

# Cartel Culpability: Benchmarking Legal Standards

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When Adam Smith<sup>2</sup>, the economist and moral philosopher had put forth his magnum opus – “An enquiry into the Nature and Causes of the Wealth of Nations, popularly referred as the “Wealth of Nations”, little he would have realized that his famous averment “*People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public or in some contrivance to raise prices. It is impossible indeed to prevent such meetings, by any law, which either could be executed or would be consistent with liberty and justice. But though the law cannot hinder people of the same trade from sometimes assembling together, it ought to do nothing to facilitate such assemblies, much less to render them necessary*” would turn out to be a virtual doctrine exemplifying the nature of collusive behavior.

While the sovereign states across jurisdictions grapple to promote to *laissez faire* and a state of utopian fair play; at the same time liberalization and globalization has brought in role of global value chains and an increased concentration resulting in anti competitive practices. A World Bank Report estimates that substantive anomaly between producers and consumer prices may have resulted in outgo of US Dollar 1000 Billion and imperfections through Cartelisation and other market distortions through intermediary level is the major cause (Morriset 1997). The World Bank Study (<sup>3</sup>) states that:-

.....“*Anticompetitive business practices have been detected in various markets that are important for a country’s overall competitiveness and poverty alleviation. Cartels, which increase prices in affected goods and services by at least 20 percent, have been found in markets such as fertilizer, cement, and transportation services. Staple consumer products such as bread and sugar, and critical financial services ranging from electronic payment systems to insurance, cost consumers more due to cartels and abuse of dominance. Bid rigging in public procurement is prevalent in construction, transportation, and health sectors.*” .....

*This Article endeavors to capture the smoke screen around cartels and the varying responses to determine cartel culpability in terms of legal standards followed.*

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<sup>2</sup> Adam Smith – Pioneer of Political Economy, had also written The Theory of Moral Sentiments during late 1760’s

<sup>3</sup> World Bank, Brief on Competition Policy, September 2016; available online at [www.worldbank.org](http://www.worldbank.org)

## Why culpability of cartels is worth examining

Competition has come to occupy the fundamental edifice of a market driven economy to act as a trigger to economic competition and is regarded as a compelling force in promotion of a welfare economy and to serve **Public Interest**. Competition is crucial for customers, economic growth and wider policy delivery and can be said to be instrumental in delivering benefits of laissez- faire.

Study by John M Connor<sup>4</sup> by surveying 700 published economic studies and judicial decisions that contain 2,041 quantitative estimates of overcharges of hard-core cartels gives the following findings of their pernicious effect on competition.

- Overcharge and dead weight loss are highly co-related. The median average long-run overcharge for all types of cartels over all time periods is 23.0% .The mean average is at least 49%.
- Overcharges reached their zenith in 1891-1945 and have trended downward ever since;
- Median overcharges of international-membership cartels are 38% higher than those of domestic cartels;
- Convicted cartels are on average 19% more effective at raising prices as unpunished cartels;
- Bid-rigging conduct displays 25% lower mark-ups than price-fixing cartels;
- When cartels operate at peak effectiveness, price changes are 60% to 80% higher than the whole episode.

A Cartel activity has anti Competitive effect as it distorts market efficiency and collusion leads to the thwarting of productivity and optimal resource generation. Rigging bids and customer allocation amongst themselves are a kind of Cartelisation. Whereas merger though may be likely to induce anticompetitive behaviour, differs from Cartelisation as a merger might result in efficiency enhancing mechanism whereas Cartelisation distorts the same. Cartelisation has direct correlation on Competitors having a concerted action on key business decisions. Cartel activity is a frontal assault

<sup>4</sup> J.M. Connor: Price –fixing overcharges, Revised 3<sup>rd</sup> edition , 2014 as available online at [ssrn-id2400780.pdf](https://ssrn-id2400780.pdf)

on the principle of economic governance and resultant public interest and is rightly construed as a deterrent to socio-economic stability and welfare<sup>5</sup>.

While Competition is perceived to result in unrestrained interaction of Competitive forces thus causing favourable allocation of productive resources, Cartelisation is nemesis and antithesis of this unrestrained reaction. A Cartel activity has been viewed very heavily in countries like US where it is treated as **felony** – a grave **misdemeanor** and as the noted antitrust exponent G. Werden says - let the punishment fit the crime<sup>6</sup> and cartel conduct have lead to civil and criminal penalties with the objective that state action should be so strong so as to deter.

A Cartelisation is a result of camouflage and concealment with criminal intent and therefore some of national jurisdictions regard their actions at par with other criminal conspiracy actions<sup>7</sup>. Since Cartels are illegal, they are highly secretive and evidence of their existence is not easy to find<sup>8</sup>. The collusive behaviour and the mutual reciprocity to cartelisation is on account of factors such as maximizing to provide reducing the threat like competition and hence reduction in uncertainties. Cartelization therefore tends to be predatory and dissuades the potential entry of new business players in the industry segment in progress using surreptitious means to survive and sustain in context of internal pressures and external shocks.

### What drives a cartel conduct?

The cartels are sustained by “Trust”<sup>9</sup> – a relationship of mutual confidence and reliance that becomes integral to their sustenance as they become co-partners (co-colluders and as Competition Enforcement Regimes treat them in Criminal Law jurisdictions – as co-conspirators) for adhering to explicit /implicit or overt/ covert arrangements in market sharing, production limitation or price increase agreements. In such a scenario, while there could be many businesses/ economic operators,

<sup>5</sup> E. Sutherland, White Collar Crime 45 (1949) – A violation of Anti Trust Laws is a violation of strongly entrenched moral sentiments.

<sup>6</sup> G Werden – Sr. Economic Counsel, US Department of Justice Quoting from the *Mikado* “Gilbert & Sullivan” ... to proclaim that “his object all sublime” is to “let punishment fit the crime” – 1885 case – a contemporary of the earliest criminal statutes relating to Cartel activity.

<sup>7</sup> T. Barnett, *Criminal Enforcement of the Anti Trust Laws: The US Model* in B. Hawk, ed, 2006 Fordham Competition Law Institute/ 3(2007).

<sup>8</sup> European Commission – Competition Website page.

<sup>9</sup> Sama Danilo, Luiss Guido Carli, University of Rome: Competition Law, Cartel Enforcement & Leniency Program (Dec 2008) online at [mpr.ub.uni-muenchen.de/14104](http://mpr.ub.uni-muenchen.de/14104)

whose conduct resembles that of a horizontal sales consortium or a monopoly seller with many similar constituents operating in tandem; at the same juncture;

- a) empirical evidence has shown that the concept of cartels is anti-competitive to the public interest but reflects within itself, an element of “Trust” and relationship of collusive reciprocity amongst the cartel adherence to element such as Market Sharing Production limitation and Price Increase Agreement to name predominant areas.
- b) the above collusive conduct i.e. operation of cartels to distort a free and fair market is forbidden<sup>10</sup> and persecuted by Anti Trust Legislations.

The Cartel conduct exemplifies “doctrine of parallelism<sup>11</sup> plus “ which is intended to convey such actions and their outcomes by oligopoly firms which do not have the rational for a unilateral conduct but can be said to be guided by a concerted and collusive action. What is important here is the outcome of action which goes beyond a unilateral conduct and evidences a joint thought process to realize unrealistic gains from the market place by resorting to said action.

The classical example of cartel conduct exemplifying collusion and common intents as a conspiracy is witness able from the findings of **Vitamin Cartel** (also referred as Mother of all Global Cartels)<sup>12</sup> Case by European Commission in which case a fine of Euro 66.34 Million was imposed – sales by these cartels were US Dollar 63 Billion – largest discovery till 2000. It was seen that at least 50% of the price announcements were made by the Vitamins Cartel before the effective dates for the price increases; however, in an earlier period when collusion was not in existence, only 5% of price announcements were made prior to the effective dates for the price increases<sup>13</sup>.

The European Commission<sup>14</sup> in case of Vitamin Cartels has observed “*The parties normally agreed that one producer should first ‘announce’ the increase, either in a trade journal or in direct communication with major customers. Once the price increase was announced by one cartel member, the others would generally follow suit.* In this way the concerted price increases could be passed off, if challenged, as the result of price leadership in an oligopolistic market.”

<sup>10</sup> Prisoner’s Dilemma – Invented in 1950 by Merritt Flood and Melvin Dresher

<sup>11</sup> Kovacic Willion E, Marshall Robert C, “Plus Factors and Agreement in Anti Trust Law” (Feb 2011)

<sup>12</sup> John M. Connor, Professor Purdue University (2006)

<sup>13</sup> Marshall, Marx, and Raiff, 2008, *The Economics of Collusion, Cartels and Bid Riggings* (MIT Press)(2008)

<sup>14</sup> 2003/2/EC: Commission decision of 21 November 2001, as available online at [http://data.europa.eu/eli/dec/2003/2\(1\)/oj](http://data.europa.eu/eli/dec/2003/2(1)/oj)



## Demystifying Cartel offence

Jurisdictions which have regarded cartelisation as a criminal activity-Price fixing, bid rigging, consumer and market allocation –and treated them as felony violation of criminal laws; have better record of containing their operations. These jurisdiction are of view that the fear factor of detection and penalties<sup>15</sup> thereafter must be so heavy so as to eclipse the potential rewards from a cartel activity amongst cartelists. While there is no agreement currently as to whether cartel regimes on US pattern should follow only criminal penalties, the practices followed by some of better developed jurisdictions is pertinent for analysis and reasoning as to jurisdictional requirements.

Culpability<sup>16</sup> at corporate and individual level must be made so and once at individual level it is forced, there is fear of incarceration (jail) for culpability of corporate executives, the situation is likely to drastically inter change element of fear for cartel directions has to be made fearful that the company in order to avoid race to the courts should come forward & disclose and the winner (i.e. first reporter) gets the major benefits; should percolate down to the best levels within enterprises.

Another school of thought remains that if enforcement is not heavily coming down upon with criminal liability; civil fines are likely to be construed as only cost of doing business which may not be a sufficient deterrent to thwart their operational existence. Even the fines imposed should be many time multiple of illegal profits generated on pattern of US Anti Trust Regime wherein “Vitamin Cartel” participant Hoffmann-La-Roche (HCR) was fined US Dollar 500 Million<sup>17</sup>. The deterring quantum of fines is also a sufficient impediment to the participant members.

A number of nations on at least five continents including Canada, Japan, UK, Israel, Ireland, Korea and Australia have or are in process of adopting law and providing for criminal sanctions. Some of these jurisdictions provided for even greater maximum jail terms than the US which in the matter had passed Antitrust Criminal Penalty Enhancement & Reform Act (ACPERA) of 2004 Section 215 of the Act provides for larger penalties<sup>18</sup>. The challenge, yet, is to get substantial evidence against cartel players.

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<sup>15</sup> American Anti Trust Institute (AAI) USSC comments 2015, pdf-page 3as available online at [www. antitrustinstitute.org](http://www.antitrustinstitute.org)

<sup>16</sup>*ibid*

<sup>17</sup> Press Release by Department of Justice available online at [www.usdoj.gov](http://www.usdoj.gov)

<sup>18</sup> SEC. 215. INCREASED PENALTIES FOR ANTITRUST VIOLATIONS.

Judicial review with respect to cartel and evidential issues most often arise in context of the alleged concerted conduct resulting in effects of concentration and or exclusionary conduct which have the effect of price rigging, bid rigging, output restriction or quota allocation and the specific participation of each undertaking in such an alleged concerted practice and thus an anti competitive conduct. The *maxim actori incumbit probatio* (shifting burden of proof on plaintiff) and *ei incumbit probatio qui dicit non qui negat* (considered innocent till found guilty) are the testaments which are typical of jurisdictions applying administrative procedures.

Under the common law, there exist procedures for judicial review that limit the reviewability of decisions by administrative law bodies. The perceptible tendency is to generalise on the basis of Common law notions and when relating to evidence; expressions like legal burden of proof, the burden of producing evidence or the standard of proof are generally seen. Typically the Anti Cartel laws have focussed on advocacy in public interest as to determination of a cartel conduct, harmful effect on competitive conduct, operation of the substantive legal provisions of jurisdictions so as to enable building capacity amongst those affected with a concerted practice to provide leads on a deleterious collusionary conduct. The challenge for the national competition authorities has been to identify the general nature and legal basis of cartel prohibition in the context of tyranny of standards in trade and legal literature. The Courts and enforcement agencies also place regard on plus factors<sup>19</sup> as evidence of incriminating factors to determine parallel exclusion in contrast to collusion for a coordinated action with unity of purpose and a common design with meeting of minds to an unlawful agreement.

In Indian context, in the famous Cement Cartel<sup>20</sup> case, according to one of opposite parties, the finding of cartelisation can result in very serious penal, commercial and reputational consequences and when such harsh penal consequences are provided, the degree of proof applicable should be

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(a) Restraint of Trade Among the States.--Section 1 of the Sherman Act (15 U.S.C. 1) is amended by--  
(1) striking "\$10,000,000" and inserting "\$100,000,000";  
(2) striking "\$350,000" and inserting "\$1,000,000"; and  
(3) striking "three" and inserting "10".

<sup>19</sup> OECD, Prosecuting Cartels without Direct Evidence of Agreement ; DAF/COMP/GF (2006)

<sup>20</sup> Builder Association of India Vs others. CCI Case no 29/2010

stringent and beyond any reasonable doubt. The opposite party has pleaded that mere suspicion of collusive behaviour or of a tacit agreement or collusive price could not be the basis for taking steps under section 3 of the Competition Act, 2002 attributing findings of alleged price parallelism or despatch parallelism<sup>21</sup>. Rejecting the contention, the Competition Commission had relied upon, the Plus factors as stated in preceding paragraph as evidence to prove existence of cartel and imposed penalty of USD 1.2 billion on 11 participants.

The issue at hand is to examine whether mere tacit collusion of pricing, retail price maintenance and alike could legally be construed as a conspiracy and while common law jurisdictions like US and Canada would treat this as a criminalized area of activity; what has been the evolution in other national legal systems in fragmenting an activity which hitherto the private law has been traditionally governing. It is but natural that in areas of private laws like negligence standards in torts, the treatment standards for cartels as unlawful activity are hazy and veritably *red herring*.

It is the actual harm<sup>22</sup> as against the perceived harm that is intended to be protected by the Competition Authority as any expression of alleged contravention of competitive conduct merely notifies a probative assumption and it would need to be established in terms of legal context as to whether or not the competition has been restricted. The issue which is receiving attention globally relates to operation of Anti cartel laws, harmful effect of cartels and to educate people about the operation of law and the typical science of cartel conduct and to generate leads about cartel activities which may be source of initiation of formal investigation.

### **Wither to legal benchmarking in anti-cartel enforcement- *rule per-se vs rule of reason***

Paradoxically one may assume cartel conduct to be a genuine convention of hand holding and getting along in a likeminded group to achieve productive efficiency ;it may turn out to viewed as a concerted practice partaking character of economy conspiracy causing consumer harm and it is

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<sup>21</sup> ibid

<sup>22</sup> Howard H. Chang David Evans Richard Schmalensee Working Paper No 4263-02 available online at [HTTP://ssrn.com/abstract?id=332021](http://ssrn.com/abstract?id=332021) (2002)

important to strengthen the legal context to thwart such concerted practice and a distinction needs to be drawn between substantive and procedural law.

Amongst the legal standards applied, the *rule per se* has been applied to naked restraints of trade which are taken as condemned contracts without having to undergo the test of reasonableness of restraint of trade as is done in *rule of reason*. The Sherman Act 1890 deals with antitrust issues in USA and Section 1 lays "every contract, combination in the form of trust or otherwise or conspiracy in restraint of trade or commerce among the several states or with foreign nations is declared to be illegal" .....In *Trans-Missouri*<sup>23</sup>, the ruinous competition argument of reasonableness (of rate) weighted lightly before interstate restraint of trade caused by firms non competition covenant. Contrary to this, the Common Law tradition has imbibed to legal validity with reasonableness; the *rule per se*. However, *Standard Oil*<sup>24</sup> laid the path that not every restraint of trade but restraint which was undue reasonable depending upon its purpose and effect could come in for condemnation. However in *Chicago Board of Trade*<sup>25</sup>, the *per se* illegality of price fixing was construed to read " *the true test of legality is whether the restraint imposed is such as merely regulates and promotes competition or whether it is such that it may suppress or even destroy competition*". One could argue, if this was a development which would converge *per se* with validity test requirement under *rule of reason*. However, *Appalachian Coals*<sup>26</sup> accepted the reasonableness as proof of not having affected the market price as defendant did not have power or intent to fix the prices which in a way was to put pre-test of substantial market effect of the business arrangement. One can see the transition from absolutely prohibited anti competitive conduct to more validation of reasonableness.

The Indian context is nascent one and the Competition Act, 2002 and Section 3 of the Act,; more particularly subsection (3) and (4) can be seen the context of legal standards whether it is *per se* or on based on *rule of reason*. The preamble of the Act *inter alia* provides to practices having adverse effect on competition and Section 3(2) puts agreement as void which cause or likely to cause appreciable adverse effect on competition. The provision of Section 3(3) *inter alia* highlights inclusive instances of

<sup>23</sup> United States Vs Trans-Missouri Freight Assn, 166 US 290 (1897)

<sup>24</sup> Standard Oil Co. Vs United States, 221 US 1(1911)

<sup>25</sup> Chicago Board of Trade Vs United States 246 US 231(1918)

<sup>26</sup> Appalachian Coals Vs United States 288 US 344 (1933)



an agreement which shall be presumed to have an appreciable adverse effect on competition and can be seen to be applicable as to horizontal chain. While Section 3 (3) use expression *which shall be presumed*; Section 3(4) applying to vertical chains uses the legal standards - *shall be an agreement* in contravention to Section 3(1) of the Act, if such agreement causes or likely to cause an appreciable adverse effect. A plain reading of Section 3(3) of the Act would give an impression that it would seek to apply legal conception of *rule per se* but whether Sub section 3(3); can be read to interpret as falling under *rule per se* is to be seen in context of noteworthy judgement of Competition Commission of India, 2002 in case of Neeraj Malhotra<sup>27</sup> which addressed the issue of burden of proof for attracting provisions of Section 3(3). The dissenting order in that case can be read to see whether it can be construed as *per se* rule application in the case when Section 3(3) is read with Section 19(3) which highlights incriminating as well as positive aspects of practice. However, the intent of legislature can be seen from the words *shall be presumed*; which presumption may be rebuttable even.

Going forward, there is no exaggeration that the anti cartel being an area which is receiving the attention of the policy and law makers when seen its context to general well being. The jurisprudence is yet emerging in terms of application of legal standards and with the haziness around treatment of legal standards, judicial inventions will pave the way for effective fight against cartels.

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<sup>27</sup> Neeraj Malhotra Vs Deutsche Post Bank Home Finance, Case No 5 of 2009 of CCI