

# The Bankruptcy Wildcard in Cartel Cases

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The ESRC Centre for Competition Policy (CCP), at the University of East Anglia is the leading UK Centre for research in the economics and law of Competition Policy. Its members undertake high quality, independent, academic research into competition and regulation and its impact on companies and society.

## BACKGROUND

- Changes to competition law in the United Kingdom introduced by the Enterprise Act 2002 have the potential to make the penalties for cartel offences substantially higher than previously by making the involvement of individuals punishable with up to 5 years in jail. However the only sanction available in the EC enforcement regime is the ability to levy a fine of up to 10% of an infringing firm's annual turnover - this is likely to fall well short of optimal deterrence. In order to strengthen deterrence either sanctions or the probability of detection need to be increased. The enforcement problem facing EC cartel policy is that both of these are effectively capped and cannot be increased. The existence of a bankruptcy discount - likely influenced by the EC treaty objectives of protecting employment and social issues - reduces the deterrent effect of the enforcement regime further by allowing firms to reduce fines already within the 10% cap.
- **SGL Carbon AG** was fined for its substantial involvement in three different cartels: *Graphite Electrodes* (2001)<sup>1</sup>, *Specialty Graphites*<sup>2</sup> (2002), and *Carbon & Graphite*<sup>3</sup> (2003). While the Commission rejected arguments concerning its ability to pay the fine for participation in the first cartel, the firm was granted a 33% reduction in each of the fines for participation in the second and third on the grounds of 'financial constraints'. This, despite the fact that SGL was a founder member of all three cartels, and continued colluding (with others) in Graphite Electrodes even when under investigation in the US and Canada.

## KEY FINDINGS

- Where fines are the only available sanction against cartels there is a trade-off between increased deterrence and the increased risk of insolvency. The significantly higher fines required to achieve optimal deterrence are unacceptable to the European Commission because of the costs and uncertainties associated with bankruptcy. There may also be scope for the abuse of softer forms of bankruptcy as a shield against cartel sanctions. **SGL Carbon Corp** attempted (unsuccessfully) to rely on the generous provisions of US Chapter 11 bankruptcy to deflect civil antitrust actions following its involvement in the price fixing of graphite electrodes. These were the only factor leading to the filing, and only antitrust plaintiffs would not receive full payment. SGL ensured that financial institutions were aware that the company was in fact financially healthy through press briefings and telephone calls from the Chairman of the company to securities analysts.
- Bankruptcy concerns in the EC have led to the emergence of a 'financial constraints' discount which is applied with a lack of transparency and consistency, leaving it open to potential abuse. This discount may be strongly influenced by the EC treaty objectives of protecting employment and social justice. Because the Commission is an inherently political institution, the existence of this discretion may provide a gateway for lobbyists and interest groups.
- A similarly flexible bankruptcy discount also exists in the US. In May 2005 a plea-bargain was reached by the DoJ in which **Hynix Semiconductor Inc** pleaded guilty to the price fixing of DRAM computer chips and agreed to pay \$185 million. Due to 'inability to pay',

<sup>1</sup> Commission Decision of 18 July 2001 – Case C.36.490 OJ [2002] L 100/1

<sup>2</sup> Commission Decision of 17 December 2002 – Case C.37.667 IP/02/1906

<sup>3</sup> Commission Decision of 3 December 2003 – Case C.38.359 OJ [2004] L 125/45

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the DOJ agreed to the fine being reduced and paid over five years interest free, without explaining precisely why this concession was deemed necessary. This is despite the fact that Hynix is about to spend \$250 million on a business venture in China.<sup>4</sup>

- The availability of such bankruptcy discounts in more than one jurisdiction has left them open to abuse by international firms party to global hardcore cartels. In Graphite Electrodes, SGL “[secured] a reduction in the appropriate fine in the United States by reference to likely penalties in the Community and then [claimed] in the latter jurisdiction that it should not be subject to any fine at all”<sup>5</sup>. The US usually has a first mover advantage in cartel cases which means that infringing firms can make reference to US sanctions as grounds for a ‘financial constraints’ discount in Europe.

## POLICY CONSEQUENCES

- Bankruptcy discounts are meant to safeguard against the costs and uncertainties associated with insolvency. But the existence of any such fine cap or guarantee against bankruptcy creates an incentive for firms to prepare as poorly for cartel fines as possible, safe in the knowledge that they will never be fined out of business. In addition they create an incentive for such firms to make their infringement larger<sup>6</sup> (raise prices further) as the cost of collusion (the fines) is effectively capped.
- The European Commission’s wide discretion has led to the inconsistent and unclear application of bankruptcy discounts, leaving them open to potential abuse. It may be that firms with larger operations and workforces within the Community are more likely to receive a bankruptcy discount than those without, because their operations have a stronger impact on employment and social protection. In addition, the existence of a ‘loose’ bankruptcy discount in the US serves to lower fines in the EC further, as firms cite sanctions previously incurred in the US as grounds for financial constraints in Europe.
- As fines against cartels are the only available EC sanction, they need to be increased in order to achieve deterrence. Bankruptcy discounts have the effect of eroding deterrence in Europe by lowering fines and reducing the cost of collusion, even where there is no real danger of an infringing firm becoming insolvent. In order to overcome this obstacle, the European Commission needs to strengthen private enforcement and consider the introduction of community wide criminal fines and imprisonment against individuals directly involved in cartel infringements. Currently, private antitrust actions are still weak in the EC and criminal cartel offences only exist on a member state level in a few jurisdictions such as the UK. EC-wide criminal sanctions would require harmonisation on the national level and the introduction of a one-stop-shop for leniency.

## FOR MORE INFORMATION:

The full working paper (CCP Working Paper 06-5. Stephan, A (2006) "The Bankruptcy Wildcard in Cartel Cases") and more information about CCP and its research is available from our website: [www.ccp.uea.ac.uk](http://www.ccp.uea.ac.uk)

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Andreas Stephan is in the second year of his PhD within the School of Law at the University of East Anglia and has a background in law and economics. The main focus of his research is the UK criminal cartel offence introduced by the Enterprise Act 2002. His aim is to critically assess the enforceability and effectiveness of the criminal offence. Of particular interest to Andreas, are possible clashes between effective cartel policy and civil action, as well as the difficulties of punishing cartels that transcend national boundaries.

<sup>4</sup> Mutchnik, H., Casamassima, C.T., 2005. United States versus Hynix Semiconductor, Inc: Opening the Door to the Inability-to-Pay Defence? *The Antitrust Source* September 2005 p4

<sup>5</sup> FN 1, at 181.

<sup>6</sup> Connor, J. M. 2005. Optimal Deterrence and Private International Cartels. *Unpublished Paper*, Purdue University, May 2005.