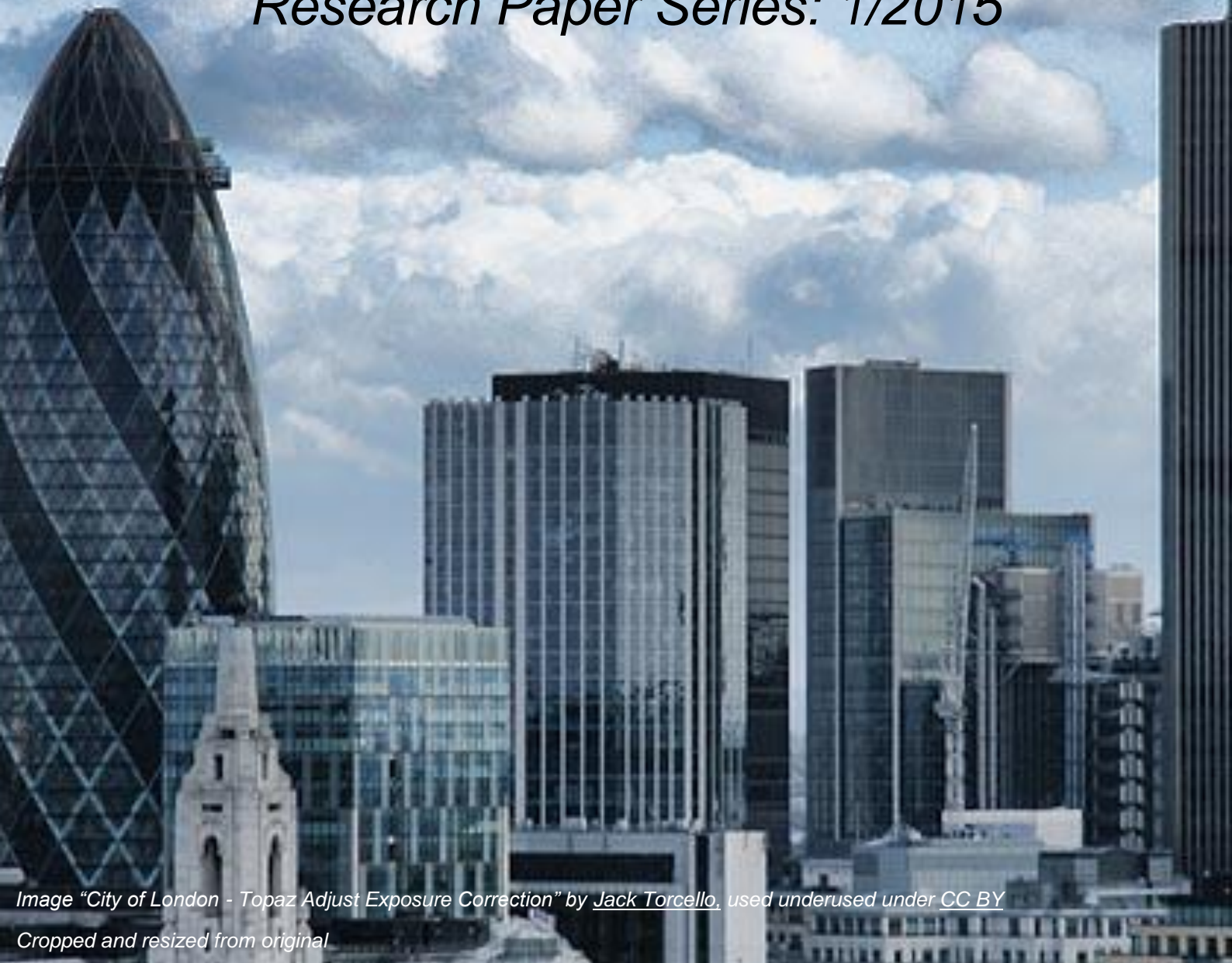


**Centre for Law, Economics and Society**

*Research Paper Series: 1/2015*



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# **The Effectiveness of Antitrust Enforcement Instruments: A Matter of Agency Relation**

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**LAW, ECONOMICS & SOCIETY**

**CLES Research Paper Series  
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**January 2015**

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ISBN 978-1-910801-06-2

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# **The Effectiveness of Antitrust Enforcement Instruments: a Matter of Agency Relation**

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## **Abstract**

*This paper explores how antitrust enforcement instruments modify the incentives and relations within companies, in the context of cartels. Among all relations, agency relations between shareholders and managers are the focus of this study. In the absence of individual liability, sanctions target the undertaking - or the principal of the agency relation; but not the responsible individuals - or the agent, who may engage the company in a cartel. Undertakings that face asymmetries of information and discrepancies of interests between actors may not have the ability and incentive to transfer a sanction to the responsible individuals. Thus, penalties that target the principal are deemed effective only if the company can reduce the interest gap internally and at low cost. Sanctions addressed to individuals in addition to companies, are able to impact directly the incentives of the agent of the agency relation. This paper argues that understanding the potential effects of competition law instruments on the agency relation is of utmost importance to assess their effectiveness to deter and detect cartel conduct. For competition policy purposes, it seems desirable that the agent and the principal have aligned interests towards sanctions. In contrast, leniency policy or bounty programmes that target the agent are effective if they aggravate the tension gap in the agency relation. The developments are based on the EU, and its member states, the US and other jurisdictions when relevant.*

**Keywords:** Competition law, antitrust, enforcement, leniency, sanctions, individual liability, bounty, agency relation, derivative actions, disqualification orders, asymmetry of information

**JEL Classification:** K21, L4, L41

# The Effectiveness of Antitrust Enforcement Instruments: a Matter of Agency Relation

Florence Thépot\*

## Introduction

Sanctions for infringing competition law are typically imposed on undertakings, while actors within the firm are rarely liable for engaging their companies into anti-competitive practices.<sup>1</sup> However, recent policy trends suggest that sanctions, instruments seeking to *deter* anti-competitive practices, increasingly target the incentives of individuals, in addition to the companies' incentives. In the US, in December 2013, the longest prison term for breach of the Sherman Act was imposed in relation to price-fixing in coastal shipping; which is part of a trend towards more frequent and longer prison sentences.<sup>2</sup> The UK Competition and Markets Authority is currently conducting a criminal investigation into the supply of galvanised steel tanks for water storage; where 3 individuals have been personally charged, potentially facing jail penalties.<sup>3</sup> Among other EU Member States, a growing number of competition regimes incorporate individual sanctions; although the enforcement level of such sanctions remains rather low.<sup>4</sup>

Instruments seeking to *detect* on-going anti-competitive practices, such as leniency policy or bounty programmes, aim at destabilising the relations between cartel members by producing effects on relations that are internal to companies.<sup>5</sup> One of the most striking (but non-typical) examples is given by Mark Whitacre who denounced his own company for participation in the lysine cartel. Mark Whitacre's

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\* PhD (UCL) Fellow of the UCL Centre for Law, Economics and Society; Max Planck Institute for Innovation and Competition (scholarship holder). This paper is based on chapter 4 of my doctoral thesis. I wish to thank my supervisor Prof. Ioannis Lianos for his helpful guidance on this chapter. I am also grateful for very insightful feedback and comments provided by my PhD viva examiners, Prof. Andreas Stephan and Prof. William Kovacic. The usual disclaimer applies.

<sup>1</sup> For example, in EU Competition Law, undertakings are the subject-matters of competition law provisions and decisions sanctions are addressed to undertakings, see for example in the UK: Enterprise Act 2002, s 188 and 204; in the US: Sherman Act, 15 USC §1. As it will be explained below, many EU Member States have sanctions against individuals but the enforcement level is low.

<sup>2</sup> <<http://www.justice.gov/atr/public/division-update/2014/criminal-program.html>>

<sup>3</sup> See <<https://www.govuk/cma-cases/criminal-investigation-into-the-supply-of-galvanised-steel-tanks-for-water-storage>>

<sup>4</sup> K Jones, F Harrison, 'Criminal Sanctions: An overview of EU and national case law' (2014) e-Competitions N° 64713.

<sup>5</sup> These instruments of course also aim to increase the cost of cartel participation and also aim at deterring cartel practice.

cooperation with the FBI, in return of which he hoped amnesty, enabled to bring down other related cartels in the international chemicals industry.<sup>6</sup>

This paper explores how antitrust enforcement instruments modify the incentives and relations within companies. Among all relations, *agency relations* between shareholders and managers are the focus of this paper. Agency relations exist whenever a relationship between two actors – a principal and an agent - involves the agent making decisions on behalf of the principal. Agency relations, such as those existing between the owner and a manager of a company, are characterised by a tension of interest between the two parties due, for example, of limited information that enables the agent to pursue their own instead of acting in the principal's best interest.<sup>7</sup> Under certain circumstances, and depending on which actor of the agency relation is targeted, competition law instruments help align interests between the parties, while in others, enforcement instruments tend to aggravate the agency problem.

In addition, it is posited that the assessment of enforcement instruments needs to learn from the effects produced on the agency relation. It seems that the assessment of the effectiveness of enforcement instruments seeks, in practice, to discuss which actor of the agency relation should be targeted. For example, most of the discussion around sanction policies asks whether companies (*the principal*), individuals (*the agent*) or both should be liable. Also, one may wonder whether competition law should seek to improve the agency relation, or whether it should purport to undermine it.

Hence, it is necessary to understand that forming and sustaining a cartel involves different types of actors within a company. Such actors may have different interests with respect to cartel benefits (which depends on whether or not they are residual claimants of the cartel profits) or different margins of discretion (depending on their position within the company). This paper firstly examines different types of agency relations that are relevant in the context of a cartel activity, with the purpose of

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<sup>6</sup> However, it seems that his actions were driven by the need to hide other criminal practice, and probably influenced by his mental health problems. Mark Whitacre, after exposing the cartel and working for 3 years with the FBI on the investigation, was eventually convicted and given a 10.5 years jail sentence, for other criminal infringements.

<sup>7</sup> RS Pindyck and DL Rubinfeld, *Microeconomics* (8<sup>th</sup> edn, Pearson 2013) 646.

understanding the role and possible motivations of different actors in the cartel participation.

The second section will examine instruments that aim to *deter* anti-competitive practices, including sanctions that range from corporate administrative fines, to individual criminal penalties. The analysis will be two-fold: first, I will present the impact of such tools on the dynamics of the agency relation; and second, I will show that the effectiveness of such tools may be a matter of agency relation. That is to say, the assessment of such tools may consist of understanding what type of dynamics for the agency relation should be desired by competition law enforcers.

The third section will focus on instruments that aim to *detect* existing anti-competitive practices. Leniency policy and ‘bounty’ programmes are examples of instruments that are designed to undermine the stability of cartels, and are deemed to constitute a powerful detection device for competition authorities. The ability of such programmes to effectively undermine the stability of the agency relation that shape cartels will be examined.

The fourth section will analyse the *ex post* effects of a cartel prosecution on the agency relation. The effects under examination include the reaction of shareholders to the prosecution of their company, the way in which corporate governance may be reorganised and legal actions that can be initiated between various actors of the agency relations.

This paper is mostly concerned with anti-competitive agreements with a particular focus on cartel practices, which are prohibited by Article 101 TFEU in the EU and Section 1 of the Sherman Act in the US.<sup>8</sup> The restriction to cartel practices enables the examination of an area of competition law where the harm to economic welfare is unambiguous and that is homogeneously prosecutable across jurisdictions.<sup>9</sup>

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<sup>8</sup> Conduct prohibited by Article 101 TFEU (EU); Section 1 of the Sherman Act 15 USC §1 (US).

<sup>9</sup> Different enforcement approaches are seen in the area of vertical restraints, where the harm to economic welfare is particularly debated. For a background of debates and contrasted approaches to resale price maintenance see: S Umit Kucuk and HJP Timmermans, ‘Resale Price Maintenance (RPM): The US and EU perspectives’ (2012) 19 Journal of Retailing and Consumer Services 537.

This paper relies on a specific theoretical framework of analysis, that of the agency relation. This enables to limit the analysis to specific relations within the firm, the study of which is also supported by well-established body of theories and literature. Accordingly, and for the sake of conciseness, it will be mostly assumed that actors within the firm are somehow rational (with limitations brought by limited expertise or imperfect information are part of the foundations of the agency problem).<sup>10</sup> However it is acknowledged and illustrated at several instances that the study of cartels needs to be enriched by approaches that move away from the assumption of rationality.<sup>11</sup> Therefore, the agency relation is here understood more generally as any mismatch of information and interests, and any behaviour, driven by rational or irrational motives, that would put the company at risk of a violation of competition.

### **1.1 Agency relations in the context of forming and sustaining a cartel**

Prior to assessing the impact of policy instruments, it is important to understand the specificity and complexity of the agency relation in the context of a cartel practice. In addition to the agency relation between shareholders and managers, it is relevant to account for multi-level types of relationships to understand the incentives and the ability which various actors have to monitor cartel formation internally.<sup>12</sup> The agency relations of relevance in the context of a cartel practice include the relationships between shareholders and managers, and that between senior-level management and lower-level management or employees at any level of the hierarchy.

#### **1.1.1 Costs and benefits of a cartel: Shareholders and managers**

It is argued that shareholders and managers have different costs and benefits of participation to a cartel, which causes an interest gap characteristic of the moral hazard problem in the agency relation. The benefits of cartel membership are common to shareholders and managers alike. Any increase in revenues of a company results in an increase in its share value and therefore benefits the shareholders. Managers also gain from an increase in the company's value; the

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<sup>10</sup> Following methodology of the economic analysis of law. See for example A Polinsky, A Mitchell and S Shavell, *Economic Analysis of Law* (2nd edn, The New Palgrave Dictionary of Economics 2008).

<sup>11</sup> For another approach to the firm's behaviour, which moves away from the assumption of rationality see for example behavioural economics – based studies: OFT1213, *Behavioural Economics as Applied to Firms: A Primer* (2010).

<sup>12</sup> DH Ginsburg and JD Wright, 'Antitrust Sanctions' (2010) 6 *Competition Policy International* 3, 16.



extent of this gain is determined by the remuneration scheme in place. Shareholders may be willing to encourage managers to participate in a cartel. When the participation in a cartel is detected, however, the situation becomes somewhat different.<sup>13</sup> In the absence of individual sanctions detection leads, in most jurisdictions, to administrative and/or monetary fines which are borne by the undertaking.<sup>14</sup> Consequently, shareholders bear the costs of these sanctions, while managers may completely avoid direct personal punishment for their actions. Adverse reputational impacts of detection can affect both the shareholders and managers.<sup>15</sup> Reputation effects may be stronger for the managers than for shareholders: it is more difficult to know the identity of shareholders, and dispersed shareholders are not supposed to have known about the cartel. In addition, detection may lead to the dismissal of the responsible manager, who thus personally faces a human capital risk. However, by the time the participation of a company in a cartel is detected and sanctioned, the manager responsible for it may have left the company.<sup>16</sup> In this respect, Stephan points out that the average time span between the end of a cartel and the fine being imposed on an undertaking is in excess of five years.<sup>17</sup> Therefore, a company that wants to fire or punish its managers may not be able to do so. In this context, the manager stands to benefit more from the participation in a cartel than the shareholders.<sup>18</sup>

Alexander and Cohen's empirical study provides further evidence that restriction of competition, as a form of corporate crime, is characteristic of the separation of ownership and control.<sup>19</sup> The study examines the ownership structure of infringing and non-infringing companies.<sup>20</sup> The authors collected data on the proportion of stock held by the top management of companies before the commencement of the corporate crime, and from companies that supposedly remained virtuous. Fewer shares being held by the top management indicates a greater separation of

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<sup>13</sup> The key issue of a low probability of detection will be the object of developments below.

<sup>14</sup> See the specific case of Germany where individuals are primarily liable: **1.2.2.1** (n 107).

<sup>15</sup> For more discussion on the reputational impact of sanctions see **1.2.1.2.2**.

<sup>16</sup> C Leslie, 'Cartels, Agency Costs, and Finding Virtue in Faithless Agents' (2008) 49 *William & Mary Law Review* 1621.

<sup>17</sup> A Stephan, *Should Individual Sanctions Be Part of Deterrence Efforts?* 'Deterring EU Competition Law Infringements: Are We Using the Right Sanctions?' Conference by TILEC and the Liege Competition & Innovation, 3 December 2012.

<sup>18</sup> See also: prices of shares, alexander & cohen,

<sup>19</sup> CR Alexander and MA Cohen, 'Why do corporations become criminals? Ownership, hidden actions, and crime as an agency cost' (1999) 5 *Journal of Corporate Finance* 1.

<sup>20</sup> Some of the corporate crimes highlighted in this study are cases of antitrust infringement.

ownership and control, and thus wider scope for agency cost, as explained by the theory of agency cost developed by Jensen & Meckling.<sup>21</sup> In the econometric model, the dependent variable is the occurrence of corporate crime and the independent variable is the proportion of stock held by the top management. The study concludes that the rate of corporate crime is higher when top management owns less than 10% of the shares of the company.<sup>22</sup> Therefore, there are more corporate crimes, including cartel participation, in situations of greater separation of ownership and control.

Participation to a cartel displays another characteristic of the agency problem inherent to the relation between managers and shareholders, that is, a negative effect on the value of the firm. An empirical study has estimated the impact of an antitrust investigation and of a fining decision by the Commission on the value of companies' shares. The results indicate an estimated loss of 1.1% in the value of shares on the day of the dawn raid on a company, and an aggregate estimated loss of 2.4% due to the investigation. To this loss must be added a further drop of 1.5% in the price of shares when the Commission issues its fining decision.<sup>23</sup>

Therefore, when detected, the participation in a cartel deepens the interest gap between shareholders and managers, manifested by different costs and benefits towards its participation. The negative effect on the firm's confirms that cartel participation is an illustration of the agency problem between managers and shareholders in firm where ownership and control are distinct.

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<sup>21</sup> MC Jensen and WH Meckling, 'Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure' (1976) 3 *Journal of Financial Economics* 305, 310.

<sup>22</sup> The cases under examination in this study do not specifically concern situations where top management were personally involved in the illegal behaviour, but mostly relate to hidden actions of other employees. The cost related to the hidden actions of employees can be addressed with monitoring schemes, but cannot be reduced completely, as it is inherent to the separation of ownership and control.

<sup>23</sup> M Motta and G Langus, 'On the Effect of EU Cartel Investigations and Fines On the Infringing Firms' Market Value' in CD Ehlermann and I Atanasiu (eds.), *European Competition Law Annual 2006: Enforcement of Prohibition of Cartels* (Hart Publishing 2006). In spite of a loss in the price of share, a cartel practice can still be highly profitable to the company as a whole. In addition, shareholders may be able to sell their shares. Especially when shareholders are dispersed, each shareholder may have little incentive (and even smaller ability) to prevent the participation in a cartel.

## 1.1.2 Top-level management and other managers/employees

### 1.1.2.1 *From the decision to the implementation of the cartel operation*

The relationship between top managers and other employees may also display a divergence of interests, in the context of cartel activity. Leslie argues that for the purpose of cartel operations, ‘the high-level decision makers are the principals and the lower-level employees are the agents who implement the price-fixing scheme.’<sup>24</sup> The distinction between the cartel-decision making - by the ‘principals’ - and its implementation by the ‘agents’, is therefore relevant. On the principal side, the decision to participate in a cartel typically originates from the higher level of the hierarchy.<sup>25</sup> In many cartel cases, price-fixing discussions occur at trade association meetings, where senior managers and CEOs meet their counterparts from competing companies.<sup>26</sup> On the agent side of the relationship, the decisions to participate in a cartel have to be implemented by lower-level management, whose role is to guarantee the actual return of the cartel practice for higher level management.<sup>27</sup> By way of example, this agency relationship is witnessed in the citric acid cartel where,

The senior executives responsible for determining the broad outline of the cartel agreement were nicknamed ‘the masters.’ The lower level executives responsible for the day-to-day workings of the cartel were ‘the sherpas’. They shared monthly sales figures and took stock at the end of the year of each company’s total sales.<sup>28</sup>

The delegation of the operation and implementation of the cartels to lower-level employees intervenes for reasons similar to the delegation of a task in the classic agency relation. The principal employs someone who is better positioned to perform

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<sup>24</sup> C Leslie, ‘Cartels, Agency Costs, and Finding Virtue in Faithless Agents’ (2008) 49 William & Mary Law Review 1621, 1640.

<sup>25</sup> A Stephan ‘See no Evil: Cartels and the Limits of Antitrust Compliance Programs’ (2010) 31 The Company Lawyer 231, 236. In some cases the top level of management was personally involved, and in other cases the top management permitted the collusion while not being directly involved.

<sup>26</sup> *Choline Chloride* Commission Decision 2005/566/EC [2004] para 98; *Citric acid* Commission Decision 2002/742/EC [2001], para 87; *Copper Plumbing Tubes* Commission Decision [2006], para 112; *Industrial and medical gases* Commission Decision 2003/355/EC [2002], para 105; *Industrial tubes* Commission Decision [2003], para 10.

<sup>27</sup> JE Harrington, ‘How Do Cartels Operate?’ (2006) 2 Foundations and Trends in Microeconomics 78, see table of allocation of authority.

<sup>28</sup> K Eichenwald ‘US Wins A Round Against Cartel,’ New York Times, 30<sup>th</sup> January 1997, in MC Levenstein and VY Suslow, ‘What Determines Cartel Success?’ (2006) 44 Journal of Economic Literature 73.

a task, be it for his specialised expertise or the time that he can dedicate to such a task. In the context of a price-fixing cartel, it seems logical that sales divisions specialised in business decisions related to pricing are very often involved in the operation of the cartel.<sup>29</sup>

### **1.1.2.2 Personal goals pursued by the agent**

With the objective of pursuing personal goals, an employee may decide not to comply with the cartel implementation instructions. In the context of a cartel operation, the agent maximises the principal's value if he implements the cartel agreement, under strict confidentiality, which includes not keeping hard evidence of any meetings and refraining from exposing the cartel to the authorities. In some cartel cases, some agents have been 'faithless' to their principal as they failed to comply with the instructions emanating from the high-level executives, due to the pursuit of personal goals.<sup>30</sup> The cartel between the auction houses, Sotheby's and Christie's provides an example, where Christie's CEO responsible for the implementation of the cartel in practice on behalf of his chairman, generated a huge amount of evidence, in spite of a promise not to leave any written notes related to the secret meetings he was holding with his counterpart.<sup>31</sup> His personal goal was to gather the maximum amount of incriminating evidence on the illegal practice, as a potential source of bargaining power against his own company, and as a way of ensuring protection through an immunity scheme should the cartel be detected and prosecuted.<sup>32</sup> The lysine cartel provides another example of a faithless agent in the context of a cartel operation.<sup>33</sup> Mark Whitacre, a corporate executive of one of the cartel companies, ADM, kept a

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<sup>29</sup> 'Sales managers and pricing specialists possess the knowledge about prices, costs, sales history, etc., needed to reach an agreement as to who will bid for what job or what price will be set for what goods.' RR Faulkner, ER Cheney, GA Fisher, WE Baker, 'Crime by Committee: Conspirators and Company Men in the Illegal Electrical Industry Cartel, 1954-1959' (2003) 41 Criminology 511.

<sup>30</sup> C Leslie (n 24) uses the expression of faithless agent to refer to employees that are weak links in the cartel organisation, therefore not maximising the principal value by adequately implementing the cartel agreement.

<sup>31</sup> The collusion was prosecuted both in the US and in the EU. EU decision: *Fine Art Auction Houses* (Case COMP/E-2/37.784) Commission Decision IP/02/1585 [2006] 4 CMLR 90; US decision: DoJ, Decision of 2 May 2001, press release available at <[http://www.justice.gov/atr/public/press\\_releases/2001/8128.htm](http://www.justice.gov/atr/public/press_releases/2001/8128.htm)>.

<sup>32</sup> C Mason, *The Art of the Steal* (GP Putnam's Sons, 2004) 246.

<sup>33</sup> The lysine cartel occurred in the mid-1990s when 5 companies fixed the price of the animal feed additive lysine. The sanctions imposed by the US authorities included a total of \$105 million fine, and jail sentences for some executives. The final US legal decision: *US v Michael D Andreas and Terrance S Wilson*, 216 F3d 645 (2000). The EU Commission issued an infringement decision in 2000 and imposed a total of €110 million fine. *Amino Acids* (Case COMP/36.545/F3) Commission Decision 2001/418/EC [2000] OJ L152.

significant amount of evidence of the price-fixing practices, which he thought would attract the investigation's attention to the case of the cartel being detected. By doing so, he was pursuing his own interest, which was to dissimulate other illegal activities that he was undertaking at the time. He hoped that the evidence provided and his cooperation in the cartel investigation would impede the FBI from discovering his other crimes.<sup>34</sup> It also seems that Mark Whitacre suffered from mental illness at that time, which may also explain his behaviour against his firm.<sup>35</sup> Therefore, due to the impossibility of fully controlling the behaviour of each actor, diverging interests towards cartel participation, be it on rational or less rational grounds, may complicate the implementation of a cartel agreement.

### **1.1.2.3 Alignment of interests**

However, as Leslie argues, the company can easily align the incentives between the cartel decision makers and those who are responsible for implementing the cartel.<sup>36</sup> Firstly, the corporate culture conveyed from the senior management in the company surely explains the natural cooperation of employees with the senior management, in implementing price-fixing behaviours. In some companies, price-fixing may have been considered as an accepted practice in the past. In such companies, long tenured executives are more likely to maintain the habit of engaging in price fixing, whilst the lower layers of management merely conform to the prevalent culture of the company.<sup>37</sup> In that situation, employees may find it natural to comply with price-fixing instructions in the same way as they would comply with any other business instruction. For example, one of the companies of the lysine cartel, ADM, fired an employee who refused to cooperate with the cartel operations.<sup>38</sup> In the electrical equipment cartel, a vice-president at General Electric admitted having used strong social pressure as a way to coerce executives to fix prices.<sup>39</sup>

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<sup>34</sup> C Leslie (n 24) 1643. Mark Whitacre, after exposing the cartel and working for 3 years with the FBI for the investigation, was convicted of a 10.5 years jail sentence, for embezzlement.

<sup>35</sup> K Eichenwald, *The Informant* (Random House, 2000) 390.

<sup>36</sup> C Leslie (n 24) 1649.

<sup>37</sup> J Sonnenfeld and PR Lawrence, 'Why Do Companies Succumb to Price Fixing' (1978) Harvard Business Review 145.

<sup>38</sup> J Connor, *Global Price Fixing (Studies in Industrial Organization)* (2<sup>nd</sup> edn, Springer 2008) 141 n 7.

<sup>39</sup> J Sonnenfeld and PR Lawrence (n 37) 148.

For the purpose of the cartel, aligning incentives consists of making the profits of the lower-level-managers move along those of the residual claimants of the company. Firstly, a company may make use of corporate governance mechanisms to make sure that price-fixing interests are aligned. Remuneration schemes, usually designed to incentivise managers to act in the shareholders' best interests, may also incentivise employees to sustain a price-fixing agreement.<sup>40</sup> Sonnenfeld and Lawrence, who examined some characteristics of companies within an industry affected by price-fixing practices, found that compensation schemes in place may have been a powerful tool to align the interests of senior management and employees in the price-fixing activity.<sup>41</sup> In contrast, the most virtuous companies were compensating their sales managers via straight salary bases. The managers' performance was assessed according to volumes of sales achieved, rather than profits and price levels.<sup>42</sup> Therefore, in these types of compensation schemes, sales managers' gains from a price-fixing agreement would not be aligned to those of the company.

In addition, looking at the stability of a cartel, certain types of remuneration plans may provide managers with the incentive to sustain a collusive agreement, because they reduce the interest of a manager in unilaterally deviating from a collusive agreement. For example, stock-based bonuses may reduce the incentive for the manager to deviate from a collusive agreement.<sup>43</sup> The role that such remuneration schemes may have played in other types of corporate crimes suggests that the adverse consequences produced are not typical to cartel behaviour.

In general, the incentives between the company and its employees may be easily aligned. Employees may be loyal to their company, complying with instructions, or with the corporate culture conveyed. Alternatively, a company may provide incentives

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<sup>40</sup> See Error! Reference source not found..

<sup>41</sup> J Sonnenfeld and PR Lawrence (n 21) 149.

<sup>42</sup> Ibid 153.

<sup>43</sup> See economic literature by G Spagnolo, 'Managerial incentives and collusive behavior' (2005) 49 *European Economic Review* 150; P Buccirosi and G Spagnolo, 'Corporate governance and collusive behavior', in WD Collins (ed), *Issues in Competition Law and Policy 1* (American Bar Association 2008). Data collected on the car glass cartel, lifts and escalators cartel and marine hose cartel suggests that the presence of a range of performance-based and stock-based compensation schemes may create incentives for managers and other employees to sustain collusive agreements.

A Petersone, 'Managerial Compensation and Cartel Behavior' (2010), available at <http://dare.uva.nl/cgi/arno/show.cgi?fid=222247>

to employees so that they benefit from a sustained price-fixing outcome financially. Competition policy instruments have the potential to affect relations at different levels within the firm. Depending on the actors considered, the agency problem operates either against or in favour of the cartel formation and stability. Therefore it is of the utmost importance to specify and identify the relation under consideration. The remainder of this paper will merely focus on the agency relation between managers and shareholders, but will consider the relation between top executives and lower level employees in several instances when relevant.

## **1.2 Competition law enforcement instruments that aim to deter infringements**

Both in the EU and in the US, sanctions for breaching competition law have two objectives:<sup>44</sup> that of sanctioning the illegal action, for which the infringer caused harm to society; and, that of preventing a future breach of competition law. The scope of sanctions imposed then does not just intend to repair the loss to society associated with the breach, but attempts to deter it by making such an action unprofitable. In the cases of cartels, whilst the infringement, if not punished, may be highly profitable to the companies, it is also highly harmful to consumer welfare. To address the necessity of making infringements unprofitable, competition authorities have been imposing increasingly higher fines on companies breaching competition law.<sup>45</sup> This is consistent with Becker's theory, which advances that wrongdoers rationally weigh up the benefits of the crimes with the cost of the expected sanction, prior to deciding whether to commit a crime. The cost of expected sanctions depends on both the amount of the fines and the probability of detection.<sup>46</sup>

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<sup>44</sup> Commission guidelines on the method of setting fines imposed pursuant to Article 23(2) (a) of Regulation No 1/2003 [2006] OJ C2010/2, para 4: "Fines should have a sufficiently deterrent effect, not only in order to sanction the undertakings concerned (specific deterrence) but also in order to deter other undertakings from engaging in, or continuing, behaviour that is contrary to Articles 81 and 82 of the EC Treaty (general deterrence). In the US a cartel conviction open the possibility for civil damages, and antitrust sanctions in general seek to deter anti-competitive practices. DoJ, GJ Werden, SD Hammond and BA Barne, 'Deterrence and Detection of Cartels: Using all the tools and sanctions' (2012).

<sup>45</sup> See statistics on fines imposed by the Commission between 1990 and 2014, available at <<http://ec.europa.eu/competition/cartels/statistics/statistics.pdf>>; US: Antitrust Division 2014 Criminal Enforcement Update available at <<http://www.justice.gov/atr/public/division-update/2014/criminal-program.html>>.

<sup>46</sup> GS Becker, 'Crime and Punishment: An Economic Approach' (1968) *Journal of Political Economy* 76, 169.

Sanction instruments range from administrative monetary fines, imposed on companies, to sanctions of criminal nature, targeting the individuals. I will first consider sanctions that are imposed on companies exclusively. In the context of the agency relation, corporate fines target shareholders – or the principal - of the company (1.2.1). Sanctions targeting the agent refer to sanctions imposed on individuals, ranging from monetary fines and imprisonment, to professional disqualification (1.2.2). This section will provide an assessment of sanctions, in the light of their effects on the agency relation.

### 1.2.1 Corporate sanctions: targeting the principal of the agency relation

In spite of the idea that wrongdoing committed by companies stems from the actions of specific individuals, in other words ‘companies don’t misbehave, people do’, companies are typically vicariously liable for the misconduct of individuals. This means that companies are liable even if they do not initiate, encourage or know of the individual’s act.<sup>47</sup> In the context of competition law, companies cannot avoid liability for infringements undertaken by their employees. Commonly with other areas of law, corporate liability regimes present a number of advantages over individual liability. First, corporate liability seems desirable if it is very costly or difficult for society to enforce the law.<sup>48</sup> The rationale underpinning the necessity of corporate liability, instead of or in combination with individual liability, is that companies have a better vision on their employee’s action, and can implement internal monitoring and control at a lower cost than would be incurred for society. For example, sanctioning companies exclusively may spare society from the potential imprisonment costs associated with the prosecution of individuals. Another argument relies on the assumption that individuals may not be rational and may be unresponsive to individual sanctions.<sup>49</sup> Companies may respond to sanctions more rationally and take action internally to prevent their realisation. In addition, individuals may have a limited ability to pay a monetary fine the value of which is related to the economic harm to

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<sup>47</sup> A Sykes, ‘The Economics of Vicarious Liability’ (1984) 93 Yale Law Journal 1231.

<sup>48</sup> L Kornhauser, ‘An Economic Analysis of the Choice Between Enterprise and Personal Liability for Accidents’ (1982) 70 California Law Review 1345, 1351.

<sup>49</sup> RJ Herrnstein and JQ Wilson, *Crime and Human Nature* (Simon and Schuster, 1985) in J Arlen and R Kraakman, ‘Controlling Corporate Misconduct: An Analysis of Corporate Liability Regimes’ (1997) 72 New York University Law Review 687, 696.



society. Because of the possibility of going bankrupt, the expected fine for an individual may be below the social cost of the infringement.<sup>50</sup>

In the EU, as they are the subject of competition law provisions, undertakings are the logical subject of sanctions that are associated with the infringement of these provisions. Targeting the undertaking implies imposing a sanction on the company as a whole, regardless of the internal dimension of the undertaking. A practical implication of the concept of undertaking and the single entity doctrine is that the principal - not the agent - of the agency relation is subject to infringement decisions. In the context of a company in which ownership and control are separated, such sanctions are borne by the shareholders of a company.<sup>51</sup> In the relationship between a parent and its subsidiary, the sanction related to the infringement is also imposed on the parent company, provided that it exercises a decisive influence on the subsidiary. In other words, the principal bears part of the responsibility for the agent's infringement of competition. Even though they fall within the concept of an undertaking for competition law purposes, parent-subsidiary relations are out of the scope of this paper.

#### **1.2.1.1 *Effects of corporate sanctions on the dynamics of the agency relation, in the absence of individual sanctions***

Sanctions targeting the principal typically take the form of administrative or civil fines imposed on companies. Monetary fines imposed on companies are used to remedy competition law infringements, across all jurisdictions, sometimes in conjunction with other sanctioning tools.<sup>52</sup> As was stated before, sanctions imposed on the principal may have the effect of magnifying the friction of the relationship between the shareholders and managers of a company. The situation of moral hazard created by sanctions imposed on companies exclusively, may translate into a regime that 'hurts the innocent (workers and shareholders) while leaving those responsible for the

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<sup>50</sup> Becker (n 46)

<sup>51</sup> Motta and Langus' empirical study explores the loss of shareholder value relating to investigation and fining decision: M Motta and G Langus, 'On the Effect of EU Cartel Investigations and Fines On the Infringing Firms' Market Value' in CD Ehlermann and I Atanasiu (eds.), *European Competition Law Annual 2006: Enforcement of Prohibition of Cartels* (Hart Publishing 2006).

<sup>52</sup> International Competition Network, *Anti-Cartel Enforcement Manual* (2011).

infringement (the managers) unscathed'.<sup>53</sup> Similarly, such a corporate liability regime triggers the analogy of sanctions imposed on companies with those imposed on a 'whipping boy',<sup>54</sup> educated with a prince at the English Courts, who bore sanctions instead of the prince when he did wrong.<sup>55</sup>

### **1.2.1.2 Parameters that affect the mismatch of interests in the absence of individual sanctions**

The imposition of corporate fines impacts on the agency problem between managers and shareholders. The scope of such an impact depends on several types of parameters, related to who the residual claimant of the cartel profits is **(1.2.1.2.1)** and also to the level of deterrence of corporate fines **(1.2.1.2.2)**.

#### **1.2.1.2.1 The mismatch of interest depends on the residual claimant of cartel profits**

The scope of the mismatch of interests between managers and shareholders depends on who the residual claimants of the cartel profits are. Spagnolo argues that, due to the structure of corporate governance in Europe, shareholders continue to be the residual claimants of cartel profits. In that case, shareholders are the ones who principally benefit from the cartel profits, and they are also the ones who principally suffer from the cartel practice. In other words, the costs of an illegal practice are borne by the actors who benefit from it.<sup>56</sup> However, consistent with

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<sup>53</sup> The word 'innocent' refers to the painting by Rubens, *The Massacre of the innocents*. L Ortiz Blanco, A Givaja Sanz and A Lamadrid De Pablo, 'Fine arts in Brussels : punishment and settlement of cartel cases under EC Competition Law' in H Hirita and E Raffaelli, E Adriano (eds) *Antitrust between EC law and national law* (Bruylant Emile Etablissements 2009) 155.

<sup>54</sup> Judge D Ginsburg, 'Are Administrative Fines the Best Way to Deter Infringements? 'Deterring EU Competition Law Infringements: Are We Using the Right Sanctions?' Conference by TILEC and the Liege Competition & Innovation (2012).

<sup>55</sup> Oxford dictionaries online.

<sup>56</sup> G Spagnolo, 'Criminalization of cartels and their internal organization' in KJ Cseres, MP Schinkel, FOW Vogelaar (eds), *Remedies and Sanctions in Competition Policy: Economic and Legal Implications of the Tendency to Criminalize Antitrust Enforcement in the EU Member States* (Elgar 2006) 142.

previous developments, this study takes the view that managers personally get a share of cartel profits.<sup>57</sup>

#### 1.2.1.2.2 The mismatch of interest depends on the probability of detection and level of fines

The scope of such a mismatch of interests depends on several other parameters, which include the probability of detection and the level of fines. As previously developed, the interest gap exists only to the extent that a cartel practice is detected and punished. In the absence of detection, cartel benefits are likely to be common to shareholders and managers.<sup>58</sup>

The level of fines also conditions the extent to which fines imposed on companies affect the agency relation between managers and shareholders. This stems directly from the fact that the divergence of interests is due to the existence of sanctions, as argued in this section. A cartel that is not detected and prosecuted does not create a situation of moral hazard between managers and shareholders, because benefits and costs are aligned. Similarly, a very low fine imposed on shareholders is not likely to outweigh the accumulation of benefits from participation in the cartel. As a result, when shareholders alone are targeted, the lower the level of fines, the narrower the interest gap between the shareholders and the managers. The question of the optimal level of fines is relevant to explain why, in practice, if the level of fines is low enough, its impact on the agency relation will be negligible. Based on Becker's theory on crime, a sanction is deterrent if the expected fine is greater than the expected gain from the infringement, the expected fine being equal to the nominal amount of the fine discounted by the probability that a cartel is detected and prosecuted.<sup>59</sup> Applying this to cartel sanctions on corporations, Wils finds that:

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<sup>57</sup> This relies on the assumption that managers' remuneration is somehow tied to the cartel profits of the company. However it must be acknowledged that the structure of remuneration is only one parameter of the agency relation and that the assumption may change if other parameters are considered.

<sup>58</sup> Benefits of cartel participation are likely to be common, but may be different in scope depending on several parameters: e.g. how increased sales profits translate into higher value of shares, and how increases sales profits impact on the managers' remuneration.

<sup>59</sup> GS Becker (n 46).

Assuming a 10% price increase, and a resulting increase in profits of 5% of turnover, a 5-year duration and a 16% probability of detection and punishment, the floor below which fines will generally not deter price-fixing would be in the order of 150% of the annual turnover in the products concerned by the violation.<sup>60</sup>

This implies that the current level of fines imposed at EU level and in other jurisdictions, is substantially lower than deterrence actually requires.<sup>61</sup> As a result, even after detection, the consequences of participation in a cartel do not substantially magnify the divergence of interests between shareholders and managers. In other words, the agency cost triggered by cartel participation is not of particular concern to shareholders. However, a broader range of parameters than just the level of fines required for deterrence, can determine the impact corporate fines may have on the agency relation. Companies being fined may suffer from reputational costs and depending on the level of publicity, an antitrust fine may impact the business relations of the company. Shareholders suffer from reputational impacts to the extent that reputational costs are reflected in the stock price. Managers within a firm may also suffer from the reputational damage associated with the prosecution of their company, depending on their position within the hierarchy.<sup>62</sup> However, managers may have left the company by the time an infringement decision is issued, which mitigates the potential reputational damage they may suffer. The business model and ethics of a company can be questioned even in the case that a company is cleared following an investigation.<sup>63</sup> Therefore, accounting for reputational impacts, monetary fines may have a deterrent effect even if their level is below the theoretical level of deterrence. As the deterrent effect determines the impact of a fine on the agency relation, this means that broader elements associated with the actual corporate fines may magnify the agency problem between managers and shareholders.

In addition to factors that are specific to a company, such as the remuneration structure of managers, external parameters related to the types of competition enforcement regimes affect the mismatch of interests. In other words, if competition

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<sup>60</sup> WPJ Wils, *The Optimal Enforcement of EC Antitrust Law* (Kluwer Law International 2002) 200.

<sup>61</sup> OFT1132, *An assessment of discretionary penalties regimes*, A report prepared for the Office of Fair Trading by London Economics (2009)8.

<sup>62</sup> Managers' personal reputation is more affected than shareholders' personal fame: it is more difficult to know the identity of shareholders, and dispersed shareholders are not supposed to have known about the cartel.

<sup>63</sup> OFT 1227, *Drivers of Compliance and Non-compliance with Competition Law* (2010)29.

policy regimes are capable of impacting the probability of detection and the level of fines, they may be able to affect the scope of the agency problem between managers and shareholders in the context of cartel participation.

### **1.2.1.3 Effectiveness of corporate sanctions: a matter of agency relation.**

This section will explore the actual impact of corporate sanctions on the agency relation between shareholders and managers. In the absence of individual liability, companies are induced to incur costs to better monitor individuals, thereby increasing the agency costs **(1.2.1.3.1)**. Therefore, it is argued that the effectiveness of corporate sanctions is determined by the nature of the agency relation. **(1.2.1.3.2)**

#### 1.2.1.3.1 Corporate sanctions: an increase in agency costs.

A company facing vicarious liability for the wrongdoing of its employees has an incentive to incur costs to minimise the agency problem. In that context, reducing the agency problem consists of reducing the probability that a company will face the consequences of cartel participation. For that purpose, a company can, in the first instance, reduce the chance that individuals will engage in practices that put the company at risk. Companies can implement measures aimed at preventing individuals from entering into an anti-competitive agreement, by implementing, for example, compliance training for positions that are particularly at risk. In addition, companies may run internal investigations and set up reporting mechanisms, with internal sanctions schemes designed to increase the cost for an individual to enter into an illegal practice.<sup>64</sup> The agency costs incurred solve the agency problem when the company is able to align incentives by punishing individuals internally, as described here:

The corporation typically bears the brunt of tort damages or criminal penalties arising out of the activities of its agents or employees. Except in the most serious cases, culpable corporate agents are monitored and sanctioned internally: The firm may fire,

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<sup>64</sup> J Arlen and R Kraakman (n 49) 693.

demote, or otherwise discipline managers or employees whose actions create unacceptable legal risks.<sup>65</sup>

However, policing measures will be implemented only if *ex ante* their costs are lower than the expected costs of being prosecuted, which again depends on the probability of detection.<sup>66</sup> In other words, the agency costs related to corporate liability that a company is ready to incur depend on the company's perception of the risk associated with being subject to an infringement decision. This is consistent with previous developments with regard to the fact that the probability of detection and the level of fines determine the existence of an agency problem in the first place. If the probability of detection is very low, companies have no incentive to incur agency costs in monitoring individuals, because corporate liability does not increment the agency problem between shareholders and managers anyway. In addition to the level of the fine and the probability of detection, reputational damage may also constitute a source of risk that a company will want to avoid, even if the level of the expected fine is low. As a result, any potential source of risk a company is sensitive to, may induce a company to incur agency costs to prevent such a risk from occurring.

#### 1.2.1.3.2 Effectiveness of corporate sanctions: a matter of agency costs.

Taking the view that the level of fine imposed is sufficiently high, or that a company is sensitive to any type of risk associated with a prosecution, vicarious corporate liability may still not induce companies to incur agency costs to prevent and punish individuals who enter into a cartel. The implementation of preventing and policing measures may have two opposite effects for a company. First, these measures may increase the personal cost of the wrongful act for individuals, and diminish the rate of crimes. Second, the implementation of measures may increase the probability of the detection of illegal conduct by the authorities. It is argued that a company who detects the wrongdoing of an agent is likely to honestly report the wrongdoing to relevant authorities. This is because companies may face higher penalties for not

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<sup>65</sup> R Kraakman, 'Corporate Liability Strategies and the Costs of Legal Controls' (1984) 93 Yale Law Journal 857.

<sup>66</sup> P Buccirossi and G Spagnolo, 'Corporate governance and collusive behavior', in WD Collins (ed), *Issues in Competition Law and Policy 1* (American Bar Association 2008) 18.

reporting the illegal act of an agent. In addition, the wrongdoing of the agent may eventually be discovered or reported to the authority. In weighing the costs and benefits of implementing internal enforcement measures, a company may decide not to incur any enforcement costs if they expect that the costs of detection are higher than the expected benefit of detecting the crime internally. Taking into account the enforcement type of agency cost, corporate liability may produce undesired or 'perverse' effects. The perverse effect of corporate liability exists even if companies do not systematically report all illegal practices. The mere fact that they expect an increased probability of detection may deter companies from implementing internal measures.<sup>67</sup>

In addition, the effectiveness of methods employed by companies to deter and detect wrongdoing questions the desirability of a strict corporate liability regime. The view that companies have 'effective methods of preventing individuals from committing acts that impose huge liabilities on them' has been questioned by subsequent scholarship.<sup>68</sup> Polinsky and Shavell argue that companies are not fully capable of disciplining employees. Alternative employment opportunities make the threat of dismissal less effective to employees. The threat of a company's suit against employees is limited to the assets owned by the individual, which is likely to be lower than the harm caused by them.<sup>69</sup> In addition, sanctions imposed exclusively on companies, may target passive actors, the shareholders, who have no oversight of the cartel decision-making process in practice. In large companies, especially those publicly listed, shareholders are widely dispersed and do not oversee the day-to-day activities of the firm themselves. The function of control is delegated to the board of directors, who themselves turn to officers to implement the day-to-day monitoring in managing the employees. As a result, shareholders may not be capable of preventing employees from entering into cartels. Their option to sell or hold shares depends on whether earnings from the collusive profits can be expected. That is why it is argued that targeting shareholders exclusively may not be efficient, especially in countries characterised by large publicly held companies, such as the UK and the

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<sup>67</sup> J Arlen, 'The Potentially Perverse Effects of Corporate Criminal Liability' (1994) 23 *The Journal of Legal Studies* 833.

<sup>68</sup> RA Posner, *Antitrust Law: an Economic Perspective* (University of Chicago Press 1976) 225 in WPJ Wils (n 60) 17.

<sup>69</sup> AM Polinsky and S Shavell, 'Should Employees Be Subject to Fines and Imprisonment Given the Existence of Corporate Liability?' (1993) 13 *International Review of Law and Economics* 13, 239.

US. This is because the sanction does not harm those actually responsible for entering into and implementing the cartel.<sup>70</sup> In contrast, continental Europe's jurisdictions may be more responsive to strict corporate liability, as the corporate structure is characterised by more concentrated ownership.<sup>71</sup>

Corporate liability is deemed efficient if the company is able to monitor adequately the behaviour of individuals, in ensuring that they act in the company's best interest. If a company's enforcement effort needs to be very costly because of a large interest gap in the agency relation, such a cost may not outweigh the benefits of avoiding corporate prosecution. In addition, the effectiveness of corporate liability depends on how effectively mechanisms of corporate governance reduce the asymmetry of information and the interest gap between the company and its agents. Corporate governance mechanisms may fail to address this tension of interests, as exemplified by the corporate scandals in Enron or Parmalat. Corporate governance schemes that fail to reach the objectives for which they have been designed, are not likely to be highly effective in preventing individuals from committing illegal acts either. In addition, corporate governance guidance and rules logically focus on auditing and financial reporting requirements, while compliance with competition law (and other areas of law) is ancillary to the fiduciary duty of directors.<sup>72</sup>

Therefore, the design of corporate liability needs to be concerned with the interest gap and the manner in which companies may implement internal enforcement measures: 'if the firm has different interests from its agents and cannot control them without cost - then simple vicarious liability may no longer be the preferred corporate incentive regime.'<sup>73</sup> Individual sanctions may enable the by-passing of corporate governance mechanisms that have to face many different challenges other than competition law compliance.<sup>74</sup>

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<sup>70</sup> KJ Cseres, MP Schinkel, FOW Vogelaar (eds) (n 56) 8.

<sup>71</sup> P Massey, 'Criminalization and leniency: will the combination favourably affect cartel stability?' in *Ibid* 180.

<sup>72</sup> Although guidelines provided by the OECD and the Cadbury Report include the need to comply with the law and behave ethically as part of corporate governance responsibility, corporate governance rules that impose strict corporate governance requirements typically relate to subjects like the independence of auditing, the certification and disclosure of financial information and criminal account manipulation etc. Sarbanes- Oxley Act 2002, Pub. L. No. 107-204, 116 Stat. 745 (2002)

<sup>73</sup> J Arlen and R Kraakman (n 49) 690.

<sup>74</sup> KJ Cseres, MP Schinkel, FOW Vogelaar (eds) (n 56) 12-13.



## **Conclusion on corporate sanctions in the absence of individual liability**

Assuming that a breach of competition law benefits individuals, corporate sanctions aggravate the interest gap between shareholders and managers. Corporate sanctions are seen to be effective when they induce companies to monitor individuals internally, providing that such controlling costs do not create adverse effects. However, when companies are not able to deter and detect illegal acts perpetrated by individuals, individual liability may be desirable in addition to corporate liability. Making individuals liable may help by-pass ineffective corporate governance mechanisms. Sanctions imposed on individuals may also be desirable when the agency problem between companies and their agents is too severe.<sup>75</sup>

### **1.2.2 Individual sanctions: targeting the agent of the agency relation**

Antitrust sanctions that target individuals may take the form of monetary fines, imprisonment penalties and disqualification from the position of director. Individual sanctions can be of an administrative, civil or criminal nature. Individual sanctions contrast with those imposed on companies as they may entail imprisonment fines. From a policy perspective, individual penalties may present a number of advantages over corporate sanctions in the way they affect the actors' incentives.<sup>76</sup> Individuals may be particularly responsive to jail sentences, while they may be less responsive to monetary fines due to their probable limited ability to pay a fine which corresponds to the total economic harm to society. Such an aspect of the discussion around the effectiveness is left aside in this section, as is the question around the enforcement cost of jail sentences over pecuniary penalties.<sup>77</sup>

This section will explore the manner in which the agency relation is affected when the agent is liable in addition to the principal. An overview of individual sanctions available in the US and in the EU Member states will first be provided.

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<sup>75</sup> Ibid 8.

<sup>76</sup> For example, WPJ Wils, 'Is Criminalization of EU Competition Law the Answer?' in KJ Cseres, MP Schinkel, FOW Vogelaar (eds) (n 56) 78-85. C Leslie (n 24) 1644.

<sup>77</sup> An example of a study on the enforcement cost of jail sentences compared to that of financial penalties for individuals. TL Cherry, 'Financial Penalties as an Alternative Criminal Sanction: Evidence from Panel Data' (2001) 29 Atlantic Economic Journal 450.

### **1.2.2.1 An overview of individual sanctions**

In the US, the original version of the Sherman Act imposed criminal sanctions on individuals, from fines to imprisonment penalties.<sup>78</sup> Since 2004, an individual involved in a cartel can be given up to ten years in jail.<sup>79</sup> At the EU level, sanctions are levied only against companies. However, individual sanctions including jail sentences can be imposed in a number of EU member states. In the United Kingdom, individual price-fixers may face disqualification, imprisonment and fines.<sup>80</sup> Imprisonment is a possible sentence in Italy, Austria, Germany and Hungary, but only for bid-rigging.<sup>81</sup> In Germany, besides criminal sanctions in bid-rigging cases, non-criminal financial fines, of up to 1 million euros, may be levied against individuals.<sup>82</sup> In the Netherlands, fines up to 450,000 euros can be imposed on natural persons.<sup>83</sup> In Belgium, administrative fines ranging from 100 to 10,000 euros can be imposed on individuals.<sup>84</sup> In Ireland, individuals are liable through the liability of the undertaking, and can face imprisonment penalties of up to ten years.<sup>85</sup> In Spain, an individual who directly took part to the decision of collusion can be given a fine of up to 60,000 euros.<sup>86</sup> The Danish Competition Act entails the possibility of imprisonment and criminal fines for individuals involved in a cartel.<sup>87</sup> The Portuguese Competition Act provides for the individual liability of directors and individuals responsible for the management or supervision of the areas of activity where there has been a violation.<sup>88</sup> In Malta, liability of directors for failure to pay a fine or to supply requested information can be joined to that of the firm, and they can be sanctioned to criminal fines as a consequence.<sup>89</sup> In France, Cyprus and the Slovak Republic there is a

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<sup>78</sup> WPJ Wils, 'Is Criminalization of EU Competition Law the Answer?' in KJ Cseres, MP Schinkel, FOW Vogelaar (eds) (eds.) (n 56) 71.

<sup>79</sup> Sherman Act, 15 USC§1.

<sup>80</sup> Enterprise Act 2002, s188 and 204.

<sup>81</sup> Italy: Article 353 of the Italian Criminal Code; Austria: §168b of the Austrian Criminal Code (Strafgesetzbuch) ; Hungary: Section 14 of Act XCI of 2005 amending the Hungarian Criminal Code, Act IV of 1978 and other acts; Germany: § 298 of Criminal Code.

<sup>82</sup> §81(4) of the Act against Restraints on Competition (ARC) German Act against Restraints of Competition.

<sup>83</sup> Dutch Competition Act, 2007, section 57.

<sup>84</sup> Art. IV70. §2 Code de droit économique.

<sup>85</sup> Section 8 of Irish Competition Act, 2002.

<sup>86</sup> Competition Act, 2007, Article 63.

<sup>87</sup> Danish Competition Act § 23, (Consolidation Act No. 23 of 17 January 2013).

<sup>88</sup> Portuguese Competition Act, Law 19/2012, article 73.

<sup>89</sup> Competition Act (Chapter 379 of the Laws of Malta) articles 21 and 21a.

possibility of prison sentences of individuals.<sup>90</sup> The Estonian Competition Act entails the possibility of sanctioning individuals through fines or detention for up to three years.<sup>91</sup> In the Czech Republic prison sentences of up to three years were introduced for individual price-fixers.<sup>92</sup> In Latvia, infringement of competition can be sanctioned by up to two years imprisonment and in Romania, by between four months and six years imprisonment.<sup>93</sup> In Slovenia, individuals who breach competition law while performing a business activity can be prescribed a jail sentence ranging from six months to five years.<sup>94</sup> In Greece competition policy provides for criminal sanctions, including imprisonment.<sup>95</sup> In June 2014, the Polish Parliament adopted the amendment of its competition act, introducing fines of up to 500,000 euros on managers responsible for participating in anti-competitive agreements.<sup>96</sup>

Notwithstanding the fact that a fair proportion of EU Member states have sanctions against individuals, such provisions may not actually be enforced. With regard to criminal sanctions, in Ireland, 5 competition cases have been prosecuted in the criminal courts, 3 of which led to jail or financial sanctions against individuals.<sup>97</sup> In the UK, only 2 criminal cartel cases reached court.<sup>98</sup> Only the *marine hose* case resulted in criminal sanctions - jail sentences and disqualification orders - against the responsible individuals.<sup>99</sup> The CMA is currently conducting another criminal investigation into the supply of galvanised steel tanks for water storage; where

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<sup>90</sup> France: Code de Commerce, Article L420-6. Imprisonment penalty of up to 4 years and a financial penalty of up to €75,000; Cyprus: The Protection of Competition Law, 2008, Part VIII; Slovak Republic: A Jones, B Sufrin, *EU Competition Law: Text, Cases, and Materials* (5<sup>th</sup> edn, Oxford University Press 2014) 670.

<sup>91</sup> Competition Act, 2006, para 148.

<sup>92</sup> Czech Criminal Code, s 248 (2).

<sup>93</sup> Latvia, Criminal Law, section 211 and 212; Romania: The Parliament of Romania Competition Law of 1996, Article 63.

<sup>94</sup> Art 225(1) of Criminal Code in A Mitić, M Rogl, 'The European Antitrust Review 2014: Slovenia' (2014) *Global Competition Review*.

<sup>95</sup> Article 44, Law 3959/2011.

<sup>96</sup> 'Parliament adopts new antitrust law.' Available at <[http://www.uokik.govpl/news.php?news\\_id=11074](http://www.uokik.govpl/news.php?news_id=11074)>.

<sup>97</sup> *Competition Authority v District Judge O'Donnell* [2007] IEHC 390; *DPP v Denis Manning*, Central Criminal Court (2007); *DPP v Pat Hegarty*, The Circuit Criminal Court, Galway (2012); details of sentences available at: 'Irish Criminal Court Cases Relating to Competition Law', The Competition Authority available at <<http://www.tca.ie/en/Enforcing-Competition-Law/Criminal-Court-Cases.aspx>>.

<sup>98</sup> *Marine Hose case: R v Whittle, Allison, Brammer* [2008] EWCA Crim 2560; *Airline fuel surcharges case: R v George, Crawley, Burns and Burnett* [2010] EWCA Crim 1148.

<sup>99</sup> Appeal decision: *R v Whittle and others* [2008] EWCA Crim 2560. Details of concluded prosecutions available at

<<http://webarchive.nationalarchives.govuk/20140402142426/http://www.offt.govuk/OFTwork/competition-act-and-cartels/criminal-cartels-completed/marine-hose>>.

individuals may face jail penalties.<sup>100</sup> In other regimes, such as France, Greece and Romania, cartels are criminalised in a tenuous manner such that the offence relates more to fraud alone than a cartel offence and hence is much narrower than a true notion of criminal antitrust. This may also illustrate the reluctance of authorities to bring criminal charges against individuals.<sup>101</sup> In France, for example, criminal charges against individuals are, in practice, limited to cases where there exist other types of infringements, such as the corruption or misuse of social assets.<sup>102</sup> The interplay of criminal proceedings for which courts are competent and administrative sanctions by the competition authority explains the extremely rare use of criminal antitrust sanctions in France.<sup>103</sup> In contrast, in Germany, criminal enforcement exists but is rather discrete. Germany seems to produce more criminal antitrust cases than are actually perceived by the public.<sup>104</sup> Several prison sentences have been imposed on individuals since the introduction in 1997 of criminal sanctions against one type of horizontal collusion: bid-rigging.<sup>105</sup> However, Germany is not perceived as a successful criminal enforcer of competition law, either internationally and nationally, which may be explained by very low coverage in the media of bid-rigging cases.<sup>106</sup> Administrative fines against individuals seem, however, more commonly imposed. As an example, between 1993 and 2010, the German Competition Authority has fined, on average, one individual for each undertaking fined.<sup>107</sup> In the Netherlands fining individuals is also becoming a common practice.<sup>108</sup>

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<sup>100</sup> See CMA, 'Supply of galvanised steel tanks for water storage: criminal investigation' available at <<https://www.gov.uk/cma-cases/criminal-investigation-into-the-supply-of-galvanised-steel-tanks-for-water-storage>>.

<sup>101</sup> K Jones, F Harrison (n 4) 3.

<sup>102</sup> Example of cases : *Affaire des enrobés bitumineux*, Chambre criminelle de la Cour de cassation, 16 mai 2001, n°99-83467 et 97-80888 ; *Affaire de l'entretien et la rénovation partielle de l'éclairage public de la ville du Havre*, Chambre correctionnelle de la Cour d'appel de Rouen, 25 février 2002.

<sup>103</sup> Ministère de l'économie, de l'industrie et de l'emploi, Rapport sur l'appréciation de la sanction en matière de pratiques anticoncurrentielles (2010) 5 available at

<<http://www.ladocumentationfrancaise.fr/var/storage/rapports-publics/104000490/0000.pdf>>.

<sup>104</sup> F Wagner-Von Papp, 'What if all Bid Riggers Went to Prison and Nobody Noticed? Criminal Antitrust Law Enforcement in Germany' in C Beaton-Wells and A Ezrachi (eds), *Criminalising Cartels, Critical Studies of an International Regulatory Movement* (Hart Publishing 2011) 157.

<sup>105</sup> Ibid 166. One unsuspended prison sentence was imposed: 'By the end of 2006, German courts had not only imposed 15 suspended prison sentences for bid rigging,70 but more importantly, had handed down at least one unsuspended prison sentence of 34 months'.

<sup>106</sup> Ibid170.

<sup>107</sup> BVerfG, 19 December 2012, 1 BvL 18/11, WuW/E DE-R 3766, paras 52, 60 – Verzinsungspflicht, available at <[http://www.bverfg.de/entscheidungen/Is20121219\\_1bvl001811.html](http://www.bverfg.de/entscheidungen/Is20121219_1bvl001811.html)>. Interestingly, Germany is one of the few jurisdictions where individuals are primarily liable for breaching competition law. (§9 OWiG) The undertaking may be liable for an administrative offence if the individual who infringed competition law, has some degree of responsibility within the company (§30 OWiG). The

Therefore, the level of enforcement of sanctions against individuals depends on the nature of the sanction – criminal or administrative – and varies from one jurisdiction to another. Individuals are likely to be sensitive to the level of enforcement they perceive. If these are barely enforced, the existence of individual sanctions may not impact the agency relation in the context of a cartel practice.

### **1.2.2.2 Impact of the individual sanctions on the agency relation**

The overview of available individual sanctions in the US and in the EU member states shows that directors and executives may be personally liable for engaging in competition law infringements. As a result they can no longer operate behind the shield of corporate liability that affects the owners of the company.<sup>109</sup>

In terms of incentives, individual sanctions align the cost of detection for the individual with that of the company. In the absence of personal punishment, the responsible individual may not bear the full cost of their behaviour, unless the company is able to punish the individual internally, or somehow recover the fine from the individual by way of a damages action or a derivative suit. Introducing individual sanctions may reduce the moral hazard situation characterising price-fixing conducts in a regime of strict corporate liability. This is based on the assumption that a collusive practice benefits both the principal and the agent of the agency relation, and the cost of such behaviour depends on the liability regime attached to such infringements. Based on the optimal sanction theory, an individual will have to discount the cost of a potential individual sanction from the benefit of cartel profits. An agent is expected to be reluctant to implement a cartel agreement if the cost of the expected personal sanction is greater than the benefits of implementing the collusive agreement. Fearing going to jail, Wayne Brassler, an employee of ADM, refused to cooperate in the lysine price-fixing conspiracy in which his company was involved.<sup>110</sup> The availability of personal sanctions surely affected the incentive of this employee.

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owner of the company will be liable if there was a lack of supervision. Such a particular liability regime may explain why, in Germany, administrative fines are often imposed (§130 OWiG).

<sup>108</sup> M Slotboom, 'Individual Liability for Cartel Infringements in the EU: An Increasingly Dangerous Minefield' Kluwer Competition Law Blog (2013) available at <http://kluwercompetitionlawblog.com/2013/04/25/individual-liability-for-cartel-infringements-in-the-eu-an-increasingly-dangerous-minefield/>.

<sup>109</sup> KJ Cseres, MP Schinkel, FOW Vogelaar (eds) (n 56) 8.

<sup>110</sup> The employee was subsequently fired for not cooperating. J Connor (n 38) 357.

In this case, while being 'faithless' to the higher level of the hierarchy, the employee of ADM, Wayne Brassler, was indirectly loyal to the shareholders of the company by refusing to cooperate. This is because he perceived that he could face a personal sanction in parallel to that imposed on the company. In other words, the interests of both the employee and the company towards the potential sanction were aligned.

As previously described, the implementation of a collusive agreement involves various agency relationships between different actors of the firm, that is, between the decision makers, typically at the highest level of the hierarchy, and those in charge of implementing the agreement, such as managers from different units of the companies. The introduction of individual sanctions has the potential to impact incentives of all such agency relationships within the company, even if not all of the individuals are personally liable. Managers at the top of the hierarchy are typically liable for the wrongdoing of the employees under their control, but in the case of perceived potential liability, an employee may be reluctant to implement an illegal agreement. As such, an individual sanction may induce an employee to be faithless to his direct manager, even though their incentives towards the sanctions are aligned with those of the company as a whole.

Theoretically, the availability of sanctions directed against individuals reduces the interest gap in the agency relation as now both the shareholders and individuals face sanctions. This implies that individuals have a better incentive to act in the shareholders' best interests by avoiding entering into a price-fixing agreement for which both the shareholders and the individuals are liable.

### **1.2.2.3 Effectiveness of individual sanctions**

The impact of individual sanctions on the agency relations depends on how such penalties affect the incentives of individuals. Firstly, it must be stressed that a particular individual may react differently to the threat of different personal sanctions. An individual may be more responsive to the risk of serving jail terms than to the threat of paying criminal fines. In addition, sensitivity to a particular sanction may differ between individuals according to, for example, their position within the

hierarchy. For example, only certain individuals in a company may face the risk of disqualification orders in the UK.<sup>111</sup>

The responsiveness of individuals to individual sanctions depends on a number of external and internal factors. The level of the penalty imposed and the probability that the illegal behaviour is detected determine the impact the sanction has on individual incentives and in turn on the agency relation. In addition, individuals are likely to be sensitive to the level of enforcement of individual sanctions they perceive. In the absence of actual enforcement, the availability of individual sanctions may not affect the relation between shareholders and managers in the context of a cartel practice.

In addition to the parameters given by the optimal sanctions theory, internal factors may affect individuals' responses to sanctions, and their effects on the agency relation. For example, the fear of being dismissed, a personal low aversion to risk, or the corporate culture that prevails in a given company may still encourage an individual to implement instructions that breach competition law, despite their personal liability for those acts.

Another key aspect is the ability a company has to indemnify its agent in case they face individual sanctions. A company may commit to reimbursing any fine imposed on an individual, or may choose to inflate the level of compensation to foresee any individual penalty. In addition, directors and officers may be externally insured against legal risks incurred as a result of their function, as part of Director and Officer Insurance ('D&O') liability insurances, for example.<sup>112</sup> Indemnification or insurance policies can foresee covering defence costs and potential damages arising out of the director or officer's function. Those costs would otherwise be funded by personal resources.<sup>113</sup>

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<sup>111</sup> See further developments about disqualification order **1.2.2.4**.

<sup>112</sup> Director and Officer liability insurance was introduced in the 1930s by Lloyds of London and expanded in the US in the 1960s when it appeared that directors and officers, not just corporations, could face significant liability themselves in the context of security laws. R Romano, 'Directors' and Officers' Liability Insurance: What Went Wrong?' (1988) 37 Proceedings of the Academy of Political Science 76. The use of D&O liability insurance extended to the UK, Canada, South Africa, Australia, Ireland and Israel, France, Belgium, the Netherlands, Spain and Switzerland in the 1980s. Allianz Global Corporate & Specialty, 'Introduction to D&O insurance, Risk Briefing', 2010 available at <<http://www.agcs.allianz.com/assets/PDFs/risk%20insights/AGCS-DO-infopaper.pdf>>.

<sup>113</sup> StrategicRISK, Guide to Directors' & Officers' Liability Insurance (2012) available at

Indemnifying or insuring individuals enables the risk of competition law breach to be shifted from the agent to the principal. If the company is fully capable of indemnifying its employees, individual sanctions may produce no effect on the agency relation in theory. This means that the principal bears the entire cost of the sanction, equivalent to situations of strict corporate liability. The ability to compensate employees depends on several factors: first, the nature of the individual penalty that the individual may face. Monetary sanctions are easily covered by an indemnity equal to the amount of the fine. In contrast, imprisonment sanctions may not be as easily indemnified, because an individual may suffer from losses that have greater implications than just a financial loss.<sup>114</sup>

In addition, D&O insurances or companies cannot indemnify employees for all types of individual sanctions they may face in their capacity as manager or director of the company. The UK Companies Act 2006, for example, prohibits companies from indemnifying against criminal fines or fines imposed by a regulatory authority to a director.<sup>115</sup> In addition, D&O insurances typically do not cover fraudulent, criminal or intentionally non-compliant acts, or cases where directors obtained illegal remuneration, or acted for personal profit. Innocent directors remain fully covered by the insurance if they are co-defendants, even if the acts of their colleagues were fraudulent or intentional.<sup>116</sup> In particular, claims in relation to antitrust cases seem to quite often be explicitly excluded from the scope of D&O policies.<sup>117</sup> As a result, it is likely that a director who personally took the initiative of entering in a cartel cannot operate behind the shield of a corporate indemnification or D&O policy.

Theoretical discussions about the desirability of banning the indemnification of employees relates to its potential effect on the effectiveness of individual

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< [http://www.strategic-risk-global.com/Journals/Newsquest/StrategicRISK/Chartis\\_White\\_Papers/attachments/A%20Guide%20to%20Directors%27%20&%20Officers%27%20Liability%20in%20Europe.pdf](http://www.strategic-risk-global.com/Journals/Newsquest/StrategicRISK/Chartis_White_Papers/attachments/A%20Guide%20to%20Directors%27%20&%20Officers%27%20Liability%20in%20Europe.pdf) >.

<sup>114</sup> WPJ Wils (n 56) 86.

<sup>115</sup> Companies Act 2006, s 234.

<sup>116</sup> Allianz Global Corporate & Specialty (n 112).

<sup>117</sup> K LaCroix, 'Professional Liability Insurance: The Antitrust Exclusion Isn't Just About Antitrust Claims' The D&O diary, 2012 available at <<http://www.dandodiary.com/2012/11/articles/d-o-insurance/professional-liability-insurance-the-antitrust-exclusion-isnt-just-about-antitrust-claims/>>.



sanctions.<sup>118</sup> Mullin and Snyder argue that companies should not be prohibited from indemnifying their employees as this triggers the risk of wrongly prosecuting companies that have not breached the law.<sup>119</sup> Therefore, the impact of individual sanctions depends on a number of factors, such as the personal sensitivity to sanctions, the types and level of sanctions and enforcement, as well as the ability of a company to indemnify employees.

As was previously mentioned, corporate sanctions are deemed to be effective when either there is no tension between the interests of shareholders and managers, which is the case for an entrepreneurial firm, or when companies can cheaply monitor their employees. As a result, the desirability of individual sanctions depends on the agency relation, as summarised here:

Cartels are formed and run by managers. A sanction policy must affect their incentives. This can be accomplished indirectly by imposing sanctions on firms. Individual liability is necessary if either the optimal enforcement policy requires the imposition of non-pecuniary sanctions, **or the principal-agent relationship cannot be shaped so as to efficiently pursue the principal's goals.**<sup>120</sup> (Emphasis added)

#### **1.2.2.4 Competition disqualification orders (CDOs) in the UK**

In the UK, Competition Disqualification orders (CDOs) provide an illustration of the intersection of sanctions of competition law and corporate governance, the main concern of which is the reduction of the agency problem between shareholders and managers. The Company Directors Disqualification Act 1986 (CDDA), part of UK Company Law, entails the possibility of directors being disqualified for acting for a company in cases of certain misconducts. Initially, disqualification orders concerned wrongdoings in insolvency and broader corporate governance contexts.<sup>121</sup> Since an

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<sup>118</sup> C Stone, 'The Place of Enterprise Liability in the Control of Corporate Conduct' (1980) 90 *The Yale Law Journal* 1; R Kraakman (n 65); F Privileggi, C Marchese and A Cassone, 'Agent's Liability Versus Principal's Liability When Attitudes Toward Risk Differ' (2001) 21 *International Review of Law and Economics* 181.

<sup>119</sup> They further posit that optimal deterrence can be better achieved by targeting the company exclusively. WP Mullin and CM Snyder, 'Should Firms be Allowed to Indemnify Their Employees for Sanctions?' (2010) 26 *Journal of Law, Economics, and Organization* 30.

<sup>120</sup> P Buccirosi and G Spagnolo (n 66) 20.

<sup>121</sup> Eg. Conviction of an indictable offense, persistent breach of company legislation and fraud.

amendment of the CDDA by the Enterprise Act 2002,<sup>122</sup> such sanctions of corporate law can be used in the context of competition law infringements: directors can be disqualified if their company breaches competition law.<sup>123</sup>

CDOs theoretically produce two types of effects on the agency relation. Because CDOs target individuals, the analysis provided for individual sanctions remains valid in the context of CDOs. CDOs are thus deemed to reduce the situation of moral hazard in cartel participation, based on the assumption that directors get a share of the cartel profit. In addition to the effect of the alignment of incentives, generic to individual sanctions, CDOs may induce companies to enhance their general corporate governance systems. The amelioration of corporate governance in a company supposedly further reduces the interest gap between shareholders and managers. CDOs target a specific category of individuals, those directly responsible for the function of corporate governance, being the directors. This implies that a director who failed to prevent or detect a breach of competition law is also unfit to ensure the corporate governance function. CDOs are expected to produce effects on corporate governance mechanisms, because directors may be willing to control the company's business more closely. Criteria to assess the unfitness of a director whose company breached competition law consider not just the actual but also the constructive knowledge of the violation. Recent changes in the OFT guidelines on CDOs confirm that directors who do not know about the conduct but who ought to have known, are not less likely to be disqualified than those who actually knew. In other words, directors cannot operate behind the shield of an absence of knowledge of the illegal conduct, if they ought to have known.<sup>124</sup> This places greater onus on a director to investigate internally potential violation of competition law.<sup>125</sup>

As a result, in order to avoid being personally liable, directors have to put in place monitoring mechanisms that corroborate with the objectives of corporate governance. In practice, directors may be induced to put in place compliance programmes, internal reporting systems and so on, and have to pay greater attention to any suspicious information, including abnormal profits made in a particular department of

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<sup>122</sup> Enterprise Act 2002, s 204, modifying the Company Directors Disqualification Act 1986.

<sup>123</sup> Company Directors Disqualification Act 1986, s 9A to 9E.

<sup>124</sup> OFT1111 4.19 to 4.23.

<sup>125</sup> N Karr, 'The OFT's revised director disqualification guidance: deterring directors or competition law breaches?' (2010) Linklaters.

the company.<sup>126</sup> Such compliance programmes are deemed to be in the long-term interest of shareholders if they reduce the risk of directors engaging in cartels.<sup>127</sup> Directors need to be aware of compliance with competition law, in the same way that they are conscious of other corporate governance requirements. As previously developed, CDOs are circumscribed to a breach of competition and to the conduct of the director related to that breach. Therefore the impact of CDOs on the quality of corporate governance may be mitigated by the fact that CDOs do not statutorily consider competition law violation in the light of breach of a director's duties. If this was the case, directors would need to accept that compliance is inherent to a director's duties.<sup>128</sup>

Similar to other types of individual sanction, the effect of CDOs on the agency relation depends on the ability to compensate a director. If a director is close to retirement, an early retirement package or generous severance package may be sufficient to mitigate the potential effect of CDOs on the agency relation.<sup>129</sup> To date, there has been one case of directors' disqualification in relation to a breach of competition law, in the context of the Marine hose cartel prosecution. However the disqualification was ordered in relation to a separate provision of the CDDA, which allows disqualification if a director has committed a criminal offence. In that case, the directors were found guilty of a criminal cartel offence.<sup>130</sup>

To conclude, 'the disqualification of company directors involved in cartels provides the possibility of aligning the incentives of directors and undertakings, to comply with cartel laws.'<sup>131</sup> A study commissioned by the OFT on the deterrent effect of competition law enforcements suggests that CDO is perceived as one of the most

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<sup>126</sup> Ibid.

<sup>127</sup> In the long-run, cartels are potentially more unstable and shareholders have greater prospects of being affected by a fine. J Schmidt, 'The Case for a European Competition Disqualification Order' (2010) 8 *Zeitschrift für Wettbewerbsrecht* 389.

<sup>128</sup> P Hughes, 'Director's Personal Liability for Cartel Activity' (2008) 29 *European Competition Law Review* 648.

<sup>129</sup> A Stephan, 'Disqualification Orders for Directors Involved in Cartels' (2011) 2 *Journal of European Competition Law & Practice* 529, 533.

<sup>130</sup> OFT, Concluded prosecutions of the Marine hose cartel case, available at <<http://webarchive.nationalarchives.gov.uk/20140402142426/http://www.of.govuk/OFTwork/competition-act-and-cartels/criminal-cartels-completed/marine-hose>>.

<sup>131</sup> A Stephan (n 129) 535.

powerful deterrent instruments, together with reputation cost and fines.<sup>132</sup> Individuals targeted by CDOs are characterised by a high level of education and experience, which may explain why there are a number of stories of individuals being promoted or employed shortly after being convicted.<sup>133</sup> Therefore, the threat of being banned from the profession may compensate for the inefficiency of the social stigma for certain high-profile executives.<sup>134</sup> As Hughes argues, a fuller use of sanctions of corporate governance in the context of competition law would enable an even greater place for competition compliance among a director's other duties.<sup>135</sup>

### **1.2.3 Conclusion on instruments aimed at deterring infringements of competition law**

The effectiveness of whom to target – either the principal or the agent in addition to the principal – depends on parameters of corporate governance.

The possibility of targeting the agent exclusively is typically excluded on grounds that relate to the agency relation. Wils describes here the moral hazard issue that would arise if companies were completely relaxed about the infringement of their employees:

If companies were not liable for the antitrust infringements engaged in by their employees, serious incentive problems would result. Because companies benefit from the antitrust infringements engaged in by their employees, companies would have an incentive to encourage violations. Companies would have an incentive to recruit those employees most likely to engage in antitrust infringements, and to give them the authority necessary to do so. Companies would have an incentive to impose on their employees profit targets or performance goals and incentive structures that pressurize their employees into committing antitrust infringements. Companies would

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<sup>132</sup> OFT962, The deterrent effect of competition enforcement by the OFT, A report prepared for the OFT by Deloitte (2007) 5.56 Although a more recent study does not necessarily confirm such finding. OFT1391, The Impact of Competition Interventions on Compliance and Deterrence, Final Report, by London Economics (2011) 3.36-41.

<sup>133</sup> See below 1.4.1.

<sup>134</sup> J Schmidt (n 127) 387.

<sup>135</sup> P Hughes (n 128) 632.

also have an incentive to develop internal cultures conducive to antitrust infringements.<sup>136</sup>

Overall, a sanction policy will not be efficient if it creates a situation of moral hazard between the agent and the principal that the firm cannot address internally. If an individual operates behind the shield of corporate liability, he may not act in the best interest of the company as he himself does not face the risk of detection. If corporations cannot address this internally, increasing the level of the corporate fine may not be optimal in terms of deterrence. Conversely, the reason for which it would not be satisfactory to punish individuals exclusively is that companies would operate behind the shield of individual liability, because only the individual faces the risk of detection of the infringement.

As a result, the discussion on the optimality of sanctions is merely a matter of whom to target among the agent and the principal. Companies repeatedly involved in cartel practices are likely to be large corporations, formed of many business departments and various subsidiaries, where shareholders have limited oversight of the managers' actions. In those types of companies, the agency problem between shareholders and managers cannot be easily overcome. Therefore, individual sanctions have the overall effect of reducing the interest gap between responsible managers and shareholders who have no oversight of the cartel decision-making process. This is based on the assumption that it is in the long-term interest for shareholders that the company complies with competition law. In addition, individual sanctions have the potential to undermine the manner in which employees implement cartel-related instructions emanating from their managers.<sup>137</sup> Therefore, individual penalties are particularly deterrent if they create agency problems in the relation between the employees and their managers, which in turn consists of aligning incentives of the agency relation between shareholders and managers. In the light of their overall effect on the agency relation, this study takes the view that individual sanctions are desirable.

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<sup>136</sup> WPJ Wils, 'Antitrust Compliance Programmes & Optimal Antitrust Enforcement' (2013) 1 *Journal of Antitrust Enforcement* 59.

<sup>137</sup> G Spagnolo in KJ Cseres, MP Schinkel, FOW Vogelaar (eds) (n 56) 142.

### 1.3 Enforcement instruments that aim to detect infringements

This section will focus on instruments that, in addition to contributing to increasing the cost of cartel participation, purport to *detect* existing anti-competitive practices. Leniency policy and ‘bounty’ programmes are examples of instruments that are designed to undermine the stability of cartels, and are deemed to constitute a powerful detection device for competition authorities. The effect of such programmes on the stability of the agency relation will be examined.

#### 1.3.1 Overview of leniency policy

Leniency policy is a core public enforcement instrument, adopted unanimously in the US and in the EU competition laws. Leniency policies contribute to the fight against cartels, an illegal activity which is typically carefully concealed by its participants and which competition authorities have difficulties in uncovering.

The competition policies of all of the EU member states have leniency programmes, apart from Malta.<sup>138</sup> For the purpose of this section, leniency is understood as a ‘catch-all’ term referring to all types of immunity and reduced fines available in the various competition regimes.<sup>139</sup>

In the jurisdiction of the European Union the term ‘leniency’ refers to immunity as well as a reduction of any fine which would otherwise have been imposed on a participant in a cartel, in exchange for the voluntary disclosure of information regarding the cartel which satisfies specific criteria prior to or during the investigative stage of the case.<sup>140</sup>

Total immunity from fines can be granted to the first undertaking that brings convincing evidence of its participation in a cartel. Companies that do not qualify for full immunity can still benefit from a reduction in fines, if they can provide evidence that adds ‘significant value’ to the investigation. The reduction in the fine for the first

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<sup>138</sup> EU Commission, Authorities in EU Member States which operate a leniency programme, available at <[http://ec.europa.eu/competition/ecn/leniency\\_programme\\_nca.pdf](http://ec.europa.eu/competition/ecn/leniency_programme_nca.pdf)>. In June 2013, Malta opened consultation on the introduction of leniency regulations. <<http://mccaa.org.mt/en/consultations-publications>>.

<sup>139</sup> R Whish and D Bailey, *Competition Law* (7<sup>th</sup> edn, Oxford University Press 2012) 414.

<sup>140</sup> Commission Notice on immunity from fines and reduction of fines in cartel cases [2006] OJ C 298/11.

company meeting these requirements ranges from 30 to 50% of the total amount that would have been imposed. Subsequent applicants can claim a reduction of up to 20%.<sup>141</sup> In contrast, the US leniency programme only grants immunity to the first undertaking that reports the cartel.<sup>142</sup> Both leniency programmes entail the possibility of immunity when the cartel is undetected or when an investigation has already started. In both cases, immunity is conditional on the prompt termination of the cartel activity as well as to the full cooperation of the firm. The scope of leniency varies from one jurisdiction to the other, to adjust for the sanctions that individuals may face. Some programmes grant immunity from fines to corporations while providing a blanket immunity to all of the employees that may face personal sanctions.<sup>143</sup> In the EU, consistent with the absence of individual sanctions, the leniency programme grants immunity exclusively to the undertakings.

For the purpose of this analysis, the most relevant aspect of leniency lies in its interaction with individual sanctions. In addition to corporate leniency programmes, some competition policies have a leniency scheme for individuals, which enables individuals to seek amnesty or reduction of personal sanctions independently from their company. The US incorporated an individual programme of leniency in 1994. An individual who is the first to report the cartel can be amnestied from any criminal sanctions he would have faced.<sup>144</sup> The United Kingdom established an individual leniency programme in 2008, from which an individual who self-reports can benefit separately from their company, provided that the cartel conduct was unknown to the CMA. However, this does not guarantee immunity for other individuals of the firm or for the company.<sup>145</sup> In the Netherlands, the introduction of individual fines in 2007 was coupled with the establishment of an individual leniency scheme. The rules for the scope of the amnesty or fine reduction disregard whether the applicant is a company or an individual. If the undertaking applies for leniency, individuals can be 'co-applicant' in cooperating with the application made by the company.<sup>146</sup> In Germany, natural persons have been able to seek leniency since 2006 which

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<sup>141</sup> Ibid.

<sup>142</sup> DoJ, Corporate Leniency Policy (1993).

<sup>143</sup> This is, for example, the case in the UK and in the US. OFT1495, Applications for leniency and no-action in cartel cases (2013); DoJ, 'Leniency Policy for Individuals'(1994)

<sup>144</sup> DoJ, 'Leniency Policy for Individuals' (1994).

<sup>145</sup> OFT1495 (n 143) section 7.

<sup>146</sup> Leniency Guidelines (2007).

automatically applies to the company and other individuals, unless specified otherwise.<sup>147</sup> To date, there is no reported experience of an individual benefiting from immunity while his company is prosecuted.<sup>148</sup>

### **1.3.2 Impact of leniency policy on the agency relation**

The primary goal of leniency policy is to undermine the stability of relations between cartel members. Unstable by nature, the longevity of cartels stems from the ability of cartel members to sustain a certain stability in their relationships. Cartel relationships may be sustainable if cartel participants are able to monitor each other, and if the cost of a retaliation strategy prevents a member from unilaterally deviating from the agreement. Therefore, leniency strategy intends to weaken such cartel relationships, by rewarding companies that self-report.<sup>149</sup> Well-designed, leniency programmes are expected to trigger a race in applications to competition authorities, while bringing highly valuable evidence to competition authorities during the cartel investigation. Ex ante, leniency policy may reduce the expected cost related to the detection of the cartel, as such an instrument results in immunity or the reduction of fines.<sup>150</sup> The impact on the ex ante decision to form a cartel will not be considered here, as the focus is on the detection of ongoing cartels.

The effect which leniency policy has on the internal dimension of the firm depends on several parameters. Some parameters stem from the competition policy of a given jurisdiction, in particular, whether individuals may face sanctions.

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<sup>147</sup> (If the natural person is authorised to represent the company) Leniency Notice No. 9/2006 (2006) para 17.

<sup>148</sup> In the lysine cartel case, Mark Whitacre could have benefited from immunity while his company was prosecuted, if he had not been found guilty for other breaches.

<sup>149</sup> Eg. M Motta and M Polo, 'Leniency Programs and Cartel Prosecution' (2003) 21 *International Journal of Industrial Organization* 347; CR Leslie, 'Trust, Distrust, and Antitrust' (2004) 82 *Texas Law Review* 515; CR Leslie, 'Antitrust Amnesty, Game Theory, and Cartel Stability' (2006) 31 *The Journal of Corporation Law* 453. G. Spagnolo, 'Divide et Impera: Optimal Leniency Programs' (2004) CEPR Working Paper No. 4840.

<sup>150</sup> Adverse effects of leniency: M Motta and M Polo (n 149) 347.



### **1.3.2.1 Corporate leniency policy: targetting the principal of the agency relation**

Turning to the effect which leniency has on the internal dimension of the firm, it is argued that one needs to take into account the 'discrepancy between individuals and the undertaking' to assess the effectiveness of leniency programmes.<sup>151</sup> In addition, issues of asymmetry of information within companies may also complicate the process of leniency application, thereby affecting the effect of leniency on the internal relations.

In competition regimes that strictly target companies, leniency programmes logically only give immunity to companies. As previously stated, in the absence of individual sanctions, individuals may be able to reap benefits from their cartel participation without bearing the cost of its detection. The availability of a corporate leniency programme may not affect the individual incentives as it does not affect the employees' payoffs, while the termination of a cartel means the individual can no longer benefit from the cartel profits.<sup>152</sup> Therefore, if leniency policy makes a cartel collapse, the individual will be worse-off. If such an individual is reluctant to terminate the cartel or to cooperate with the investigation process, a tension of interests between the company and its employees can arise. The interest gap will also depend on the extent to which the guilty manager, on which the company heavily rely for the cooperation with competition authorities, may use leniency against its company.<sup>153</sup> For example, a guilty manager may condition its cooperation to a substantial pay rise. In addition, issues of asymmetry of information within the firm may hinder the leniency application process: leniency applications are filled by executive members of the board of directors, who may not have participated themselves in the cartel conduct. In complex corporate structure identification of the participants, the exact duration of the cartel activity and whether all activity was actually terminated at the time of the application may be difficult information to gather. Therefore, weighing the costs and benefits of leniency application may lead to another outcome than that of a race to

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<sup>151</sup> N Zingales, 'European and American Leniency Programmes: Two Models Towards Convergence?' (2008) 5 Competition Law Review 5, 12.

<sup>152</sup> As stated before, the assumption is that individuals somehow benefit from the cartel profits.

<sup>153</sup> A Stephan and A Nikpay, 'Leniency Decision-Making from a Corporate Perspective: Complex Realities' in C Beaton-Wells and C Tran (eds), *Anti-Cartel Enforcement in a Contemporary Age: The Leniency Religion* (Hart Publishing 2015). Based some empirical data, this chapter provides a realistic assessment of leniency policy as deterring and detecting device.

the competition authority.<sup>154</sup> Leniency applications in Europe are often only received once the cartel failed – which may reflect the lack of consequences of leniency for the responsible individuals, as well as internal asymmetries of information that complicate the process.<sup>155</sup> Thus, the actual achievement of cartel detection by leniency policy has been questioned.

Now, the case will be considered, where individual sanctions are available, or where a company is able to punish internally the responsible individual when the cartel is detected. Any instrument that potentially increases the probability of detection and cartel termination may be detrimental to the individual. This is because leniency does not protect such an individual from the internal sanctions they may face afterwards. Therefore, if the application for leniency is in the hands of such individuals, they may try to avoid it in the first place. As a result, individuals will never seek to report the cartel. The sanction suffered by the individual is irrespective of whether their company or another one blows the whistle, or whether the cartel is detected by the competition authorities. In such circumstances, corporate leniency that does not also protect individuals may not generate a race in application because responsible individuals do not benefit from it personally. Therefore, one should consider the extent to which individual incentives in self-reporting parallel those of the company to understand the effectiveness of leniency policy. A policy implication is that the introduction of individual sanctions may hamper the effectiveness of leniency programmes, unless they adequately protect the individuals.<sup>156</sup> The issue is quite relevant in the EU, where individuals cannot be prosecuted at EU level but still face the threat of individual conviction in their member state.<sup>157</sup>

If corporate leniency policy also protects all the employees of the company, the incentive for individuals to report the cartel is deemed to be aligned with that of the company. For example, the UK competition regime grants a 'blanket' immunity to former and current individuals of the company.

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<sup>154</sup> Ibid.

<sup>155</sup> A Stephan, 'An Empirical Assessment of the European Leniency Notice' (2008) 5 *Journal of Competition Law and Economics* 537.

<sup>156</sup> D Schroeder and Silke Heinz, 'Requests for leniency in the EU: experience and legal puzzle' in KJ Cseres, MP Schinkel, FOW Vogelaar (eds) (n 56) 163.

<sup>157</sup> WPJ Wils (n 78) 93.

### **1.3.2.2 Individual leniency policy: targetting the agent of the agency relation**

Leniency programmes that contain an individual scheme produce a completely different effect on the incentive an individual has to self-report. Individual leniency provides amnesty for an individual in distinction from his company.

Firstly, individual leniency can address the tension of interests that can arise between the company and the individuals if they are not protected by corporate programmes of leniency. If the individual can join their application to that of the company, their incentives to self-report and to cooperate with the competition authority parallel that of the company. In that context, individual leniency programmes address the discrepancy of interest previously described.

Secondly, individual leniency can be granted to the individual of the company, without protecting his company. The possibility of a company being prosecuted as a result of an individual initiative to self-report has the potential to induce huge tensions of interests within the company. An individual wishing to benefit from leniency has to provide very valuable evidence to the competition authority. Evidence secured typically includes information regarding other persons responsible for initiating and implementing the cartel. Similar to corporate leniency which enables the competition authority to prosecute other companies, individual leniency may trigger the conviction of other persons in the company. This is added to the sanction that the company as a whole faces.

Individual leniency destabilises the agency relations within the firm, between those who initiate the cartel and those responsible for implementing it. The cost of operating a cartel is increased, as individuals need to ensure that others do not unilaterally report the cartel activity to the authorities. An employee may need to be bribed in exchange for promising not to blow the whistle.<sup>158</sup> Game theory insights teach us that the expectation about each other's reasoning is supposed to trigger an internal race to individual leniency applications. Expecting that individuals are likely to apply for individual leniency and depending on the degree of awareness, top

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<sup>158</sup> MA Han, *Vertical Relations in Cartel Theory* (Amsterdam Center for Law & Economics 2011) 43.

executives then have every incentive to apply for leniency at the corporate level. Therefore, Hammond expressed that phenomena, stating that: ‘The real value and measure of the Individual Leniency Program is not in the number of individual applications we receive, but in the number of corporate applications it generates’<sup>159</sup> As such, individual leniency seeks to undermine the horizontal relationships between cartel members, through the effect it has on (vertical) relations within the firm.<sup>160</sup>

The potential impact of individual leniency on the agency relation needs to be nuanced. The prospect of being amnestied induced Mark Withacre to uncover the lysine cartel and to cooperate with the FBI. As a result of his action other executives received jail sentences, and a \$100 million was imposed on his company ADM. In addition, Mark Whitacre’s cooperation enabled to bring down other related cartels in the international chemicals industry.<sup>161</sup> However, it seems that his actions were driven by the need to hide other criminal practice, and probably influenced by his mental health problems. Mark Whitacre, after exposing the cartel and working for 3 years with the FBI on the investigation, was eventually convicted and given a 10.5 years jail sentence, for other criminal infringements.<sup>162</sup> Outside these particular circumstances, personal consequences are likely to considerably reduce the incentive for an individual to apply for leniency against his company, especially if amnesty could be obtained through a corporate leniency application. (see developments about bounty programmes).

### 1.3.3 Bounty programmes

Bounty or whistle-blower programmes are another instrument aimed at destabilising the agency relations in companies, which in turn ought to undermine cartel stability. Whistle-blower programmes typically grant protection to individuals coming forward with information on a cartel, while not necessarily being involved in the cartel themselves. Individuals reporting the wrong-doing of third-parties need to be

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<sup>159</sup> SD Hammond, ‘Cornerstones of an Effective Leniency Program’, speech delivered to ICN Workshop on Leniency Programs, Sydney, 2004, available at [www.justice.gov/atr/public/speeches/206611.pdf](http://www.justice.gov/atr/public/speeches/206611.pdf).

<sup>160</sup> Argument developed in F Thépot, ‘Leniency and Individual Liability: Opening the Black Box of the Cartel’ (2011) 7 Competition Law Review 221. Economic model in MA Han (n 158).

<sup>161</sup> A. Stephan, ‘Is the Korean Innovation of Individual Informant Rewards a Viable Cartel Detection Tool?’ in T Cheng, B Ong, and S Marco Colino (eds), *Cartels in Asia* (Kluwer 2014)

<sup>162</sup> CR Leslie (n 24) 1643.

protected from possible retaliation from other individuals, and probable dismissal by the company who may be convicted following an individual's action. In addition to individual protection, bounty programmes incentivise individuals with financial rewards. Only a few competition regimes include whistle-blower programmes.<sup>163</sup> In the UK, the CMA may grant a reward of up to £100,000 to an individual who brings valuable evidence of the existence of a cartel in which he does not take part.<sup>164</sup> In Korea, the Cartel Informant Reward Programme provides a financial incentive of up to 2 million US dollars to an individual coming forward with information on cartel existence.<sup>165</sup> In Hungary, an individual reporting private information about a cartel may be granted at least 1% of the fine eventually imposed (but no more than 50 million forints, the equivalent of about £150,000).<sup>166</sup> The introduction of a whistle-blower programme which protects an innocent third-party that denounces a cartel is currently being discussed in the US. In the current bill, no financial reward will be provided for individuals.<sup>167</sup>

The impact of bounty programmes on the relevant agency relations resembles that of individual leniency. Bounty programmes have the potential to undermine the stability of agency relations that exist in the operation of the cartel. The prospect of a financial reward may provide an incentive to an individual to report that outweighs the incentive to comply with cartel instructions. Also, the availability of a bounty may trigger a race to the authority just to avoid the benefit of the programme being captured by other employees. The necessity to collect evidence in exchange for a

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<sup>163</sup>For more details about the availability of bounty programmes in different jurisdictions, see A. Stephan (n 161).

<sup>164</sup>CMA, Rewards for information about cartels available at <[https://www.govuk/government/uploads/system/uploads/attachment\\_data/file/299411/Informant\\_rewards\\_policy.pdf](https://www.govuk/government/uploads/system/uploads/attachment_data/file/299411/Informant_rewards_policy.pdf)>.

Following conviction in commercial vehicle cartel, the CMA specifically calls for information about cartels in the motor industry against financial reward, available at

<[https://www.govuk/government/uploads/system/uploads/attachment\\_data/file/325623/Open\\_letter\\_to\\_the\\_motor\\_industry.pdf](https://www.govuk/government/uploads/system/uploads/attachment_data/file/325623/Open_letter_to_the_motor_industry.pdf)>. There is no reported case of such a financial reward being granted to date.

<sup>165</sup> A number of informants have been rewarded under this scheme, with the biggest reward being 0.2 million dollars in 2007. JS Kim, Director, Cartel Policy Division, Korea Fair Trade Commission, Cartel Regulation in Korea (2012) available at <<http://www.adbi.org/files/2012.05.02.cpp.sess3.3.kim.cartel.regulation.korea.pdf>>. A number of informants have been rewarded under this scheme, with the biggest reward being 0.2 million dollars in 2007.

<sup>166</sup> G Bennett and B Domineck, Hungary (2013) The European Antitrust Review 2013.

<sup>167</sup> Bill, Criminal Antitrust Anti-Retaliation Act of 2013, available at <<http://www.govtrack.us/congress/bills/113/s42/text>>.

financial reward further undermines cartel agency relations.<sup>168</sup> In addition, the particularity of bounty programmes with respect to leniency programmes is that individuals not directly liable for the cartel may use the threat of reporting. For example, an employee may find in the possibility of reporting the cartel a source of bargaining power to obtain a pay rise. This may create or aggravate agency problems that are not specifically related to the cartel operation.<sup>169</sup> Bounty programmes may increase the situation of moral hazard in the cartel operation *ex post*, while *ex ante* aligning the incentive of the informant individual with the long-term interest of shareholders, providing that they do not benefit from the cartel in the long-run.

However, the ability of bounty programme to undermine the agency relation within the firm strongly depends on its design. In addition to a sense of loyalty that exists between employees and their company, duties of confidentiality may reduce one's incentive to report an illegal conduct. In addition, the act of whistleblowing is associated with considerable personal risks such as dismissal, problems of re-employment and also carries consequences for the family, personal and social life.<sup>170</sup> Tragic consequences of whistleblowing is exemplified by the story of Stanley Adams, who reported to the European Commission illegal price-fixing practices undertaken by its company Hoffman-La-Roche in 1973. Following his act, he was sued in Switzerland for having disclosed confidential business information, faced retaliation measures from his company, became bankrupt, and his wife reportedly committed suicide in response to the conviction of her husband of a long jail sentence.<sup>171</sup> To counterweight possible huge personal costs, the reward for whistle-blowers must amount to a lottery win, and legal protection must be adequate.<sup>172</sup> Therefore, bounty programmes may destabilise the agency relation only if they provide positive and defensive incentives that are strong enough to trigger a very peculiar and risky action.<sup>173</sup>

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<sup>168</sup> CR Leslie (n 24)1668.

<sup>169</sup> C Aubert, P Rey and WE Kovacic, 'The Impact of Leniency and Whistleblowing Programs on Cartels' (2006) 24 International Journal of Industrial Organization 1241, 1264.

<sup>170</sup> A Stephan (n 161)

<sup>171</sup> Eric Newbigging, 'Hoffman-La Roche v Stanley Adams – Corporate and Individual Ethics' (1986) Cranfield University Working Paper

<sup>172</sup> A Stephan (n 161)

<sup>173</sup> Other information on Stanley Adams indicates that he was also a quite high profile and unusual character: Eg. In 1994 he was jailed for plotting the murder of his wife in view of getting huge life

## Conclusion of section 1.3

The effectiveness of instruments that seek to detect cartels depends on their effective impact on agency relations within the firm. Corporate leniency programmes are deemed not to be effective if there is a discrepancy of interest in applying for leniency between the shareholders and the managers. In contrast, the potential value of individual leniency and bounty programmes stands in their ability to destabilise stable agency relations in companies which are part of a cartel.

### 1.4 *Ex-post*: impact of competition law infringement decisions on the agency relation

#### 1.4.1 The reaction of shareholders

It is expected that shareholders do not receive favourably infringement decisions imposing high levels of fines on their companies. The reasons for the potential reputational damages and the impact on the value of the shares have been previously explained. In some cases, shareholders publicly expressed their discontentment regarding the illegal acts of individuals in their companies, or were expected to do so. Following the conviction of ThyssenKrupp for participation in the rail cartel in Germany, shareholders publicly expressed their disapprobation to managers for the harm the infringement created to the company.<sup>174</sup> During the annual general meeting, a number of the shareholders called for the resignation of the chairman of

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pension benefits. Tearing Down The Facade of 'Vitamins Inc.' D. Barboza, New York Times, 10 October 1999, available at <http://www.nytimes.com/1999/10/10/business/tearing-down-the-facade-of-vitamins-inc.html>

<sup>174</sup> C Klahold - Chief Compliance Officer ThyssenKrupp AG Importance and Challenges of Antitrust Compliance for Large Corporations 'Deterring EU Competition Law Infringements: Are We Using the Right Sanctions?' Conference by TILEC and the Liege Competition & Innovation (2012); Deutsche Welle 'ThyssenKrupp to face fiery shareholders' meeting' available at <<http://www.dw.de/thyssenkrupp-to-face-fiery-shareholders-meeting/a-16528518>>; 'Remarks By Dr. Heinrich Hiesinger Chairman of the Executive Board of ThyssenKrupp AG at the 14th Annual General Meeting on January 18, 2013 at RuhrCongress Bochum' available at <[http://www.thyssenkrupp.com/documents/hv\\_2013\\_01\\_18\\_en/ThyssenKrupp\\_HV\\_2013\\_Speech\\_Hiesinger.pdf](http://www.thyssenkrupp.com/documents/hv_2013_01_18_en/ThyssenKrupp_HV_2013_Speech_Hiesinger.pdf)> 14.

the supervisory board, for his implication in the price-fixing scandal, and for other failed investments. He subsequently decided to step down from his position.<sup>175</sup>

In 1996, following the conviction into several price-fixing scandals, including the lysine cartel, shareholders' reactions brought about significant changes in the corporate governance structure of ADM. The number of external or independent directors on the board was increased, and directors' compensation levels were drastically reduced. The changes in corporate governance coincided with the end of a series of price-fixing scandals for ADM.<sup>176</sup>

However, it is not always the case that companies take disciplinary steps towards top executives involved in anti-competitive infringements. While in 1999 Robert Koehler was given a personal fine of \$10 million for participation in the graphites electrode cartel, he remained at the position of CEO of the company SGL until his retirement in 2014.<sup>177</sup> In addition, British Airways promoted to the company's board one of the sale executives allegedly involved in the fuel surcharge cartel case, a few weeks before he was due to appear in court, potentially facing a jail sentence.<sup>178</sup> One of the possible reasons explaining the lack of action is the constraint imposed by the capital market. Dismissing executives or taking any legal action is likely to send signals of uncertainty with possible negative effect on the share of the price.<sup>179</sup>

#### **1.4.2 Derivative actions: competition law concerned with the agency problem?**

In some cases, shareholders make use of a derivative action against top executives to recover from an antitrust fine imposed on the company. Derivative actions or suits

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<sup>175</sup> Wall Street Journal, 'ThyssenKrupp Chairman Gerhard Cromme to Step Down March 31', available at <<http://online.wsj.com/article/BT-CO-20130308-703815.html>>.

<sup>176</sup> Changes were made sometimes fitfully, as by late 1996, there was still more insiders than outsiders on the board of directors, following resignations. J Connor (n 38) 464.

<sup>177</sup> J Harrington, *Optimal Deterrence of Competition Law Infringement* in 'Deterring EU Competition Law Infringements: Are We Using the Right Sanctions?' Conference by TILEC and the Liege Competition & Innovation (2012).

<sup>178</sup> Financial Times, 'BA sales chief on price-fixing charge to join board' (28 Nov 2008) available at <<http://www.ft.com/cms/s/0/7902ab56-bceb-11dd-af5a-0000779fd18c.html#axzz2NcerGgH8>>. The sales executive was finally acquitted in the trial.

<sup>179</sup> Similarly as the impact of the opening of an investigation on the price of shares. See M Motta and G Langus (n 23).



are available in almost all EU Member states, in different variations.<sup>180</sup> Experience with derivative actions is particularly developed in the US and the UK, while remaining quite rare in continental Europe jurisdictions.<sup>181</sup> This section will look at the manner in which the possibility of shareholders recovering from antitrust fines has been considered in the US and the UK.

The US state of Delaware admitted the possibility of shareholders bringing a law suit against directors for failure of oversight. In *Graham v. Allis-Chalmers Manufacturing Co*,<sup>182</sup> shareholders brought a suit against directors subsequent to the conviction of Allis-Chalmers for a price-fixing violation. Shareholders claimed that, having not implemented an internal monitoring scheme, directors should be liable for the antitrust violation as it resulted in failure to oversee the employees' price-fixing act. The Supreme Court of Delaware relaxed the directors, finding they were entitled to rely on the honesty and integrity of their subordinates unless 'something occurs to put them on suspicion.'<sup>183</sup> Refusing to impose a duty for directors to 'install and operate a corporate system of espionage to ferret out wrongdoing' the Supreme Court's judgment opens the possibility that a director's duty includes a duty to monitor.<sup>184</sup> In *re Caremark International Inc. Derivative Litigation*, the Delaware Court of Chancery specified that the necessary condition of directors' liability is to establish their lack of good faith which consists in 'only a sustained or systematic failure of the board to exercise oversight-such as an utter failure to attempt to assure a reasonable information and reporting system exists.'<sup>185</sup> Endorsing the *re Caremark* standard, *Stone v. Ritter* narrowed the condition to directors liability, requiring to showing that directors either 'utterly failed to implement any reporting or information system or controls' or if they 'consciously failed to monitor or oversee its operations thus disabling themselves from being informed of risks or problems requiring their attention.'<sup>186</sup> In *American Inter-national Group, Inc. v. Greenberg* the court inferred the lack of good faith from knowledge of the director's high-level in the managerial

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<sup>180</sup> S Kalss, 'Shareholder Suits: Common Problems, Different Solutions and First Steps towards a Possible Harmonization by Means of a European Model Code' (2009) 2 European Company and Financial Law Review 324, 339.

<sup>181</sup> M Gertner, 'Why do Shareholder Derivative Suits Remain Rare in Continental Europe?' (2013) 37 Brooklyn Journal of International Law 843.

<sup>182</sup> *Graham v Allis-Chalmers Mfg Co*, 188 A2d (Del 1963).

<sup>183</sup> *Ibid* para 130.

<sup>184</sup> *Ibid*.

<sup>185</sup> *In re Caremark Int'l Inc Deriv Litig*, 698 A.2d at 959, 971 (1996).

<sup>186</sup> *Stone v Ritter* 911 A.2d 362 (Del. 2006).

hierarchy, finding that it was unlikely that illegal bid-rigging in the insurance market would have occurred without their knowledge.<sup>187</sup> In *Robert F. Booth Trust v. Crowley* the Seventh Circuit Court of Appeal affirmed that a derivative action could also be brought in relation to the violation of Section 8 of the Clayton Act provision on interlocking directorates.<sup>188</sup>

The recent case *Safeway v Twigger* raised the question of the availability of a derivative action in the context of an antitrust infringement in the UK. Following the imposition by the OFT of a £11 million fine for illegal price-fixing behaviour in the dairy products market, Safeway brought a derivative action before the High Court against former employees supposedly responsible for the cartel practice.<sup>189</sup> Relying on the principle of ‘ex turpi causa non oritur actio’, the former directors and employees applied for the claim to be struck out by the High Court. According to this principle, a legal action cannot be brought in relation to the claimant’s own illegal act.<sup>190</sup> The High Court dismissed the defendants’ application to strike out the claim. The Court considered that the illegal price-fixing conduct was the act of the directors and/or employees acting as agents for the companies. As such, the illegality came from the Defendant’s acts, rather than from the companies’ personal actions. As a result, the Court considered that the claimants had a chance to defeat the defence’s argument based on the ‘ex turpi causa non oritur actio’ principle at the trial.<sup>191</sup> The High Court judgment opened the possibility that companies, in spite of being the subject of the Competition Act provisions and liable for their infringement, could, in some cases, be ‘innocent victims’ of the hidden action of individuals in the context of the breach. In other words, this judgment would enable companies to use a device of corporate governance as a way to address issues of the agency relation.

The High Court interim judgment was subsequently appealed by the defendants to the Court of Appeal. In its judgment, The Court of Appeal struck out Safeway’s claim

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<sup>187</sup> *American Inter-national Group v Greenberg* 965 A2d 763, 795-99 (Del Ch 2009).

<sup>188</sup> *Robert F Booth Trust v Crowley* 687 F.3d 314 (2012).

<sup>189</sup> Safeway admitted the breach of chapter 1 of the Competition Act 1998, following which they entered into an ‘early resolution agreement’. OFT Press Release ‘OFT fines certain supermarkets and processors almost £50 million in dairy decision’ (10 August 2011). Available at <<http://webarchive.nationalarchives.govuk/20140402142426/http://www.of.govuk/news-and-updates/press/2011/89-11>>.

<sup>190</sup> *Holman v Johnson* (1775) 1 Cowp 341.

<sup>191</sup> *Safeway Stores Ltd and others v Twigger and others* [2010] EWHC 11 (Comm) paras 45 and 54.

against its former directors. The Court of Appeal reaffirmed that, based on Section 36 of the Competition Act 1998, a company is liable for the violation of competition law prohibitions by its employees or directors. Therefore, the illegal action could not be attributed to individuals of the company because '[t]he whole hypothesis of the undertaking's liability is that it is personally at fault'<sup>192</sup> This contrasts with the High Court's approach that Safeway could not be 'personally' at fault unless it could be shown that the former directors were the 'directing mind or will' of the company. The High Court rejected Safeway's subsequent application to appeal the Court of Appeal's judgment.

While the High Court's interim decision seemed to open the possibility of a company bringing a derivative suit in the context of a breach of competition law, the Court of Appeal reaffirmed that UK competition law applies to an undertaking strictly, disregarding the issues of corporate governance. The alternative conclusion would have implied that competition law is newly concerned with the relationship between a company and its executives. The availability of a derivative action in the context of the breach of competition law would have been the recognition that competition law violations need to be addressed along the line of other corporate governance issues.

The circumstances of *Safeway v Twigger* were quite unusual, because Safeway was not seeking to recover the penalty from the directors themselves, but from its D&O insurers.<sup>193</sup> In addition the action was brought after the company had been acquired by a rival supermarket, which makes the legal action slightly outside the scope of intra-company relations. For all these reasons, together with the capital market uncertainty that such legal action may trigger, it seems quite unlikely that the possibility of a derivative action will arise again in the UK. In addition, some have argued that such the possibility of having derivative actions could have had adverse effects on other competition law instruments, such as leniency or settlement policies.

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<sup>192</sup> *Safeway Stores Ltd and others v Twigger and others* [2010] EWCA Civ 1472, para 22. 'There is a liability it cannot be imposed on any person other than the undertaking, and the undertaking is personally liable for the infringement. If a penalty is imposed it will only be because the undertaking itself has intentionally or negligently committed the infringement. In those circumstances it is the undertaking which is personally at fault (there can be no one else who is), and once the maxim is engaged the undertaking cannot say that it was not personally at fault in order to defeat the application of the maxim. The whole hypothesis of the undertaking's liability is that it is personally at fault'

<sup>193</sup> S Goldring, 'Insurers' liability for civil fines and penalties', Lexology, 27 July 2011 available at <http://www.lexology.com/library/detail.aspx?g=762e2955-82dd-45f0-86f6-6a6dc1d57cbe>

In fear of being sued by their company, executives may be deterred from cooperating in the context of leniency or a settlement procedure because such cooperation may increase the potential for a derivative action against them.<sup>194</sup> Similar concerns are and typically expressed in relation to potential adverse effects of damages claims<sup>195</sup> and individual sanctions.<sup>196</sup>

## 1.5 Conclusion

Understanding the potential effects of competition law instruments on the agency relation is of utmost importance to assess their effectiveness to deter and detect cartel conduct. Instruments that target the principal of the relation are deemed effective only if the company can reduce the interest gap internally and at low cost. Instruments that target the agent of the agency relation, in addition to the principal, affect this interest gap. For public policy purposes, it seems desirable that the agent and the principal have aligned interests towards sanctions. In contrast, leniency policy or bounty programmes that target the agent are effective if they aggravate the tension gap in the agency relation.

In some cases, the reaction of shareholders following the prosecution of their company exhibits a mismatch of interests between shareholders and managers. Considering the possibility for shareholders bringing a derivative action against responsible managers consists in examining whether shareholders can make use of corporate governance tools to remedy cartel infringement. Following the *Safeway – Twigger* case in the UK, it seems that, competition law in the EU remains inclined to disregard agency issues and tools that address those.

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<sup>194</sup> P Scott, 'Competition Law Briefing: Safeway v Twigger - Safeway's claim against former directors reaches end of shelf life' (Norton Rose, 2011) available at <http://www.nortonrose.com/knowledge/publications/52713/safeway-v-twigger-safeways-claim-against-former-directors-reaches-end-of-shelf-life>.

<sup>195</sup> See for example: C Cauffman 'The Interaction of Leniency Programmes and Actions for Damages' (2011) 7 Competition Law Review 181.

<sup>196</sup> See for example: United Nations Conference on Trade and Development, Note by the UNCTAD secretariat, 'The use of leniency programmes as a tool for the enforcement of competition law against hardcore cartels in developing countries' (2010) 6. Available at [http://unctad.org/en/Docs/trbpcconf7d4\\_en.pdf](http://unctad.org/en/Docs/trbpcconf7d4_en.pdf).