public penalties imposed and the total civil liability of individual cases in the US, based on data on international cartels between 1990 and 2003, private settlements in the US were almost double the size of government fines. Even so, Connor illustrates that private settlements tend to be significantly less than the triple damages available under the Sherman Act.

This might suggest that, in the US, the leniency provisions set out in ACPERA may have only a limited effect, though a more important one than we might expect in the EU, given the relative importance of civil liabilities as a proportion of the public penalty in the US compared to the EU.

The number of cases to date that have discussed the application of ACPERA with respect to the size of the private settlement is small. Examples include:

- *In re Sulfuric Acid Antitrust Litigation* (ND Illinois) – where the legislation was used to reduce the settlement amount paid by amnesty defendants.
- *In re International Air Transportation Surcharge Antitrust Litigation* (ND California) – where the legislation was used to reduce the settlement amount paid by the amnesty defendant.
- *In re Urethane Antitrust Litigation* (D Kansas) – where the settlement accounted for ACPERA co-operation.

The seemingly infrequent application of the prescriptions on leniency suggests they have had a limited impact on cartels and the behaviour of cartelists. However, the fact that the leniency extension has apparently not been applied in many cases does not preclude the possibility that it has affected behaviour, in particular a decision by the whistleblower to come forward.

ACEPERA also introduced more severe penalties for companies contravening the Sherman Act: (1) the maximum corporate fine was increased from \$10m to \$100m; (2) the maximum individual fine was increased from \$350,000 to \$1m; and (3) the maximum jail term was increased from three to 10 years.

These strengthened penalties make it even harder to determine the impact of extending leniency to civil cases as they will also have had an impact on behaviour, both in terms of deterring companies from colluding in the first place and in increasing the incentive for firms engaged in a cartel to come forward and benefit from the leniency programme. Separating out these effects from the incentives created by extending the leniency programme to private actions would be so difficult as to be nigh impossible.

That said, what evidence that exists can provide some interesting insights into the impact of the legislation. Of particular interest is the fact that it is the more severe penalties that appear to have been most frequently employed by the courts, rather than the leniency aspect. Most civil cases have tended to be settled out of court for less than or equal to the actual amount of damage anyway, so the leniency element of the legislation appears to have been less relevant.

The de-trebling provision is subject to a five-year sunset provision and, therefore, in theory only lasts until the end of June this year. It will be interesting to see if there is a deluge of companies applying for leniency in the run-up to this point, as companies seek to benefit from the leniency in civil liabilities. This would go some way to indicate that it has a real impact on the effectiveness of the leniency programme.

### Conclusions

Given the general success of leniency programmes in encouraging disclosure of cartels, it is important not to undermine them with any changes that might increase the likelihood of companies facing private action claims. In principle, if leniency is not extended to civil liabilities, the incentive for first movers to come forward would be reduced. However, it is not clear, based on the evidence from the US, that an extension to civil action would have a significant effect if fines are increasing at the same time. Nonetheless, maintaining the strength of the incentive for first movers to disclose will be an important element of the work the Commission is carrying out to encourage civil actions.

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