COMMENT OF THE GLOBAL ANTITRUST INSTITUTE, GEORGE MASON UNIVERSITY SCHOOL OF LAW, ON THE JAPAN FAIR TRADE COMMISSION'S CONSULTATION ON THE ADMINISTRATIVE SURCHARGE SYSTEM

This comment is submitted in response to the Japan Fair Trade Commission's (JFTC's) request for comments on its Summary of Issues Concerning the Modality of the Administrative Surcharge System (the Report). We submit this comment based upon our extensive experience and expertise in antitrust law and economics.[1] We commend the JFTC for inviting comments on the Report and for endeavoring to update and improve its current administrative surcharge system.

GENERAL RECOMMENDATIONS

This comment addresses key issues raised by the Report, including the calculation of surcharges, the development of a settlement process, and due process.

We agree with the JFTC that the current inflexible system of surcharges is unlikely to accurately reflect the degree of economic harm caused by anticompetitive practices. We therefore respectfully recommend that the JFTC limit punitive surcharges to matters in which: (1) the antitrust violation is clear (i.e., if considered at the time the conduct is undertaken, and based on existing laws, rules, and regulations, a reasonable party should expect the conduct at issue would likely be illegal) and is without any plausible efficiency justification; (2) it is feasible to articulate and calculate the harm caused by the violation; (3) the measure of harm calculated is the basis for any fines or penalties imposed; and (4) there are no alternative remedies that would adequately deter future violations of the law. In the alternative, and at the very least, we strongly urge the JFTC to expand the circumstances under which it will not seek punitive surcharges to include two types of conduct that are widely recognized as having efficiency justifications: unilateral conduct, such as refusals to deal and discriminatory dealing, and vertical restraints, such as exclusive dealing, tying and bundling, and resale price maintenance. In either formulation of the new surcharge system, surcharges imposed should rely upon economic analysis, rather than using sales volume as a proxy, to determine the harm caused by violations of the Antimonopoly Act.

---

[1] The Global Antitrust Institute (GAI), a division of the Antonin Scalia Law School at George Mason University is a leading international platform for research and education that focuses upon the legal and economic analysis of key antitrust issues confronting competition agencies and courts around the world. University Professor Joshua D. Wright, Ph.D. (economics), is the Executive Director of the GAI and a former U.S. Federal Trade Commissioner. Koren W. Wong-Ervin is the Director of the GAI and former Counsel for Intellectual Property and International Antitrust at the U.S. Federal Trade Commission. Professor of Law Douglas H. Ginsburg is a Senior Judge, United States Court of Appeals for the District of Columbia Circuit, Chairman of the GAI's International Board of Advisors, and a former Assistant Attorney General in charge of the Antitrust Division of the U.S. Department of Justice. Associate Dean for Research and Faculty Development and Professor of Law Bruce H. Kobayashi, Ph.D. (economics), is a GAI Senior Scholar and Founding Director.

Economic theory teaches that penalties should be set at a level sufficient to induce offenders to internalize the full social cost of their illegal conduct.[2] From the perspective of a market participant, there is no meaningful economic distinction between a monetary penalty that is remedial (such as disgorgement) and one that is punitive (such as a surcharge). The form of monetary penalty does not affect *ex ante* incentives to commit an antitrust violation. In other words, market participants care only about the expected penalty and not about whether the expected penalty is labeled as a "surcharge," "fine," "disgorgement," "restitution," or some other legal term of art that connotes the payment of money.

In a world with imperfect detection and punishment of antitrust violations, optimal deterrence requires profit-maximizing market participants to face a potential damage award calibrated to a level sufficient to induce offenders to internalize the full social cost of their illegal conduct. A necessary condition for optimal deterrence, therefore, is that the gains from engaging in the prohibited conduct—the profits that accrue as a result of the anticompetitive behavior—are less than the expected penalty at the time the firm decides to engage in the challenged conduct. The expected penalty equals the magnitude of the total penalty imposed multiplied by the probability of punishment. The probability of punishment is dependent upon the likelihood of both private and public enforcement actions. If all anticompetitive conduct is likely to be detected by private persons with standing to sue or the national competition agency and penalized at a level exactly equal to its social cost, then any additional penalties are unnecessary to deter antitrust violations. With imperfect detection—that is, a likelihood of detection less than 100%—penalties that exceed the social cost of the violation may be warranted effectively to deter future violations.

The optimal penalty—including all sources of monetary fines, disgorgement, and civil recoveries—when only type II errors, or false negatives, are possible (i.e., when firms that have violated the law escape punishment) should equal the harm caused by the violation divided by the probability of punishment. Optimal deterrence theory suggests, then, that the total amount of monetary penalties in cases when conduct is most likely to be detected should be less than in cases when anticompetitive conduct is likely to go unnoticed. In cartel cases, the clandestine nature of the agreements requires a larger total penalty to achieve deterrence than is necessary for single-firm violations, which are more easily detected. In the case of price fixing cartels and other horizontal conspiracies, we can reasonably expect that regulators and private litigants do not ferret out and challenge every illegal conspiracy that exists because such conspiracies are by their very nature clandestine.[3] On the other hand, most examples of potentially harmful single-firm conduct are open and notorious. For example, an upstream input supplier to a downstream

---

[2] Gary S. Becker, *Crime and Punishment: An Economic Approach*, 76 J. POL. ECON. 169 (1968); *see also* William M. Landes, *Optimal Sanctions for Antitrust Violations*, 50 U. CHI. L. REV. 652 (1983); Douglas H. Ginsburg & Joshua D. Wright, *Antitrust Sanctions*, 6 COMPETITION POL'Y INT'L 3, 3 (2010) [hereinafter Ginsburg & Wright, *Antitrust Sanctions*]; Bruce H. Kobayashi, *Antitrust, Agency, and Amnesty: An Economic Analysis of the Antitrust Laws Against Corporations*, 69 GEO. WASH. L. REV. 715 (2001) [hereinafter Kobayashi].

[3] Indeed, the best available evidence implies a probability of detection no greater than 35%. *See* Ginsburg & Wright, *Antitrust Sanctions*, *supra* note 2.

monopolist is keenly aware of any restraint on distribution put in place by the monopolist and, to the extent the input supplier is harmed by the restraint, will generally have the appropriate incentive to challenge the conduct.

Cartel cases can also be distinguished in terms of the costs of type I errors (false positives, or efficient, welfare increasing conduct that is mistakenly penalized). Because naked pricing fixing cartels lack any offsetting efficiency benefits, the costs of type I error arising from prosecution of such a cartel is close to zero. In contrast, when evaluating conduct with an ambiguous impact on consumer welfare, the cost of a type I error is relatively large and creates a risk that large penalties may deter lawful and procompetitive conduct. The potential for significant type I error costs lowers the level of optimal penalty.

In general, any antitrust enforcement system should seek to minimize the total social costs associated with implementing the policy.[4] These costs include the costs of type I errors, type II errors, and the costs of administering the antitrust enforcement system. Antitrust scholars have relied upon this decision theoretic framework to identify antitrust rules that best promote competition and protect consumer welfare across a variety of institutional settings.[5] The U.S. Supreme Court has recognized the limitations the courts face in distinguishing between pro- and anticompetitive conduct in antitrust cases and emphasized the need to avoid type I errors, particularly in monopolization cases.[6] The U.S. Supreme Court has also expressed concerns, originally explained in Judge Frank Easterbrook's seminal analysis, that the cost to consumers arising from type I errors might be greater than those attributable to type II errors because "the economic system corrects monopoly more readily than it corrects judicial errors."[7]

---

[4] *See* Frank H. Easterbrook, *The Limits of Antitrust*, 63 TEX. L. REV. 1, 15 (1984) [hereinafter Easterbrook]; *see also* James C. Cooper et al., *Vertical Antitrust Policy as a Problem of Inference*, 23 INT'L J. INDUS. ORG. 639, 658 (2005) [hereinafter Cooper et al.]; Joshua D. Wright, *Abandoning Antitrust's Chicago Obsession: The Case for Evidence-Based Antitrust*, 78 ANTITRUST L.J 241 (2012).

[5] *See, e.g.,* C. Frederick Beckner, III & Steven C. Salop*, Decision Theory and Antitrust Rules*, 67 ANTITRUST L.J. 41 (1999); Cooper et al., *supra* note 4; David S. Evans & A. Jorge Padilla, *Designing Antitrust Rules for Assessing Unilateral Practices: A Neo-Chicago Approach*, 72 U. CHI. L. REV. 73, 98 (2005); Keith N. Hylton & Michael Salinger, *Tying Law and Policy: A Decision-Theoretic Approach*, 69 ANTITRUST L.J. 469 (2001); Geoffrey A. Manne & Joshua D. Wright*, Innovation and the Limits of Antitrust*, 6 J. COMPETITION L. & ECON. 153 (2010).

[6] Pac. Bell Tel. Co. v. LinkLine Commc'ns, Inc., 555 U.S. 438, 451 (2009) ("To avoid chilling aggressive price competition, we have carefully limited the circumstances under which plaintiffs can state a Sherman Act claim by alleging that prices are too low."); Credit Suisse Sec. (USA) LLC v. Billing, 551 U.S. 264, 283 (2007) ("[W]here the threat of antitrust lawsuits, through error and disincentive, could seriously alter underwriter conduct in undesirable ways, to allow an antitrust lawsuit would threaten serious harm to the efficient functioning of the securities markets."); Verizon Commc'ns Inc. v. Law Offices of Curtis V. Trinko, LLP, 540 U.S. 398, 414 (2004) ("Mistaken inferences and the resulting false condemnations are especially costly, because they chill the very conduct the antitrust laws are designed to protect." (internal quotations omitted)).

[7] Easterbrook, *supra* note 4, at 15.

In particular, the cost of overdeterrence is greater when the conduct alleged to violate the antitrust laws is more likely to be procompetitive. Thus, overdeterrence is a more significant concern where the economic literature has identified and substantiated efficiency explanations for the conduct at issue. For example, economists have long understood that unilateral conduct (e.g., refusals to deal or discriminatory dealing) and vertical restraints (e.g., exclusive dealing, tying and bundling, and resale price maintenance) are frequently procompetitive.[8] Antitrust enforcement involving these arrangements increase the risk of type I error because courts have difficulty distinguishing between procompetitive and anticompetitive uses.

Further, as discussed above, many competition law violations involving single firm conduct are likely to be detected. The economic analysis of penalties implies that optimal deterrence when the probability of detection and enforcement is high does not require multiple or supracompensatory damages or sanctions.[9] For example, vertical restraints such as resale price maintenance or exclusive dealing necessarily involve customers of the alleged monopolist, and thus the probability of detecting the underlying conduct is near 100 percent. The probability of detection is also relatively high in other instances of alleged monopolization involving overt acts by the defendant. Punishing these types of violations with fines that exceed single damages is likely to discourage other firms from using similar arrangements even when they would have welfare-enhancing and procompetitive benefits.

We also strongly urge that the surcharge system not apply to violations, such as unfair trade practices, that do not require a showing of harm to competition. While the regulation of unfair methods of competition is a common feature of antitrust enforcement in many jurisdictions, implementation of those regulations is often in significant tension with an effects-based approach to antitrust law.[10] While evaluating unfairness from an *ex ante* perspective—that

---

[8] *See, e.g.*, Cooper et al., *supra* note 4; Francine Lafontaine & Margaret Slade, *Exclusive Contracts and Vertical Restraints: Empirical Evidence and Public Policy, in* HANDBOOK OF ANTITRUST ECONOMICS 391, 409 (Paolo Buccirossi ed., 2008); Daniel O'Brien, *The Antitrust Treatment of Vertical Restraint: Beyond the Possibility Theorems, in* THE PROS AND CONS OF VERTICAL RESTRAINTS 40, 76 (2008).

[9] Gary S. Becker, *Crime and Punishment: An Economic Approach*, 76 J. POL. ECON. 169 (1968). For an application of optimal penalties analysis relying upon the high probability of detection of alleged patent holdup, see Bruce H. Kobayashi & Joshua D. Wright, *The Limits of Antitrust and Patent Holdup: A Reply to Cary et al.*, 78 ANTITRUST L.J. 2, 505, 704-07 (2012).

[10] The U.S. experience is a useful example. The first century of the FTC's experiment with enforcement against unfair methods of competition, which relied upon a combination of justifications including non-economic and *ex post* unfairness principles, is generally understood to have been a failure and inconsistent with the goals of antitrust. *See generally* William E. Kovacic & Marc Winerman, *Competition Policy and the Application of Section 5 of the Federal Trade Commission Act*, 76 ANTITRUST L.J. 929 (2010) ("The FTC's record of appellate litigation involving applications of Section 5 that go beyond prevailing interpretations of the other antitrust laws is uninspiring."). In 2015, the FTC corrected its approach, linking its unfairness authority directly to the concept of harm to competition. Fed. Trade Comm'n, Statement of Enforcement Principles Regarding "Unfair Methods of Competition" Under Section 5 of the FTC Act (Aug. 13, 2015), https://www.ftc.gov/system/files/documents/public_statements/735201/150813section5enforcement.pdf; *see also* Jan M. Rybnicek & Joshua D. Wright, *Defining Section 5 of the FTC Act: The Failure of the*

is, interpreting unfairness-based regulation to bar only interfering with the opportunity to compete on the merits—can be reconciled with the antitrust approach, *ex post* applications of unfairness principles use competition tools inappropriately to govern the outcomes of bargaining disputes, to set prices, or otherwise to deter conduct unlikely to harm competition.

With respect to the development of a settlement process, we respectfully recommend that the JFTC consider incorporating safeguards that prevent settlement provisions unrelated to the violation and limit the use of extended monitoring programs. In our observation, consent decrees and commitments extracted to settle a case too often end up imposing abusive remedies that undermine the welfare-enhancing goals of competition policy.[11] An agency's ability to obtain *in terrorem* concessions reflects a party's weighing of the costs and benefits of litigating versus the costs and benefits of acquiescing in the terms sought by the agency. When firms settle merely to avoid the high relative costs of litigation and regulatory procedures, an agency may be able to extract more restrictive terms on firm behavior by entering into an agreement than by litigating its accusations in a court. In addition, while settlements may be a more efficient use of scarce agency resources, the savings may come at the cost of potentially stunting the development of the common law arising through adjudication.[12]

Lastly, with respect to due process, while we recognize that the process may vary depending on the jurisdiction, we strongly urge the JFTC to adopt the core features of a fair and transparent process that have emerged based on the substantial work of the International Competition Network (ICN) and the Organization for Economic Cooperation and Development (OECD).[13] These include:

Common Law Method and the Case for Formal Agency Guidelines, 21 GEO. MASON L. REV. 1287 (2014); Joshua D. Wright & Angela M. Diveley, *Unfair Methods of Competition After the 2015 Commission Statement,* ANTITRUST SOURCE (Oct. 2015) at 1, http://papers.ssrn.com/sol3/Papers.cfm?abstract_id=2664953.

[11] *See* Douglas H. Ginsburg & Joshua D. Wright, *Antitrust Settlements: The Culture of Consent*, *in* 1 WILLIAM E. KOVACIC: AN ANTITRUST TRIBUTE—LIBER AMICORUM 177, 179–80 (2012) [hereinafter Ginsburg & Wright, *Culture of Consent*] (documenting instances of antitrust agencies entering into settlements that exceed the relief they could achieve "in a contested case in court").

[12] Faaez Samadi, *Whish: Be Wary of DG Comp Settling Too Many Cases*, GLOBAL COMPETITION REVIEW (2013), http://globalcompetitionreview.com/news/article/34549/whish-wary-dg-comp-settling-cases.

[13] INT'L COMPETITION NETWORK, INVESTIGATIVE TOOLS REPORT (2013), http://internationalcompetitionnetwork.org/uploads/library/doc901.pdf; INT'L COMPETITION NETWORK, COMPETITION AGENCY TRANSPARENCY PRACTICES (2013), http://internationalcompetitionnetwork.org/uploads/library/doc902.pdf; INT'L COMPETITION NETWORK, COMPETITION AGENCY CONFIDENTIALITY PRACTICES (2014), http://internationalcompetitionnetwork.org/uploads/library/doc1014.pdf; INT'L COMPETITION NETWORK, GUIDANCE ON INVESTIGATIVE PROCESS (2015), http://www.internationalcompetitionnetwork.org/uploads/library/doc1028.pdf; ORG. FOR ECON. CO-OPERATION & DEV., PROCEDURAL FAIRNESS AND TRANSPARENCY (2012), http://www.oecd.org/daf/competition/mergers/50235955.pdf; *see also* Douglas H. Ginsburg & Taylor M. Owings, *Due Process in Competition Proceedings,* 11 COMPETITION L. INT'L 39 (2015).

(1) Legal representation for parties under investigation, allowing the participation of local and foreign counsel of the parties' choosing;

(2) Notifying the parties of the legal and factual bases of an investigation and sharing the evidence on which the agency relies, including any exculpatory evidence and excluding only confidential business information;

(3) Direct and meaningful engagement between the parties and the agency's investigative staff and decision-makers;

(4) Allowing the parties to present their defense to the ultimate decision-makers; and

(5) Ensuring checks and balances on agency decision-making, including meaningful access to independent courts.

Further reforms consistent with the core features of due process include full access to evidence, attorney-client privilege, the right to have a lawyer present during deposition, access to deposition transcripts, and audio and video recordings of depositions.

Such core features are likely to provide substantial benefits to the JFTC itself, including: (1) enabling the agency efficiently to reach fully informed and vetted decisions (i.e., due process can lead to better substantive results); (2) maintaining credibility with stakeholders and the public; (3) ensuring reliable deterrence; and (4) avoiding cooperation gaps in parallel investigations due to asymmetric information, which can contribute to different analysis and conflicting outcomes.

Providing fundamental due process protections can improve substantive analysis by allowing the agency to develop and vet its case; focus on dispositive issues; gain valuable insight from the parties, who are often in a better position to know the specifics of a particular industry; and gain insight into the parties' evidence and defenses. It can also improve the reputation of the agency. Concerns about process can create the impression that substantive results are flawed, undermining the perceived legitimacy of the agency's decisions. In contrast, fair, predictable, and transparent processes bolster the legitimacy of the enforcement outcome. Lastly, it can improve the deterrent effect of antitrust enforcement by increasing the transparency and predictability of decisions, providing parties with guidance, and facilitating their ability to determine in advance whether their actual or proposed conduct may violate the antitrust laws.

SPECIFIC RECOMMENDATIONS

Part 3, Issues 1(1)A-Methods of calculation

We recommend that the JFTC revise its administrative surcharge system to base the calculation of surcharges on the economic harm of the act as calculated by economic analysis, as opposed to incorporating more flexibility in the identification of sales volume. This method would require case-by-case analysis of the effect of the harm in question, and have the virtue of ensuring proportionality to the harm inflicted. The JFTC should maintain the requirement that these fines be based on identified restraining effects and the specific results restraining competition for each good or service.

We strongly urge the JFTC to limit the application of fines to the economic harm caused in Japan. In the absence of coordination between jurisdictions, administering surcharges based upon sales outside Japan invites conflict with other national competition agencies and may impose duplicative penalties, which increase the likelihood of overdeterrence. We recommend the JFTC develop clear guidelines for the exceptional circumstances in which it would seek surcharge penalties for sales outside of Japan.

When assessing fines, we strongly urge the JFTC to differentiate between naked price-fixing activity, which is widely regarded as conduct that has no justification on efficiency or welfare grounds, and practices that have plausible efficiency justifications such as vertical restraints and unilateral conduct.

Part 3, Issues 1(1)B-Period of Calculation

We recommend that the fine be based upon an economic calculation of the complete duration of the harm caused by the violation, rather than an approximation of harm based upon a limited sales period.

Part 3, Issues 1(2) A-C

The surcharge should be proportional to the harm caused by the violation of the antimonopoly law. In some sentencing systems, including the U.S. Sentencing Guidelines for corporations, the sanctions are determined by first calculating a "base fine" that reflects the harm done by the conduct and then applying a multiplier to adjust the base fine.[14] Under the optimal penalties framework, the multiplier will be inversely related to the probability that the illegal conduct would be detected and punished. For example, the optimal penalty for a firm that self-reports a previously undetected antimonopoly law violation should equal the harm caused by the violation (i.e., the multiplier should equal 1). Any factors used to adjust the multiplier upward from 1 should identify the circumstances that make the activity less likely to be detected or punished.

Any factors used to adjust the base fine (as opposed to the multiplier) should adjust the final surcharge so that it reflects the harm caused. Because economic analysis of the harm will take into account the magnitude of the harm inflicted, factors such as the type of business and whether the firm is small or medium sized do not need to be included in order to calculate the penalty when harm or a reliable proxy for harm can be calculated.

Part 3, Issues 2-Differences by type of infringement

We recommend that the surcharges imposed be proportional to the economic harm inflicted. When proof of harm to competition is not required for liability (e.g., unfair trade

[14] U.S. SENTENCING GUIDELINES MANUAL, CHAPTER 8. (U.S. SENTENCING COMM'N 2015).

practices such as abuse of superior bargaining position) or in cases where conduct is often found to be pro-competitive (e.g., vertical restraints such as resale price maintenance, exclusive dealing, or other unilateral conduct), we recommend that the JFTC not impose surcharges to avoid deterring welfare-enhancing behavior.

Surcharges should not be imposed for unfair trade practice violations, including the abuse of superior bargaining power. Unfair trade practices, which do not require a showing of harm to competition, should not be a part of competition policy.[15] While an *ex ante* approach to fairness can be compatible with an effects based approach to competition policy, an *ex post* approach to fairness can undermine the goals of antitrust by prohibiting or chilling procompetitive conduct.

The widely recognized purpose of competition law is the protection of competition and consumer welfare, not of individual competitors. It follows from this understanding that competition law should not be concerned with particular outcomes of contractual negotiations between parties. The conditions under which bargaining between parties is likely to result in harm to competition rather than the mere redistribution of rents between parties are limited. As the U.S. antitrust agencies explained in recognition of this point, "[i]n the absence of harm to competition, governments generally should make every effort not to interfere in privately-negotiated contracts."[16]

Moreover, regulating relative bargaining power may harm consumers rather than offering them additional protection. The fundamental economic role of contract is to enable parties efficiently to allocate costs, risks, and rights among themselves. In the absence of a demonstrable market failure, the outcome of a competitive contracting process is likely to best serve the interests of consumers. The risk of *ex post* regulation interfering with the outcome of a contract negotiation on the ground that one party had superior bargaining power increases significantly the costs of contracting for firms—costs that are inevitably passed on to consumers in the form of higher prices or fewer goods and services.[17] Businesses will adjust other terms of the contract that each had considered efficient *ex ante*. Adjusting terms that would have otherwise been considered efficient may then result in an increase in contracting costs. Accordingly, both parties will be worse off and will generally pass on the increased costs to consumers through an increased quality-adjusted price.

Part 3, Issues 3(2)-(3) Relationship between the new system and criminal penalties, civil penalties

In order to minimize potential welfare losses from overdeterrence, we recommend that the JFTC adopt a policy of reducing surcharges by the amount of penalties and fines paid for the same violation. According to the economics of penalties, activity is sufficiently deterred when

---

[15] We recommend that the Antimonopoly Act be amended to eliminate violations for unfair trade practices not tied to harm to competition, such as abuse of superior bargaining position.

[16] INT'L COMPETITION NETWORK, REPORT ON ABUSE OF SUPERIOR BARGAINING POSITION 17 (2008), http://www.internationalcompetitionnetwork.org/uploads/library/doc386.pdf.

[17] Benjamin Klein, *Transaction Cost Determinants of "Unfair" Contractual Arrangements*, 70 AM. ECON. REV. 356, 360-61 (1980).

the total penalty is a function of the economic harm and the likelihood of discovery. If, under the new system, the surcharge is calibrated so the net expected value of the illicit activity is zero, then there is no need to impose both surcharges and criminal penalties (fines) for the same infringement. If the surcharge system imposes optimal fines that are tied to the harm imposed by the violation, imposing penalties on top of these optimal penalties will result in overdeterrence. Penalties that exceed the optimum, even in the case of cartels, can result in welfare losses by encouraging firms to implement excessively costly compliance programs, the costs of which will be borne by customers and public shareholders, who have little or no ability to prevent the firm or its agents from engaging in illegal activity.[18]

1. Settlements and the Mitigation/Aggravation of Surcharges

Settlements, consent decrees, the mitigation or aggravation of surcharges, and leniency programs used to create incentives for cooperation by reducing punishment for those who admit guilt and/or come forward with information can serve as important means of increasing the detection of crimes and conserve agency resources—but only when the incentives of such systems are structured properly. For example, the U.S. Department of Justice revised its corporate leniency policy in 1993. Among other things, the new policy extended the leniency policy to situations where a criminal investigation had already begun, and made the grant of leniency more predictable.[19] Following the change in policy, applications for leniency increased from approximately one per year to two per month.[20] Some economic evidence suggests the corporate leniency program introduced in the U.S. increased the detection of cartels by as much as 60 percent.[21]

Successful leniency programs create a prisoners' dilemma in which each cartel member has a clear incentive to defect from the cartel and apply for leniency. That incentive is created by lowering or eliminating the penalties faced by the successful leniency applicant so the net payoff from applying for leniency is lower than the net payoff from remaining in the cartel. The result is the detection and punishment of cartels that would otherwise have remained undetected without having to substantially increase agency resources used to uncover cartel activity. While the successful leniency applicant and its employees often go unpunished, overall deterrence is enhanced by increasing the expected penalties, *ceteris paribus*, faced by the non-leniency cartel members who now face a higher probability of detection and punishment.

---

[18] Kobayashi, *supra* note 2.

[19] David A. Balto, *Antitrust Enforcement in the Clinton Administration,* 9 CORNELL J.L. & PUB. POL'Y 61, 65 (1999) (discussing changes in the Antitrust Division's criminal enforcement policy under the Clinton administration).

[20] *See* Gary R. Spratling, Making Companies an Offer They Shouldn't Refuse: The Antitrust Division's Corporate Leniency Policy—An Update, Address Before the Bar Association of the District of Columbia's 35th Annual Symposium on Associations and Antitrust (Feb. 16, 1999), https://www.justice.gov/atr/speech/making-companies-offer-they-shouldnt-refuse-antitrust-divisions-corporate-leniency-policy.

[21] Nathan H. Miller, *Strategic Leniency and Cartel Enforcement,* 99 AM. ECON. REV. 750, 760 (2009).

The increased deterrence benefits of leniency are widely recognized. The effectiveness of any one country's leniency program can be reduced, however, absent inter-jurisdictional coordination. As noted above, the incentives generated by leniency programs work by increasing the differential between the payoff of being the successful leniency applicant versus remaining in the cartel. This differential, and the incentive it creates, are reduced if the successful leniency applicant faces increased expected fines and penalties from other jurisdictions, or increased expected civil penalties from private actions.

Moreover, leniency, mitigation, and settlement programs in some cases may serve to undermine the welfare-enhancing goals of competition policy. Leniency programs can have the perverse effect of stabilizing viable cartels when large expected penalties are endogenous to a member firm's decision to defect.[22] If the increased expected penalties generated by leniency and mitigation programs rise above the optimal penalty, such programs may also encourage excessively costly monitoring that has the perverse result of increasing prices for consumers. Leniency, settlement, and mitigation programs that require the provision of substantial assistance to authorities may increase the potential for false convictions, creating a mechanism by which a firm can impose costs on its competitors.[23] Additionally, leniency, settlement, and mitigation programs used in a manner inconsistent with the welfare-enhancing goals of antitrust enforcement can adversely affect an agency's case selection decisions.

The relevant question for setting the appropriate parameters for mitigation on the corporate level is how much vicarious liability is appropriate to induce a corporation to undertake the optimal amount of monitoring and prevention of crime by agents of the corporation. Optimal-penalty theory suggests the corporation should be fined an amount equal to the social cost of the crime, adjusted for the probability of non-detection. A fine that exceeds this level will cause the private return of monitoring and compliance to exceed the social return and result in excessive expenditures.

In many cases, expenditures by the firm aimed at monitoring and preventing crimes committed by its agents will also produce an increase in the probability that the firm will be

---

[22] Kobayashi, *supra* note 2, at 742; *see also* Massimo Motta & Michele Polo, *Leniency Programs and Cartel Prosecution* 13-17 (IGIER Working Paper No. 150, 1999), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=165688; Giancarlo Spagnolo, *Optimal Leniency Programs* (FEEM Working Paper No. 42.2000, 2000), http://papers.ssrn.com/sol3/papers.cfm?abstractid=235092# Paper%20Download; Giancarlo Spagnolo, *Self-Defeating Antitrust Laws: How Leniency Programs Solve Bertrand's Paradox and Enforce Collusion in Auctions* (FEEM Working Paper No. 52.2000, 2000), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=236400; Barbara McCutcheon, *Do Meetings in Smoke-Filled Rooms Facilitate Collusion?*, 105 J. POL. ECON. 330 (1997).

[23] Whistle-blowing in antitrust settings is likely to provide an opportunity to impose fines on future rival firms. Kobayashi, *supra* note 2, at 743; *see* William J. Baumol & Janusz A. Ordover, *Use of Antitrust to Subvert Competition,* 28 J.L. & ECON. 247 (1985); Frank H. Easterbrook, *Detrebling Antitrust Damages,* 28 J.L. & ECON. 445, 458-59 (1985); *see also* William F. Baxter, *The Political Economy of Antitrust, in* THE POLITICAL ECONOMY OF ANTITRUST- PRINCIPAL PAPER BY WILLIAM BAXTER (Robert D. Tollison ed., 1980).

punished, in effect altering the analysis of optimal penalties.[24] Thus, penalties in excess of the optimum can actually deter these types of expenditures. One possible solution is to mitigate surcharges for companies with compliance programs. If the corporation still faces large penalties from criminal and civil actions, however, then mitigation may be insufficient to induce compliance. Additionally, one practical problem with awarding mitigation for an "effective compliance program" is that its detection of a violation may mistakenly be interpreted as showing that the program is *de facto* ineffective.[25]

If the JFTC decides to mitigate surcharges for compliance programs, it should provide clear guidance to corporations regarding the circumstances in which they will receive deductions for violations detected through their compliance program, and in which the agency will take the program into consideration when deciding whether to prosecute a violation. A discretionary policy in the form of settlement with mitigated surcharges that awards companies for admitting wrongdoing, through a compliance program or otherwise, can successfully increase incentives for companies to develop compliance programs and admit wrongdoing. In designing a settlement program, however, caution is necessary to ensure these incentives remain intact and settlements do not become abusive.

Part 3, Issues 1(3)-(4) Aggravating/mitigating surcharges

We emphasize the need for transparency and predictability in the surcharge system, and recommend the JFTC adopt guidelines that clearly identify aggravating and mitigating factors *ex ante*. These factors should be tied to adjustments that generate more accurate measures of harm or adjustments that are inversely related to likelihood of detecting violations.

For instance, it may be appropriate for the JFTC to adopt measures to mitigate surcharges for wrongdoing detected and reported as part of a corporate compliance program. In many cases, expenditures by the firm aimed at monitoring and preventing crimes committed by its agents will also produce an increase in the probability that the firm will be punished, in effect altering the analysis of optimal penalties. Thus, high penalties can actually deter these types of expenditures.[26] Under these conditions, the surcharge would need to be reduced to reflect the optimal penalty (including both criminal and civil penalties), and the corporation would need assurance that reporting a violation would not disqualify it from receiving a discount for its compliance program.

Obstructing an investigation by concealing, destroying, or falsifying evidence decreases the likelihood of detection and punishment. Increasing penalties for these activities by

---

[24] *See* Jennifer Arlen, *The Potentially Perverse Effects of Corporate Criminal Liability*, 23 J. LEGAL STUD. 833 (1994); *see also* Robert Innes, *Self-Policing and Optimal Law Enforcement when Violator Remediation is Valuable,* 107 J. POL. ECON. 1305 (1999); Robert Innes, *Violator Avoidance Activities and Self-Reporting in Optimal Law Enforcement,* 17 J.L. ECON. & ORG. 239 (2001).

[25] Kobayashi, *supra* note 2, at 738.

[26] *Id*. at 737.

increasing the surcharge multiplier or adding separate charges and penalties for obstruction is both necessary and consistent with the optimal penalties framework.

The Report acknowledges the potential for mitigating and aggravating surcharges to have harmful effects, including "being forced to accommodate the picture of a case that policies of the JFTC or investigators have, or drawing into JFTC's investigations to enterprises that ultimately would be determined not to be violators."[27] We have seen similar deleterious effects as a result of U.S. settlement/consent decree policy, and address these concerns below in the settlement section.

Part 3, Issues 1(5)-Settlement Procedure

The Report poses several questions regarding the adoption of a settlement procedure. Specifically, it asks whether to adopt a system that would allow for simplified procedures if a firm has admitted illegal behavior and how the process would work.

We recommend that a settlement procedure be established for corporations that admit wrongdoing, but wish to draw the attention of the JFTC to the dangers inherent in establishing such a program. Settlements enable agencies to economize their scarce agency resources, but settlements may also undermine the welfare-enhancing goals of antitrust enforcement. We therefore advise the JFTC to take adequate measures to ensure that the settlement system will be welfare-enhancing.

We respectfully recommend that any settlement procedures adopted require remedies that are directly related to the harm in question by limiting the non-surcharge items that can be included in such agreements, including time limits on the JFTC's monitoring and supervising role. We also suggest that the JFTC verify the reliability of testimony provided as part of cooperation in an investigation, as such testimony may be unreliable.[28]

Antitrust settlements subvert the purposes of antitrust law when they depart from the consumer welfare standard. In seeking to remedy anticompetitive behavior, antitrust authorities sometimes include provisions that actually diminish rather than enhance consumer welfare.[29] Common examples of abuses include settlement provisions imposing restrictions upon merging firms' employment decisions; requiring a settling firm to make charitable contributions unrelated to compensating victims of its antitrust violation; and extracting concessions that are simply irrelevant to the firm's alleged antitrust violation.

Settlements often contain provisions for the continuous monitoring of the firm's behavior. These provisions can have materially adverse consequences for consumers—even when the settlement targets conduct that reduces consumer welfare—by placing the agency in a

[27] JAPAN FAIR TRADE COMM'N, SUMMARY OF ISSUES CONCERNING THE MODALITY OF THE ADMINISTRATIVE SURCHARGE SYSTEM § 3(1)(4)(A).

[28] *See* Kobayashi, *supra* note 2.

[29] Ginsburg & Wright, *Culture of Consent, supra* note 11.

position of monitoring and supervising competition for an extended period of time. This type of remedy may exceed what the agency would be able to obtain through litigation, due to a parties' desire to avoid protracted and expensive proceedings. The remedy can also have a chilling effect on potentially welfare-enhancing behavior by other firms, as they become aware of the agency's willingness to challenge a business practice that is potentially pro-competitive.

The prevalence of settlements also may adversely affect the case selection of the agency. When settlements become the primary way cases are resolved, the likelihood of a settlement becomes a criterion for case selection, potentially displacing other relevant criteria such as the benefit to consumers from terminating anticompetitive practices.

For these reasons, we recommend a cautionary approach to a settlement policy that seeks to avoid imposing welfare-decreasing provisions.

2. Additional Comments and Recommendations

Part 3, Issues 3(2)-(3) Relationship between the new system and criminal penalties, civil penalties

The Summary of Issues requests comment on the relationship between the surcharge system and criminal penalties. We address two related questions posed by the Summary of Issues: (1) Is there a need for both surcharges and criminal penalties? and (2) Is there a need for criminal penalties against natural persons?

Antitrust enforcement agencies have largely followed the conventional wisdom that the best cure for insufficient deterrence of hard-core cartel activity, such as price-fixing, is to increase corporate fines. Despite already large and ever-increasing corporate fines, cartels—particularly international cartels—remain a substantial problem, and recidivism among price fixers is not infrequent.[30]

Although the corporation is the current focus of antitrust sanctions aimed at deterrence, the individual who fixes prices on the corporation's behalf is another potential target. The challenge for antitrust law is to calibrate available corporate and individual sanctions to achieve optimal deterrence.

Corporate fines alone are unlikely to efficiently deter conduct by an individual employee because he will internalize almost none of the fine imposed against his employer. To deter price-fixing, individuals should be given sufficient disincentives.[31] The U.S. Antitrust Division reasonably believes that "individual accountability through the imposition of jail sentences is the

---

[30] Ginsburg & Wright, *Antitrust Sanctions*, *supra* note 2.

[31] *Cf.* Donald I. Baker, *The Use of Criminal Law Remedies to Deter and Punish Cartels and Bid-Rigging*, 69 GEO. WASH. L. REV. 693, 713-14 (2001).

single greatest deterrent" to cartel activity.[32] A survey done for the U.K. Office of Fair Trading confirms that criminal penalties are the penalties of greatest concern to business people.[33] Adding the threat of criminal sanctions imposed upon the persons directly engaged in or complicit with the price-fixing conspiracy would create more deterrence of antitrust violations than increasing the fines levied upon the corporation that employed them.

We recommend that the JFTC apply criminal penalties in price fixing cartel cases under the new system, so long as the JFTC strengthens due process provisions. Because criminal sanctions impose significant penalties on individuals, it is critical for the JFTC to increase due process protections when applying criminal sanctions to ensure these penalties are applied fairly. Criminal penalties should be limited to naked cartel activity only, and should not be applied to conduct that may be mischaracterized as price fixing, such as resale price maintenance, which can be procompetitive in some circumstances. The JFTC should provide clear guidance to prevent the application of criminal penalties to such cases such.

Part 3, Issues 4-Penalties for obstructing investigations

Separate charges and penalties for obstruction are consistent with the optimal penalties framework. Obstruction of investigations impedes detection and punishment. In order to deal effectively with the obstruction of investigations, the JFTC should clarify how it will apply charges for obstructing investigations stipulated in Article 94 of the Antimonopoly Act and consider adding "concealing evidence" to the list of crimes considered as obstruction.

Part 3, Issues 6-Verification of the new system as a whole

To ensure transparency and fairness, we recommend that the JFTC adopt provisions to guarantee enterprises (1) access to information needed to duplicate the JFTC's calculation of economic harm, and (2) the ability to contest the JFTC's calculation.

CONCLUSION

[32] Scott D. Hammond, Deputy Assistant Attorney Gen., Antitrust Div., Dep't of Justice, Ten Strategies for Winning the Fight Against Hardcore Cartels (Oct. 18, 2005), https://www.justice.gov/atr/file/517851/download.

[33] UK OFFICE OF FAIR TRADING, THE DETERRENT EFFECT OF COMPETITION ENFORCEMENT BY THE OFT (Nov. 2007), http://webarchive.nationalarchives.gov.uk/20140402141250/http:/www.oft.gov.uk/shared_oft/reports/Evaluating-OFTs-work/oft962.pdf.

We appreciate the opportunity to comment and would be happy to respond to any questions the JFTC may have regarding this comment.