

## BOOK REVIEW

### ***The Economics of Collusion***

Editors: Robert C Marshall and Leslie M Marx

MIT Press (2012); 304 pp; £24.95

ISBN: 978-0-262-01732-9

The Antitrust Division's detection and prosecution of sophisticated international cartels has not yet marked its 20th anniversary but it is, without question, the single most successful development in competition law enforcement history. The size and structure of these cartels and the creativity (yes, creativity) of those who organised and oversaw them remains a competition policy phenomenon, and a continuing challenge for government enforcers, defence counsel and in-house counsel.

Prior to the era of international cartel enforcement, serious economic study of cartels was virtually non-existent. Because the conduct was per se illegal and proof of agreement constituted the entirety of the offence, there was little in those cases that fascinated economists other than the mystery of why corporate executives would engage in such risky conduct. As the blockbuster international cartel cases came to be prosecuted, the level of interest in these cases increased dramatically. In recent years, the competition law world has benefited from the publication of several excellent books that explain the law and economics of cartels. Two exceptional examples of taking the reader inside the cartels are Professor John Connor's excellent work on the vitamins cartel<sup>1</sup> and Kurt Eichenwald's compelling narrative of the lysine cartel, the first major international cartel case, in *The Informant*.<sup>2</sup> Yet none of that scholarship or history provides the comprehensive insights and understanding of multiple international cartels and cartel enforcement that is presented so skillfully in *The Economics of Collusion* by Drs Robert C Marshall and Leslie M Marx, who have studied collusion extensively as Professors of Economics

1 John M Connor, *Global Price Fixing: Our Customers Are Our Enemy* (Springer, 2001).

2 Kurt Eichenwald, *The Informant: A True Story* (Broadway Books, 2000). See also, James B Leiber, *Rats in the Grain: The Dirty Tricks and Trials of Archer Daniels Midland, the Supermarket to the World* (Four Walls Eight, Windows 2000) (providing another study of the lysine conspiracy that is more focused on the legal analysis of the investigation). The highly publicised investigation and prosecution of the art auction market – particularly Christie's and Sotheby's – was also memorialised in Christopher Mason, *The Art of the Steal* (G P Putnam's Sons, 2004).

at Pennsylvania State University and Duke University, respectively.<sup>3</sup> This volume is a competition law masterwork in which the authors begin their study with the facts, not the economic theory. This is a strategy that will make antitrust lawyers – and hopefully their clients – take serious notice, especially since this book is accessible to the many readers in the competition law community who suffer from serious ‘economics-phobia’. Equations are minimal in this volume.

As someone who has both prosecuted and defended corporations and their senior executives in cartel investigations over many years, I can echo the authors’ confession in the preface that they would rather read US plea agreements and EC Statements of Objections than today’s bestsellers.<sup>4</sup> The authors provide the opportunity to understand the intricate factual details of international cartel activity early in the book. Indeed, the centerpiece of the book is the first person narrative of the formation and operation of a cartel or bidding ring, followed by a description of the challenges to cartel implementation and duration. In two early chapters, Marshall and Marx present ‘The Narrative of a Cartel’<sup>5</sup> and ‘The Narrative of a Bidding Ring.’<sup>6</sup> What they do in these chapters is compile the details of many recent cartels, particularly the headline-grabbing international cartels of recent years – vitamins, graphite electrodes, computer parts, etc. Collecting the facts from multiple cases and presenting them in a first person invitation to join the cartel (replete with ‘frequently asked questions’); the effect is remarkable. The reader walks through the cartel formation process action by action and finds that everything is planned and agreed upon, including the cartel’s financial accounting and sanctions. Marshall and Marx give us a greater understanding of what cartels need to do to succeed and how they handle their operations and infrastructure. In their efforts to piece together the evidence, enforcers and defence lawyers

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3 Dr Marshall is a Liberal Arts Research Professor, Head of the Economics Department, and co-Director of the Center for the Study of Auctions, Procurements, and Competition Policy at the Pennsylvania State University. Dr Marx is the William and Sue Gross Research Fellow and Professor of Economics at the Fuqua School of Business at Duke University. She also served as the Chief Economist of the Federal Communications Commission (FCC) from August 2005 to August 2006.

4 Competing for our attention against the likes of John Meacham’s biography of Jefferson and Manchester’s final volume on Churchill, *The Economics of Collusion* tells an exciting human story – the formation and implementation of cartels. The fact that Marshall and Marx provide the details of most major cartel cases that were investigated by the European Commission, as well as press descriptions of many interesting cases makes this a fascinating book. Details, such as the description of Hoffmann la Roche’s Kuno Sommer not disclosing evidence of the vitamins conspiracy during the plea process in citric acid (see Marshall and Marx at 47), provide a comprehensive human story that should teach valuable and essential lessons to defense and in-house counsel – and to executives.

5 Marshall and Marx, pp 29 to 54.

6 Marshall and Marx, pp 55 to 70.

focus almost exclusively on cartel formation for the very good reason that the Sherman Act, and anti-cartel laws in other jurisdictions, simply require proof of an agreement and what happens after formation and before withdrawal is largely irrelevant to proving the enforcement action. If enforcers and defence counsel spent more time on the implementation of cartels and the suppression of rivalry described by Marshall and Marx, they could have a much more complete picture of how a cartel operates, succeeds or fails.

Casting the suppression of rivalry in the framework of Michael Porter's 'five forces'<sup>7</sup> is a perfect mode of description and analysis<sup>8</sup> – and one that will be familiar to many business executives who admire Professor Porter's thinking. It is worth noting that Porter has a substantial following in Asia, which is the primary arena of cartel enforcement right now.<sup>9</sup> The Porter 'forces' – potential entrants, power of suppliers, power of buyers, threat of substitute products and rivalries among existing firms<sup>10</sup> – establish how difficult it is to maintain a cartel and make it successful and profitable. One important insight that could be of great value to enforcers (and class action plaintiffs) is that not all cartels result in higher prices and higher profits – the leverage of any one of these forces may doom some cartels and, with others, it may allow the cartel to continue without improving prices or profits. This situation often allows defence counsel to argue that if the companies were colluding, they were not very effective at it. Given that the Antitrust Division, in the Sentencing Guidelines,<sup>11</sup> presumes a ten per cent overcharge and a pecuniary loss to the victim that results in a presumed base fine of 20 per cent of the defendant's affected volume of commerce, the determination that some cartels are financially unsuccessful should be something enforcers pay some attention to. Surely, these are cases where the 20 per cent gain/loss presumption is low and the cartelists have made huge profits but, thanks to the rivalry suppression analysis that Marshall and Marx posit, there are often cartels that are unsuccessful or modestly successful. In those cases, the 20 per cent presumption is disproportionate in assessing punishment.

This volume is the most lucid and accessible work that I have encountered that begins its title with 'The Economics of...'. While it should be studied and used by every industrial organisation economist and economics student on the planet,

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7 Michael E Porter, *Competitive Strategy: Techniques for Analyzing Industries and Competitors* (The Free Press, 1980).

8 Marshall and Marx, pp 22 to 23. The Porter analysis flows through the remainder of the volume and is something astute executives will understand and appreciate.

9 Companies and executives from Taiwan, Japan and South Korea have disproportionately been the targets of major international cartel investigations – and antitrust fines – over the past three years.

10 Marshall and Marx, pp 93 to 96.

11 US Sentencing Guidelines Manual, section 2R1.1 (2012).

it has far greater value to the antitrust practitioner and antitrust enforcer because it provides the complete picture of the operation of the cartel and goes far beyond the concept of proving an agreement,<sup>12</sup> which is where many cartel investigations effectively conclude. For the antitrust practitioner, it provides the most comprehensive development of how a cartel is formed and what challenges it continues to face, make a profit and avoid detection. By explaining this process (indeed, by explicating the life cycle of a cartel) and drawing on a treasure trove of cartel narratives (courtesy of the European Commission's Statements of Objections),<sup>13</sup> the authors provide the practitioner with all of the variables (such as plus factors) that need to be analysed in evaluating a cartel.

For the enforcement official, this book opens the door to all of the generally hidden details of cartel operation – something that the US Antitrust Division, in particular, rarely sees or worries about because of the per se nature of the violation in the United States. Understanding the success, or lack of success, of the cartel should cause the Antitrust Division to consider occasionally the lack of success of a particular cartel and temper the numerically based Sentencing Guidelines that assume that every cartel was successful to the maximum degree. The Sentencing Guidelines analysis of the presumption of 20 per cent gain/loss is the best example of this rigid focus on an arbitrary number.<sup>14</sup> The suppression of rivalry concept that is detailed in the book<sup>15</sup> provides the enforcement officials with a more sophisticated picture of what happens after the cartel agreement is implemented and how much the consumer is actually harmed.

For the defence lawyer and the client, I believe that this volume is of enormous value in presenting sophisticated compliance training and audits. To get inside the executive's head and gain his attention during compliance training, we often use hypothetical scenarios that may seem innocent enough but almost always result in criminal liability.<sup>16</sup> Marshall and Marx provide more and more possible hypotheticals based on the details of actual cartels and their implementation stories. Suppression of rivalry is a key factor in the success of the cartel and exploring that concept during a compliance training event is a very effective way to grab the attention of the savvy executive. Explaining the formation process and the implementation

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12 See, for example, William E Kovacic, Robert C Marshall, Leslie M Marx, Halbert L White, Jr, 'Plus Factors and Agreement in Antitrust Law', 110 *Mich L Rev* 393 (2011).

13 Rather than focusing on one or two examples, Marshall and Marx present a comprehensive history of the major international cartels of the past 20 years – lysine, citric acid, vitamins, graphite electrodes and various food additive and chemical products.

14 US Sentencing Guidelines Manual, section 2R1.1 (2012).

15 Marshall and Marx, pp 83 to 104.

16 For a current view of compliance training, see Donald C Klawiter and Jennifer M Driscoll-Chippendale, 'Antitrust Compliance in the Age of Multi-Jurisdictional Leniency: New Ideas and New Challenges', 2009 *Antitrust Review of the Americas* (Global Competition Review, 2008).

steps – especially the ‘plus’ factors – will provide a clear warning if any of those factors are present with the industry. For audits, the investigative team can take the implementation elements and search for them in the company’s activities. The only downside is that the narrative on cartels and bidding rings would also provide the rogue executive a literal roadmap of how to organise and run a cartel. An unscrupulous executive could use the book to set up a sophisticated cartel with minimal chance of detection – the book even supplies the full sales pitch of why to join the cartel. This should not be an excuse for not using Marshall and Marx’s ideas in compliance training. Indeed, some have said that the release of the ADM videos<sup>17</sup> would have the same effect, since it was a tutorial on how to organise cartels. The compliance value of the videos – and, similarly, this book – far outweigh the possible risk of educating a few executives on how to fix prices.

For in-house counsel who oversee the activities of corporate executives and assess the risks resulting from their activities, this book offers the checklist of risky activities. By studying this book, in-house counsel will understand the variety of cartel types, the suppression of competition when it occurs and the plus factors so essential to successful cartels. Filled with the knowledge from this book, in-house counsel can keep an experienced eye on corporate activities and detect problems quickly. Combined with good compliance training, in-house counsel will be better armed to protect the company and do the job effectively – and sleep soundly at night.

Marshall and Marx have created a very compelling structure to analyse cartels, not only to establish whether there was an agreement, but also whether the cartel members created a successful and profitable cartel. They are to be congratulated for the grand scale of their analysis and their use of facts and understandable economics to serve the wider audience of enforcers, economists, defence lawyers and clients. This joins the collection of must-have reference materials for the competition bar.

**Donald C Klawiter**

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17 The ADM tapes are available from the Antitrust Division. They are a series of video clips of the meetings of the lysine conspiracy recorded by the FBI. The viewer gets to see the price discussions first hand, as well as the attitude of the conspirators towards the law. They are gripping and a sobering wake-up call to those who might consider following in that path.