

Criminalizing Cartel Activity: Lessons from the U.S. Experience*

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Introduction

Cartel enforcement in Australia has been on the rise in recent years, most recently aided by the implementation of the ACCC's amnesty program in June 2003. Under the existing civil penalty regime in Australia, corporations involved in cartels face pecuniary penalties of up to AUS\$10 million per contravention, while their executives face penalties of up to AUS\$500,000 per contravention.

On June 24, 2004, the Australian Federal Government introduced legislation to amend the Trade Practices Act ("TPA") in response to the Dawson Report to further stiffen the sanctions for cartel behavior. The proposed amendments would introduce criminal sanctions, including jail terms, for individuals for "hard-core" cartel behavior, as well as substantially increase the maximum fines for corporations. The maximum penalty for corporations would increase from its current level to the greater of AUS\$10 million, three times the gain from the contravention, or where the gain cannot be readily ascertained, 10% of the group's annual Australian turnover. Under the proposed amendments, corporations will be prohibited from indemnifying employees and officers for penalties they incur, and individuals who are convicted of such offenses may be prohibited from managing corporations.

Cartels have been crimes punishable by imprisonment in the United States ever since the passage of the Sherman Act in 1890. As Australia considers making cartels criminal, I have been invited to share our experiences over the last century with you and to discuss the key lessons we have learned. I believe there are five.

- The first lesson is that criminal sanctions for individuals, including jail time, are absolutely critical for effective enforcement and deterrence. Nothing catches a corporate executive's attention as effectively as the threat that she might have to serve jail time. In addition, jail sentences for individuals provide a means to induce lower level employees to testify against their superiors and co-conspirators in exchange for immunity from prosecution or a reduced sentence.
- The second lesson is that a criminal enforcement system can work effectively only with the right level of sanctions and with a sentencing regime that provides a sufficient level of certainty to encourage cartel participants to cooperate with the

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government's investigation. Unrealistically long sentences, even for individuals who cooperate with the government's investigation, will discourage cooperation. Uncertainty as to sentencing will discourage cooperation even more.

- The third lesson is that criminal sanctions make a lawyer's job immeasurably more difficult. They require much more difficult judgment calls, and they require paying much closer attention to possible conflicts of interest between the company and its employees.
- The fourth lesson is that the availability of criminal sanctions makes it more important than ever that companies have in place effective antitrust compliance programs and that they react quickly and effectively when they discover cartel activity. To assist you in designing effective compliance programs, I will review some of the common characteristics of cartels that have emerged from the multinational cartels that have been prosecuted in the United States over the last ten years.
- The fifth, and final, lesson is the importance of international cooperation among enforcement agencies in prosecuting multinational cartels and the corresponding need for counsel to closely coordinate their defense of a cartel investigation with co-counsel in other jurisdictions.

I begin with a brief history and overview of U.S. criminal enforcement over the past century. I then turn to each of these five lessons.

History and Overview of U.S. Criminal Enforcement

A. Increased Penalties for Criminal Violations

When the Sherman Act was enacted in 1890, it provided that violations would constitute misdemeanors, punishable for individuals by imprisonment of no more than one year and fines of no more than \$5,000. The statute therefore gave the Department of Justice the authority to prosecute violations criminally, but also gave it authority to proceed civilly, seeking equitable relief to enjoin violations or, as in several famous early cases such as *Standard Oil* and *American Tobacco*, dissolution of an unlawful combination. In 1914, in the Clayton Act, Congress added a private right of action, allowing victims of antitrust violations to sue to recover treble damages, plus their attorneys' fees.

Under this dual liability regime, the Department of Justice can prosecute violations criminally only if they are offenses commonly understood to be criminal. The policy of the Justice Department is, accordingly, to prosecute a case criminally only when it clearly falls into a "hard core" category of antitrust violations -- which is limited to horizontal price-fixing, bid rigging, and market allocation agreements.

From 1890 to 1974, criminal prosecution followed by imprisonment of individuals was rare, and fines were rarely substantial enough to constitute much of a deterrent. This changed

dramatically in 1974, when Congress passed the Antitrust Procedures and Penalties Act.¹ The Act upgraded criminal antitrust offenses from misdemeanors to felonies, and substantially increased the penalties for these crimes -- providing for fines of up to \$1 million for corporations and up to \$100,000 for individuals, and jail sentences of up to three years for individuals. Following this increase in penalties, prosecutions jumped dramatically -- from 14 in 1972 to 34 in 1977 to 92 in 1983.

In 1987, enactment of the alternative sentencing provision further upped the potential penalty, providing for recovery of fines in excess of the statutory maximum -- for up to twice the gain to conspirators or twice the loss sustained by victims of the conspiracy.² Just three years later, in 1990, Congress once again increased the maximum fines for criminal antitrust convictions, raising the maximum fine to \$10 million for corporations and \$350,000 for individuals.³ And just two months ago, Congress increased the penalties yet again in the Antitrust Criminal Penalty Enhancement and Reform Act of 2004.⁴ The Act increases the maximum Sherman Act corporate fine to \$100 million, the maximum individual fine to \$1 million, and the maximum Sherman Act jail term to 10 years.

B. Evolution of Enforcement Focus

In the 1980s, the Antitrust Division's cartel prosecution efforts were mainly aimed at domestic cartels, often in very local businesses. These included, among others, road paving, trash hauling, linen supply, and electrical contracting. While there were a large number of prosecutions, and a number of individuals served jail time, the corporate fines associated with these cases generally were quite small. The largest corporate fine, as of 1995, was only \$11 million.

This focus changed dramatically in the mid-1990s starting with the Archer-Daniels-Midland Co. ("ADM") lysine conspiracy, which marked the beginning of an era of increased cartel enforcement aimed primarily at large multinational cartels. In 1996, ADM entered into a \$100 million plea agreement, with the Division expressly utilizing the alternative minimum sentencing provision.⁵ Since then, the Division has investigated and prosecuted many international cartels, several of which have resulted in corporate fines greater than \$100 million. The largest corporate fine to date was collected in 1999, when Hoffman LaRoche agreed to pay \$500 million for its participation in the vitamins ~~cartel~~.⁶

In addition to seeking much larger fines from companies, the Justice Department has also been successful in securing longer prison sentences for individuals. The average prison sentence for a U.S. citizen convicted of an antitrust violation is now 22 months. Foreign executives have been treated somewhat more leniently, with the maximum jail sentence imposed to date being only seven months. These shorter sentences reflect the Justice Department's recognition that it

¹ Pub. E. No. 93-528, § 3, 88 Stat. 1706, 1708 (1974) (current version at 15 U.S.C. §§ 1-3 (1994)).

² 18 U.S.C. § 3571(d) (1994).

³ Antitrust Amendments Act of 1990, Pub. L. No. 101-588, § 4, 104 Stat. 2879,2880 (1990) (codified at 15 U.S.C. §§ 1-3 (1994)).

⁴ Pub. L. No. 108-237, 118 Stat. 661 (2004).

⁵ United States v. Archer Daniel Midland Co., Crim. No. 96-CR-00640 (N.D. Ill. October 15, 1996).

⁶ United States v. F. Hoffman-La Roche Ltd., Crim. No. 99-CR-184-R (N.D. Tex. May 20, 1999).

has to be willing to recommend a shorter sentence for foreign executives in order to induce them to agree to surrender voluntarily and come to the United States to serve jail time. This will become a less important consideration as more countries criminalize cartel conduct, exposing their nationals to extradition.

As the Division turned its eyes toward detecting and prosecuting multinational cartels, it has had to confront a host of other issues. Because of the international scope of these cases, the Antitrust Division realized that it could not investigate these cases on its own. Rather, it would need assistance, wherever possible, from foreign enforcement agencies and foreign governments -- assistance both in regard to gathering and collecting evidence as well as with capturing fugitives. Consequently, the Division worked very hard in the 1990s to develop relationships and to put into place bilateral treaties that would facilitate coordinated activities and the sharing of information. As the past years have shown, these efforts have proved very fruitful indeed. However, the landscape is still evolving and further changes can be expected as more and more countries begin to contemplate criminalizing cartel conduct.

As the Division became more involved in the prosecution of multinational cartels, issues also arose in connection with efforts to prosecute foreign executives who participated in conspiracies. In the U.S., foreign citizens who are convicted of a felony offense risk deportation and permanent exclusion from the U.S. Realizing this would serve as a major disincentive for foreign executives who might otherwise agree to enter a plea agreement, in March 1996 the Division entered into a Memorandum Of Understanding ("MOU") with the Immigration and Naturalization Service ("INS") which establishes a protocol whereby the Division can advise cooperating aliens of their immigration status prior to entry of a plea agreement. This MOU ensures that the Division can provide written assurances to cooperating foreign executives that their convictions will not be used by the INS as a basis to deport or exclude them from the United States.

Similarly, the Division also realized that some culpable foreign executives might not be so troubled by remaining a fugitive from the U.S. or by the inability to ever travel to the United States. Consequently, the Division needed some other way to maximize their ability to get jurisdiction over these individuals. Thus, in 2001, the Division adopted a policy of placing indicted fugitives on the Interpol "Red Notice" list, which serves as a request to Interpol member nations that if the named person is apprehended at customs or otherwise, he or she be arrested, with a view towards extradition. The Division clearly announced that it would seek to extradite any fugitive apprehended through this mechanism. With this mechanism in place, fugitives know that it is not only travel to the United States that they need to worry about. Rather, they now know that their ability to travel to many other countries may also be significantly impeded and that, should they choose to nonetheless travel they risk being apprehended, detained and (depending on the country) deported to the U.S. where they will no longer be the beneficiary of any sort of "leniency" for cooperation.

Lesson One -- The Importance of Criminal Sanctions to Effective Cartel Enforcement

Our experience in the United States has taught us that criminal sanctions are absolutely essential to effective cartel enforcement. There is no more effective deterrent to cartel behavior

than the knowledge that, if caught, the individuals involved will have to serve jail time. Almost as importantly, there is no other effective way to persuade lower level employees to cooperate in an investigation and to supply evidence that will incriminate their superiors, their employers, and their co-conspirators. The ability to offer a participant in a cartel either immunity from prosecution or a reduced sentence in exchange for testimony is the prosecutor's single strongest weapon in cartel enforcement. Without that weapon, most employees would be unwilling, either for reasons of loyalty or because of fear of retaliation or of being ostracized, to "fink" on their fellow executives and co-conspirators.

In the United States, it is standard practice in any cartel investigation in which there is not a corporate amnesty applicant for the prosecutors to "work their way up the food chain" by offering lower level employees whom they believe may have incriminating evidence immunity or a reduced sentence in exchange for their agreement to testify. This has led to the development of a standard set of procedures for accomplishing this. The first is to approach an employee, usually through an unannounced visit to her home during which the lawyers conducting the investigation, often assisted by an agent of our Federal Bureau of Investigation ("FBI"), will advise the employee that the Department has reason to believe the employer has been involved in unlawful cartel activity, but offering her immunity from prosecution or a reduced sentence if she agrees to cooperate. In some instances, as in the famous case of Mark Whitacre in the ADM lysine case, the individual will agree not only to tell the investigators what he knows but may also agree to wear a wire and otherwise cooperate in assisting the Division in conducting surveillance of future cartel meetings and telephone communications. For a fascinating description of how this works in practice, I recommend Kurt Eichenwald's book, *The Informant*, to you

Employees who consult an attorney will generally be advised that it is not in their interest to talk to the prosecutors without the attorney first making an "attorney proffer," in which the attorney describes in hypothetical terms what information the client has to offer. Assuming the Division indicates that this information will be sufficient to qualify the employee for immunity or a reduced sentence, the next step is to set up an interview under what we call "Queen for a Day" rules, in which the prosecutors agree not to use anything the witness tells them as direct evidence against the witness so long as she tells the truth, but is free to use the information to develop leads and other evidence. There is a standard form letter that is used for this purpose. The final step is to obtain a court order granting the witness full immunity or to enter into a plea agreement with a "5K1.1 letter" recommending a reduced sentence, following which the prosecutor will put the witness before the grand jury in order to take her testimony under oath with a full transcript.

Lesson Two -- The Importance of Certainty: Amnesty Policy and the Sentencing Guidelines

A. The Importance of the Leniency Program to U.S. Criminal Cartel Enforcement

The Leniency Program has played a major role in the Antitrust Division's successful prosecution of criminal cartels. As criminal penalties associated with cartel conduct have increased, companies and individuals have more to lose by not being first in the door.

Companies become less willing to risk that their cartel activities will go undiscovered or unreported, and more willing to self-report promptly in the hopes that they get the first mover advantage.

Even in the face of criminal sanctions, a company is only likely to self-report and apply for amnesty where the uncertainty associated with the grant of amnesty is minimal. This was a major weakness of the original Amnesty Policy implemented in 1978. The 1978 policy was one under which the grant of amnesty was *discretionary* and under which amnesty was *never* available once the Division had begun an investigation. In 1993, the Division significantly revised its Amnesty Policy in three ways -- amnesty was made *automatic* if there was not a pre-existing investigation (and if the other conditions were met), amnesty was still available where the cooperation began after the investigation was started, and all employees of the amnesty applicant who cooperated were protected from criminal prosecution. By all accounts, these modifications had a major impact on the Antitrust Division's enforcement efforts. Whereas under the old program the government received roughly one applicant per year, under 1993 revised policy applications by 2003 had jumped to more than one per month.'

The recent passage into law of the Antitrust Criminal Penalty Enhancement and Reform Act of 2004 not only makes the proverbial "stick" bigger by dramatically increasing the penalties for criminal antitrust violations, but also sweetens the "carrot." The Act provides that, in addition to obtaining immunity from prosecution, the successful applicant no longer faces the prospect of liability for treble damages in the inevitable follow-on civil suits, but will be liable only for actual damages. Given the potential civil exposure associated with joint and several liability and treble damages, this new law creates even greater incentives for those who discover cartel conduct to promptly and completely self report.

A second important feature of the Leniency Program that has been critical to its success is that a grant of amnesty extends not only to the company, but also to all employees who agree to come forward and cooperate with the government's investigation. Since the government needs the testimony of these employees, and since no employee in her right mind would agree to testify without protection from prosecution or at least a plea agreement recommending a reduced sentence, extending the grant of amnesty to individual employees is absolutely crucial in a regime in which cartel behavior can be prosecuted criminally.

A third important feature of the Justice Department's Leniency Program that has been critical to its success is that it is paperless. Because amnesty does not protect recipients from liability in private damage actions, companies would be loathe to participate or cooperate if there were a substantial risk that the evidence they provide the Justice Department could be used against them in the civil suits that inevitably follow. The Department, therefore, does not require a written application for amnesty, but instead will accept an oral proffer by the company's attorneys. Similarly, in taking evidence, the Department will interview employees informally, without taking a transcript, until late in the investigation when it may be necessary to have them testify before a grand jury in order to build a record to support indictment of other participants in

⁷ James M. Griffin, *The Modern Leniency Program After Ten Years: 'A Summary Overview of the Antitrust Division's Criminal Enforcement Program,'* presented at the ABA Section of Antitrust Law Annual Meeting (August 12, 2003).

the cartel. And in taking evidence from overseas, the Department will agree to inspect documents while they remain in the company's possession, not taking copies until the company's amnesty application has been perfected.

B. The Importance of the Sentencing Guidelines in Providing Certainty

Because there can be only one amnesty recipient under the Division's leniency policy, the remaining co-conspirators are left to decide whether or not to cooperate with the Division and to enter into plea agreements. While often tied together, the considerations in making this decision can be very different for the corporation and its at-risk executives.

Corporate conspirators faced with a decision to cooperate are often in situations where the government, through the amnesty applicant or other cooperating conspirators, has gathered evidence sufficient to prove liability. Thus, where an internal investigation indicates that the company did in fact step over the line, the principal question that remains is the extent of fines. In these situations, the Sentencing Guidelines provide a mechanism by which companies can readily ascertain what their maximum exposure would be if they litigated the matter. Similarly, the Division's practice of making fine calculation worksheets publicly available provides a level of transparency that enables companies contemplating cooperating with the Division to ascertain what kind of "deal" they could get from cooperation.⁸ Armed with this information, companies can quickly make an assessment of the risks vs. rewards associated with cooperating. More often than not, the ultimate decision, while admittedly difficult for companies to swallow, is obvious.

A recent Supreme Court decision has called into question the use of the Sentencing Guidelines to enhance fines or sentences based on factors that are not plead and proven beyond a reasonable doubt. In *Blakely v. Washington*,⁹ the Court held, in a case arising under state law, that the statutory maximum "is the maximum sentence a judge may impose solely on the basis of the facts reflected in the jury verdict or admitted by the defendant."¹⁰ This decision is anticipated to have a profound affect on many criminally prosecuted cases that result in plea bargains. In such cases, both the government and defendants will know that the government has to work harder to prove beyond a reasonable doubt any facts that could potentially increase a defendant's sentence. Consequently, defendants may have more leverage in negotiating settlements. In order to cure the uncertainty *Blakely* has introduced, the Division is joining with other divisions in the Justice Department in seeking prompt Supreme Court review of the issue of whether *Blakely* applies to the federal Sentencing Guidelines. In addition, the Division (and other divisions in the Department) are requiring that defendants execute a waiver of their rights under *Blakely* as a condition to the acceptance of any plea agreement.

⁸ The Division often publishes the actual fine calculation work sheets it submits to the court at the time of sentencing. These break down the fine calculation, showing mitigating and aggravating factors that were considered. Sample worksheets which can be found on the Division's website include the worksheets for Hoffman-La Roche, BASF AG and SGL Carbon AG.

⁹ 124 S.Ct. 2531 (2004).

¹⁰ Id. at 2537.

The decision of whether or not to cooperate can be much more difficult for individual employees who may be subject to individual liability or expected to enter an individual plea agreement in connection with the corporation plea." It remains to be seen how the recent increase in jail terms from three to ten years will affect the number of individuals who decide to plea, but it is safe to say that the reaction may well be mixed. For some, the threat of a much more substantial jail sentence (a very real threat given recent trends in the Division's enforcement efforts with regard to prison sentences) could motivate them to settle more quickly and to cooperate more readily. For others, the threat of such a substantial sentence could well cause them to refuse to cooperate and to, wherever possible, fight it out or leave their fate to a jury. Foreign defendants may more seriously consider (as many already do) living the rest of their lives as fugitives to be an acceptable alternative. At the end of the day, the true impact of the increased maximum sentences may depend on whether the Division's recommended sentences in connection with individual plea agreements increase as a result of the new statutory maximum. Only time will tell.

Lesson Three -- The Challenges for Defense Counsel

Criminal sanctions greatly compound the challenges facing a lawyer representing either a company or an individual employee in a cartel investigation. There are at least four important issues a lawyer will face in almost every case: potential conflicts of interest; indemnification for legal fees; joint defense arrangements; and avoiding charges of obstruction of justice.

A. Conflicts of Interest

Some of the most difficult issues for a lawyer in representing clients in criminal antitrust investigations relate to the ever-present conflicts of interest that arise. Except for the few individuals who are the true ringleaders of a cartel, it is almost always in the interest of individual employees to cooperate with the government. This makes it very difficult for a lawyer to represent both the company and its employees unless the company, too, has decided to follow a path of cooperation. Even then, a lawyer must recognize that even if the company is willing to cooperate in exchange for a reduced sentence, individual executives at a senior level who face prosecution personally will need separate counsel to advise them as to whether it is in their interest to cooperate as well, and to negotiate for them for as favorable treatment as possible.

These issues first arise at the very outset of any investigation when the lawyers seek to interview employees in order to learn the facts. In the United States, it is now customary in these initial interviews for a lawyer to give each employee what amounts to a modified Miranda warning. (Miranda is a Supreme Court decision requiring police to warn suspects of their right to consult an attorney before conducting a custodial interrogation.) In this warning, the lawyer tells the employee that she is representing the company, not the individual personally; that whatever the employee tells the lawyer is privileged, but that the privilege belongs to the company, not the individual and can be waived by the company; that while the lawyer does not know of any current conflict between the interests of the employee and the company, she will

¹¹ This, in turn, can be a problem for corporate defendants to the extent failure of a key conspiracy participant to cooperate in connection with the corporate plea negotiations and the subsequent carving out of any such person would diminish the value of the corporate cooperation.

advise the employee when and if such a conflict arises; and, finally, that if the employee wants to consult with separate counsel, the company can provide names of qualified lawyers who could serve in that capacity. This warning is viewed in the United States as highly advisable in order to minimize the risk that the employee might later claim not to have understood that the lawyer was not representing her and seek to have the lawyer disqualified or to have the information supplied treated as privileged with the privilege belonging to the employee.

The most difficult judgment call for the lawyer is whether and at what point to advise an employee that she should retain separate counsel. The Justice Department sometimes makes this decision for the lawyer by advising that it will object to the lawyer representing particular individuals at the company in addition to the company itself. More often, the time to advise an employee will come when the Department tells the company lawyers that it has particular executives in its sights. Even before this, counsel may decide that she should recommend that an employee retain separate counsel in one of two situations. The first is where the company has committed to cooperate, but particular employees seem unwilling to come clean or where counsel recognizes that the information the company will supply will make prosecution of the employees likely. The second is where the company is not willing to cooperate, but there are employees who have knowledge of wrongdoing whose personal interests would be better served by cooperating.

B. Indemnification for Legal Fees

One of the first questions any employee is likely to ask when given the option of consulting separate counsel is: who's going to pay the attorney fees. Under U.S. law, companies can generally agree to advance the monies needed to pay the attorneys' fees of individual employees during the course of an investigation, subject to an agreement by the employee to repay the company if the employee is convicted of, or pleads guilty to, criminal wrongdoing.

C. Joint Defense Arrangements

Because individual employees who retain separate counsel are subject to prosecution, they and the company may have a sufficiently common interest in the investigation to enter into a joint defense agreement. Such an agreement allows the lawyers for the company and the individual employees to exchange confidential information they receive from their clients without thereby waiving the attorney-client privilege. Such joint defense agreements are common and are advisable in most cases. I should caution, however, that in some recent investigations other components of the Justice Department have taken the position that a joint defense agreement may itself provide evidence of collusion.

D. Obstruction of Justice

In the United States, prosecutors are becoming increasingly aggressive in pursuing obstruction of justice charges against the subjects of criminal investigation. Three of the most visible and notorious criminal trials in the United States in the last three years have been for obstruction of justice: Arthur Andersen; Martha Stewart; and Frank Quattrone. The Antitrust Division is likewise making increased use of the obstruction of justice laws against the subjects

of cartel investigations, both to increase the prison terms of the co-conspirators and, in at least one case, to pursue the parent of a subsidiary that had engaged in cartel conduct.

In order to avoid obstruction charges, it is imperative that a company that has received a grand jury subpoena, or that knows it is about to become the subject of a criminal investigation, issue a document retention order to prevent the destruction of relevant evidence. This includes documents in electronic form, including e-mails. It is particularly important in this regard to discontinue the recycling of backup tapes. It is important also that the company do more than simply issue a document retention order; it must actively supervise the order to assure compliance with it. Finally, it is important that employees understand that the document retention order extends to documents they have in their possession at home relating to the conspiracy. One thing we have seen over and over again is that conspirators often keep the most sensitive documents at home where they can quickly and secretly be destroyed when an investigation commences. When that happens, and it is detected, the employee and even the company may be prosecuted for obstruction.

To avoid obstruction charges, it is also imperative to instruct employees not to discuss the subject matter of the investigation with each other or with counterparts at other companies who may have been involved in the conspiracy. Nothing will raise a prosecutor's antennae faster than evidence that co-conspirators are talking among themselves to coordinate their stories.

Lesson Four -- The Importance of Compliance Programs

The increase in criminal fines in the United States and the corresponding increase in value of being first in the door, makes it more important than ever to have an effective antitrust compliance program that is designed to prevent antitrust violations and to detect them quickly when they occur. The case for such programs becomes stronger as other countries, such as Australia, contemplate criminalizing or, in the case of the U.K., do criminalize cartel activity. In today's enforcement environment, a multinational firm, and its executives, engaged in cartel activity face enormous exposure: criminal convictions in the United States and possibly elsewhere; massive fines for the firm and substantial jail sentences for the individuals; proceedings by other, increasingly active antitrust enforcement agencies around the world where fines may be, individually or cumulatively, as great as or greater than in the United States; private treble damage actions in the United States; damage actions in other countries; and debarment from government contracting.

Given this exposure, it would be difficult to overstate the value of a compliance program that can prevent the violation from occurring. And if a violation does occur, it again would be difficult to overstate the value of a compliance program in detecting the offense early because amnesty is available to only one firm, the first to successfully apply in each cartel investigation. Only a company with an effective antitrust compliance program can hope to be in a position to be the first company in the door.

In order to design an effective compliance program, you have to know what you are looking for. From the dozens of multinational cartels that have been prosecuted over the last decade, we can discern a number of common characteristics that help explain why cartel

behavior remains common, notwithstanding the strong sanctions to which it is subject. Understanding these can help companies and their advisers in developing effective compliance programs.

A. Why Do Companies Form Cartels?

The cartels we see tend to fall into one of two categories. The first are those -- like the lysine and vitamin cartels -- in which the cartel members were fully aware that they were violating the law in the U.S. and elsewhere. In these cartels, the conspirators openly discussed, and even joked about, the criminal nature of their agreements; they discussed the need to avoid detection by antitrust enforcers in the United States and abroad; and they went to great lengths to cover-up their actions -- such as using code names with one another, meeting in secret venues, creating false "covers" for their meetings, using home phone numbers, and giving explicit instructions to destroy any evidence of the conspiracy.

The second type of cartel is one in which the participants seem oblivious to the serious risks they are running. These are particularly common in jurisdictions without a long tradition of aggressive anti-cartel enforcement and in industries in which cartel behavior has been a way of life for generations. In these situations, executives are often uncertain as to where the line is drawn between lawful consciously parallel conduct and illegal cartel behavior. This permits them to deceive themselves into believing that what they are doing is not really wrong, especially if they believe it is necessary to correct what they see as an imbalance in bargaining power between themselves and their customers.

1. Involvement of Senior Executives

In both types of cartels, one of the most startling characteristics is that these multinational cartels almost invariably involve the most senior executives at the firms involved -- in some cases, executives who have received extensive antitrust compliance counseling and who themselves have significant responsibilities in the firm's antitrust compliance programs. For example, the vitamin cartel was led by the top management at some of the world's largest corporations, including one company -- F. Hoffmann-La Roche -- which continued to engage in the vitamin conspiracy even as it was pleading guilty and paying a fine for its participation in the citric acid conspiracy. These executives are not only disdainful of their customers and of the law, but also show equal contempt for their own company's rules -- rules adopted to protect the company and them from criminal conduct. They will, therefore, go to great lengths to make sure that you, as inside or as outside counsel, don't find out about their criminal activity. As such, it is important that antitrust audits be as thorough as possible.

2. Awareness of Wrongdoing

The power of criminal enforcement is illustrated by another characteristic common to those cartels in which the conspirators know that their conduct is unlawful -- namely, their efforts to stay away from the United States. International cartels often try to minimize their contacts in the United States by conducting their meetings abroad. This has been particularly true since 1995, when the lysine investigation became public. In fact, cooperating defendants in

several recent cases have revealed that the cartels changed their practices and began avoiding contacts in the United States at all costs once the Division began cracking and prosecuting international cartels. Some cartel members go so far as to try to keep their cartel activity secret from all U.S.-based employees, even those responsible for carrying out their instructions as to the firm's output and prices. However, the cartel members continue to target their agreements at U.S. businesses and consumers; the only thing that has changed is that they conduct nearly all of their meetings overseas. We can expect to see similar concern arising with respect to other countries such as the U.K. and Australia as they implement stricter penalties for cartel activities and to see a corresponding increase in their cartel enforcement activities.

B. What Type of Companies Participate in Cartels?

1. Cartel Members Come in All Sizes

While many cartels involve closely-held companies, many others have involved top management at some of the world's largest corporations and most respected corporations including ADM, Hoffmann-La Roche, BASF, ABB, and a host of others. What this means is that even the largest companies can become sloppy about their antitrust compliance programs and can fail to do all they should to educate managers about the risks at which they put themselves and their companies by engaging in cartel activity.

2. Cartel Participants Tend to be Recidivists

Experience shows that cartel participants tend to be recidivists. The most notorious example is Hoffmann-La Roche, which continued its participation in the vitamin conspiracy even as it was entering into a plea agreement for its participation in the citric acid cartel. It is not surprising, therefore, that many cartel investigations originate as follow-on investigations in circumstances where the competition authorities have uncovered cartel conduct in one market and then find similar conduct in other markets in which the same companies participate. One of the first things to do, therefore, if you client has participated in a cartel in one industry is to look under every rock in every other industry in which the company competes for similar misconduct.

C. What Types of Agreements Are Commonly Used to Restrain Competition?

A single cartel will often involve multiple forms of agreement. Just as George Stigler observed, cartels can take many forms, with the choice of form being determined in part at least by balancing the comparative cost of reaching and enforcing the collusive agreement against the risk of detection.¹² The vitamin cartel, for example, included price-fixing, bid-rigging, customer and territorial allocations, and coordinated total sales.

¹² George J. Stigler, *A Theory of Oligopoly*, 72 *Journal of Political Economy* 4 (1964).

1. Fixing Prices Globally

Prosecutors got an unprecedented view of the power of an international cartel to manipulate global pricing in the lysine videotapes. Executives from around the world can be seen gathering in a hotel room and agreeing on the delivered price, to the penny per pound, for lysine sold in the United States, and to the equivalent currency and weight measures in other countries throughout the world, all effective the very next day. Cartel members met on a quarterly basis to fix prices. In some cases the price is fixed on a worldwide basis, in other cases on a region-by-region basis, in still others on a country-by-country basis. The fixed prices may set a range, may establish a floor, or may be a specific price, fixed down to the penny or the equivalent.

2. Worldwide Volume-Allocation Agreements

Cartel members recognize that price-fixing schemes are more effective if the cartel also allocates sales volume among the firms. For example, the lysine, vitamin, graphite electrode, and citric acid cartels prosecuted by the Division all utilized volume-allocation agreements in conjunction with their price-fixing agreements. Cartel members met to determine how much each producer has sold during the preceding year and to calculate the total market size. Next, the cartel members estimated the market growth for the upcoming year and allocated that growth among themselves. The volume-allocation agreement then became the basis for (1) an annual "budget" for the cartel, (2) a reporting and auditing function, and (3) a compensation scheme.

3. Worldwide Customer Allocation

Another common means of restraining competition is for cartel members to agree among themselves which one will serve which customer or territory. Customer allocation cartels are particularly effective in industries in which products and prices are more heterogeneous so that a price-fixing agreement would be difficult to administer and enforce.

D. What Types of Industries Are Susceptible to Cartel Behavior?

1. Industry Concentration

Cartels can involve a surprisingly large number of firms. The number of participants in several of the cartels the Department has prosecuted was surprisingly high. Five or six members were not uncommon and occasionally the Division uncovered cartels with 10 or more members. This appears to be due to customers being reluctant to switch to smaller fringe players or to the fringe players feeling they will profit more by going along with the cartel than by trying to take share away from the larger firms by undercutting their prices.

2. Product Heterogeneity and Barriers to Entry

While product homogeneity and high-entry barriers may facilitate cartel behavior, they are not essential to it. While the products cartel cases tend to be fungible, there are sometimes

exceptions. One case the Division prosecuted involved bid rigging on school bus bodies. School bus bodies have many options, but the conspirators were able to work out a formula that incorporated the options and trade-in value to determine a price at or below which the designated winning bidder was supposed to bid. Similarly, while most cartel cases involve industries in which entry tends to be difficult, there are notable exceptions, such as in the Division's many bid-rigging cases in the road building industry. The road building industry, at least at the time of the conspiracies, was not difficult to enter, yet the Division turned up numerous cartels.

2. Large, Sophisticated Buyers Can Still be Victims

In merger analysis, some assume that large purchasers in the market will provide sufficient discipline to prevent cartels. Experience has shown to the contrary that many successful cartels sell to large, sophisticated buyers. In the lysine cartel, the buyers included Tysons Foods and Con Agra; in citric acid, the buyers included Coca-Cola and Procter & Gamble; and in graphite electrodes, the victims included every major steel producer in the world. Indeed, one common motivation for cartels is when suppliers feel oppressed because their customers are larger and more economically powerful than they are. One almost senses that the conspirators justify their conduct to themselves through a kind of Robin Hood mentality.

! Are the Common Devices Used to Implement Cartels?

1. Use of Trade Associations to Provide Cover

International cartels frequently use trade associations as a means of providing "cover" for their cartel activities. In order to avoid arousing suspicion about the meetings they attended, the lysine conspirators actually created an amino acid working group or subcommittee of the European Feed Additives Association, a legitimate trade group. The sole purpose of the new subcommittee was to provide a false, but facially legitimate, explanation as to why they were meeting. Similarly, the citric acid cartel used a legitimate industry trade association to act as a cover for the unlawful meetings of the cartel. The cartel's so-called "masters," i.e., the senior decision-makers for the cartel members, held a series of secret, conspiratorial, "unofficial" meetings in conjunction with the official meetings of ECAMA, a legitimate industry trade association based in Brussels. At these unofficial meetings, the cartel members agreed to fix the prices of citric acid and set market share quotas worldwide. Because of this, it is not uncommon for those investigating cartel activity to immediately focus on trade association and other industry events in an effort to ascertain whether, in connection with those legitimate events, separate meetings were held to discuss cartel matters. As such, it is advisable that in connection with internal antitrust compliance audits, such meetings are similarly scrutinized.

2. Audits And The Use Of Scoresheets

Many cartels develop a "scoresheet" to monitor compliance with and enforce their volume-allocation agreement. Each firm reports its monthly sales to a co-conspirator in one of the cartel firms -- the "auditor." The auditor then prepares and distributes an elaborate spread sheet or scoresheet showing each firm's monthly sales, year-to-date sales, and annual "budget" or allocated volume. This information may be reported on a worldwide, regional, and/or

country-by-country basis and is used to monitor the progress of the volume-allocation scheme. Using the information provided on the scoresheet, each company will adjust its sales if its volume or resulting market share is out of line.

3. Compensation Schemes

Another common feature of international cartels is the use of a compensation scheme to discourage cheating. The compensation scheme used by the lysine cartel is typical and worked as follows. Any firm that had sold more than its allocated or budgeted share of the market at the end of the calendar year would compensate the firm or firms that were under budget by purchasing that quantity of lysine from any under-budget firms. This compensation agreement reduced the incentive to cheat on the sales volume-allocation agreement by selling additional product, which, of course, also reduced the incentive to cheat on the price-fixing agreement by lowering the price on the volume allocated to each conspirator firm.

4. Budget Meetings

Cartels often have budget meetings. Like division managers getting together to work on a budget for a corporation, here senior executives of would-be competitors meet to work on a budget for the cartel. Budget meetings typically occur among several levels of executives at the firms participating in the cartel; their frequency depends on the level of executives involved. The purpose of the budget meetings is to effectuate the volume-allocation agreement -- first, by agreeing on the volume each of the cartel members will sell, and then periodically comparing actual sales to agreed-upon quotas. Cartel members often use the term "over budget" and "under budget" in comparing sales and allocations. Sales are reported by member firms on a worldwide, regional, and/or country-by-country basis. In many instances, executives become very proficient at exchanging numbers, making adjustments, and, when necessary, arranging for "compensation."

5. Retaliation Threats -- Policing The Agreement

As is often said, there is no honor among thieves. Thus, cartel members have to devise ways -- or even make threats -- to keep their co-conspirators honest, at least with respect to maintaining their conspiratorial agreements. It is common for cartel members to try to keep their co-conspirators in line by retaliating through temporary price cuts or increases in sales volumes to take business away from or financially harm a cheating co-conspirator. Excess capacity in the hands of leading firms can be a particularly effective tool for punishing cheating and thereby enforcing collusive agreements. In lysine, ADM, which had substantial excess capacity, repeatedly threatened to flood the market with lysine if the other producers refused to agree to a volume allocation agreement proposed by ADM. In another case where competitors bought from one another, the cartel member with the extra capacity threatened to not sell to a competitor who was undercutting the cartel.

Lesson Five -- The Importance of International Cooperation

With the increased focus on multinational cartels, competition authorities are cooperating more closely than ever in investigating and prosecuting cartels. Cooperation is particularly close between the United States and Australia. Australia is still, to date, the only foreign government to enter into an agreement pursuant to the International Antitrust Enforcement Assistant Act providing for the exchange of information.

Knowing that the competition authorities are cooperating closely should cause lawyers representing companies in cartel investigations to cooperate equally closely with their co-counsel in other jurisdictions. A company will be well advised in any multinational cartel investigation to appoint one firm to act as coordinating counsel. Often a company's general counsel may try to play this role herself, but unless the general counsel has extensive multinational cartel experience, it is generally better to have experienced outside counsel handle the coordination.

However the coordinating counsel role is handled, there are certain principles that should guide every defense. The first is to assume that whatever you tell one authority will find its way to other authorities. This means that it is absolutely imperative to tell a consistent (and truthful) story in all jurisdictions. The second is to assume that anything you tell any competition authority, especially in writing, will find its way into the hands of private plaintiffs. This dictates that you try to persuade each competition authority to reduce as little to writing as possible. In our experience, even those competition authorities whose formal leniency policies require written submissions will generally agree to follow a paperless procedure at least to some extent.

It is important to understand that when your client gets caught up in a cartel investigation, it faces a long road before the matter is completed in all the affected jurisdictions and before all the follow-on private litigation is resolved. One recent survey found that the average duration of multinational cartel cases is now around four years and that companies incur, on average, \$5-6 million a year in legal fees in defending these cases. In short, it will not be cheap. Which returns us to the number one lesson: ***Prevention Is The Best Cure.***