

Exercise: Corporate Leniency Programs

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Week 3

Corporate Leniency Programs

- A cartel is a collection of firms in a market that, instead of competing for customers' business, coordinate in raising prices and profits to the detriments of consumers
- Although such behavior is illegal in many countries, a challenge for the government to enforce the law is that collusions are not easy to be caught
- The most important innovation in recent times for uncovering and prosecuting cartels is the corporate leniency program
 - The first member of an unlawful cartel to come forward and cooperate with the Department of Justice (DOJ) in convicting the other cartel members will be absolved of penalties

Corporate Leniency Programs

- However, how effective the program is depends on how much the penalties will be absolved
 - e.g., In the fine arts auction house cartel, as a “betrayer” to the cartel Christie’s avoided \$45 million fine but still had to pay \$256 million in customers’ damages
- If the amount of penalties relief from applying the program is low, then the cartel members face a coordination game for which there are two Nash Equilibria

		Sotheby's	
		Apply	Do not apply
Christie's	Apply	-7, -7	-6, -8
	Do not apply	-8, -6	-3, -3

Corporate Leniency Programs

- Firms want to coordinate on the “no one applies” equilibrium, whereas the DOJ wants them to be at the equilibrium for which they both apply
- How can the government ensure that a race for leniency?
 - Changing the situations face by the firms from a coordination game into a Prisoner’s Dilemma!
 - That is, what the government want to do is make applying for leniency a dominant strategy

		Sotheby's	
		Apply	Do not apply
Christie's	Apply	-5, -5	-2, -8
	Do not apply	-8, -2	-3, -3

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- One way to do so is to increase the amount of penalties that are avoided from receiving leniency, and this is exactly what Congress did in 2004 when it passed (and the President signed into law) the *Antitrust Criminal Penalty Enforcement and Reform Act*.
- Instead of paying a penalty equals to triple consumer damages as before, firms are now liable for only single damage
- Furthermore, the avoided penalties will be paid by the other cartel members
- All this makes it more likely that applying for leniency is the optimal strategy irrespective of what other cartel members do