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## **EE&MC CARTEL-AUDIT: SUCCESSFUL PREVENTION OF FINES AND PRIVATE DAM- AGE CLAIMS**

In fact, there is no guarantee for a company that employees are not involved in cartel activities. However, management can take action to protect the company from such cartel infringements. One option is the use of legal compliance programs. Another new and effective option is a "cartel-audit". A cartel-audit is a forensic screening instrument which enables an early detection of cartels. Discovered anti-competitive behaviour can be stopped immediately and effectively. Recent developments in fine setting show that such a pro-active approach is recommended.

The benefits of an additional cartel-audit are impressive: private damage claims can be denied for example - according to German law - if the culprit is able to prove that he employed business methods with all reasonable diligence. Cartel audit is such a business method. Thus, by performing additional efforts companies can avoid huge fines as well as sore private damage claims.

### **STATUS QUO: RECENT FINES**

It is well known that Competition Commissioner Neelie Kroes is fighting against cartel activities. Quite recently, the European Commission has fined eleven groups of companies with a total of €750 Mio. for participating in a cartel for gas insulated switchgear projects, in violation of the EC Treaty's ban on restrictive business practices (Article 81). The total fines imposed in this case make it the largest set of fines ever imposed on a

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single cartel, and the fine of € 396 Mio. on Siemens, Germany, constitutes the largest ever fine that the Commission has imposed on a single company for a single cartel infringement.<sup>1</sup>

## FUTURE: FINES & PRIVATE DAMAGE CLAIMS

The fines in this cartel were measured in accordance with the old fine setting standards. In June 2006, the European Commission has adopted new Guidelines<sup>2</sup> on the method of setting fines to be imposed on companies that infringe EC Treaty rules that outlaw cartels and other restrictive business practices (Article 81). In accordance with the more economics based approach, the economic effects of cartel activities will influence explicitly the amount of the fine. Thus, the revised Guidelines reflect the overall economic significance of the infringement as well as the share of each company involved. The three main changes – the new entry fee, the link between the fine and the duration of the infringement, and the increase for repeat offenders – are clear signals that fines will increase. Breaking the anti-trust rules will be quite expensive.

Moreover, the Guidelines introduce a new mechanism. In order to deter companies from ever entering into seriously illegal conduct: the Commission may add to the amount as calculated above a sum equal to 15% to 25% of the yearly relevant sales - whatever the duration of the infringement ! According to the Guidelines, such an “entry fee” will be applied in cartel cases and may be applied in other types of anti-trust infringements too. In other words, the mere fact that a company enters into a cartel could “cost” it at least 15 to 25% of its yearly turnover in the relevant product market.

In addition to the fines, any person or firm affected by anti-competitive behaviour may bring the matter before the courts of the Member States and seek damages, submitting elements of decisions of the cartel authorities as evidence that the behaviour took place and was illegal. Although companies have been fined, damages may be awarded without these

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1 See European Commission, IP/07/80.

2 See 2006/C 210/02 from 01.09.2006.

being reduced on account of the Commission fine.

The issue is how management can protect their company effectively from huge fines as well as from private damage claims?

## SUPPLEMENTING LEGAL COMPLIANCE: THE CARTEL AUDIT

The application of legal compliance programs, which are implemented in most companies already, is a first step. Legal compliance means conformance with the law and supports the compliance of laws and guidelines. However, many real life examples demonstrate that illegal behaviour may still exist within a company. Individual anti-competitive action of employees can first lead to significant fines and secondly to considerable damage claims. Even double private damage claims for hard-core cartels is an option currently discussed in the Commission's Green Paper on Private Enforcement. These private damage claims can surmount the legal fines many times over. This means that in addition to legal compliance programs additional instruments are recommended to protect companies' interests.

Cartel-audits as forensic analyses allow the identification of sectors in firms' activities. Cartel agreements become visible. Companies applying a cartel-audit are able to detect cartels early in-house, even before competition authorities or competitors benefiting from a leniency program come into action. Management can immediately stop any illegal behaviour and use the discovered information to apply for a leniency program itself. A participation in leniency programs is profitable as the case of the Swiss ABB demonstrates. ABB was also involved in the cartel for gas insulated switchgear projects discussed above, but acted as "whistle blower" in 2004. Because of the leniency program, the fine of € 215 Mio. was remitted. The general forecast is that fines for whistle blowers will be waived in the future as well whereas fines for the other cartel members will further increase.

## EE&MC CARTEL AUDIT

As a forensic analysis tool, the EE&MC Cartel Audit identifies problematic sectors and discovers cartel activities. Economic screening tools like the CFD cartel-check - illustrated in the following - are applied. The EE&MC Cartel Audit is an effective mechanism allowing management to control the observance of competition law. Cartel violations can (at least with high probability) be excluded. With this procedure, management is able to comply with its responsibility to the shareholders. The advantage of the EE&MC Cartel Audit is a fast detection and an ending of the violations. Another advantage employing the EE&MC Cartel Audit is the evidence that all available instruments of forensic economics are applied to prevent any possible cartel infringement.

## CFD CARTEL-CHECK

Coordination Failure Diagnostics (CFD) is a model that analyses real market processes with the help of time pattern analysis. It investigates whether markets operate efficiently. The detection of cartels takes place via characteristic market process patterns. This method is based on the assumption that existing cartels cause failures in the observed process patterns. The CFD cartel-check is an attempt to draw conclusions from these process patterns.

As an empirical tool, the CFD cartel-check uses available economic data to screen the different sectors of firm activity. Collusive markers are developed in order to indicate cartelised structures. The markers are applied in suspicious sectors, particular in sectors where cartelised structures are more probable than in other sectors.

## MARKERS FOR THE CFD CARTEL-CHECK

Cartels affect the five market processes in a special manner. The CFD cartel-check method analyses these processes. Usually market processes do function, but there are dysfunctionalities, if cartel activity in the market

takes place. The following table highlights the characteristics typically associated with collusive behaviour.

**Table 1: Collusive markers in the CFD cartel-check**

Process	Indicator	Characteristics
Market Clearing Process	nominal price	seldom and high volatile changes of price-index fixed prices in cyclical downturns
	capacity utilization	small capacity utilization permanent excess supply
Rate-of-Return Normalisation Process	rate of return	oligopolistic excess rate of return, reduced by excess capacities or by fixed prices in recessions (under fixed costs)
	dysfunctional growth of capacities	excess capacities independent of rate of return reduction of capacities only by acquisition
Erosion of Market Power Process	HHI, equivalence index number	concentration ratios show market power and oligopoly
	volatility of market shares	low volatility of market shares, especially by fixed quotas
Product Innovation Process	market share of new products	obvious innovation lags
Technology Innovation Process	labour productivity	innovation success hindered by X-Inefficiency little incentives for productivity gains without competition

Source: Lorenz, 2006, Marktscreening nach Kartellstrukturen mittels ökonomischer Indikatoren, in: Wirtschaft und Wettbewerb, 07/08 2006, 748-759.

The analysis of the five market processes indicates typical characteristics, which can be summarized as cartel syndrome and provides evidence for cartel structures. Thus, the CFD cartel-check is an instrument for the identification of cartel-characteristic process pattern-syndromes, which can be utilised in form of collusive markers whilst screening for cartels.

### Market Clearing Process

Cartel members act as quantity takers under fixed prices until the cartel assigns capacities by quotas. Cartel members hold reserve capacities to get higher quotas and to be prepared in case the cartel breaks up. This behaviour leads to little capacity utilization and permanent excess capacities.

### Rate-of Return Normalisation Process

In a successful collusion all members benefit from excess rate-of-return. This value could be reduced by the costs for excess capacities or by fixed prices during a fall in demand under constant fixed costs. Capacities grow independently from the rate of return.

### Erosion of Market Power Process

The Herfindahl-Hirschmann-Index can function as a measure of concentration, which is composed of all firms in the market  $n$  with the market share  $P$  of each firm. The exact setup is  $HHI = \sum_{i=1}^n p_i^2$ . The fewer the number of suppliers in a market, the easier it is to establish collusional behaviour. That is the reason why most cartels are found in oligopolistic markets with less than 10 relevant players and an equivalence index number of  $n^* \leq 10$ . The equivalence index number is the reciprocal of the HHI (correction-adjusted by entry barriers and legal cooperating firms) under the assumption that firms are of equal size.

### Innovation Process

The Technology Innovation Process and especially the Product Innovation Process are characterized by little incentives for productivity gains due to lack of competition. Therefore the market shares of new products and the labour productivity usually remain low in markets characterised by cartelistic structures.

The more collusive market are found to show cartelised structures and the higher they are above certain thresholds, the higher is the probability of the existence of a cartel in this sector. However, the results of the CFD cartel-check are just starting points for further analyses. Additional analyses have to be carried out.

## CONCLUSION

There are typical characteristics for collusive behaviour. Markets analysed so far illustrate that e.g. the instrument of the CFD cartel-check is a systematic method to find suspicious markets by economic criteria.

The aim of the EE&MC Cartel-Audit is the detection of suspicious sectors by using these economic criteria. As marker these economic criteria are an appropriate tool for the in-house detection of problematic areas. The EE&MC Cartel-Audit can filter those sectors where antitrust problems like cartel agreements probably occur. The screening is followed by further investigations. To conclude, the EE&MC Cartel-Audit is a useful tool for antitrust and compliance officers to detect suspicious markets and concentrate further activities on them.

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