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**DAF/COMP/WD(2013)117**

Organisation de Coopération et de Développement Économiques  
Organisation for Economic Co-operation and Development

**27-Sep-2013**

**English - Or. English**

**DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS  
COMPETITION COMMITTEE**

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**ROUNDTABLE ON EX OFFICIO CARTEL INVESTIGATIONS AND THE USE OF SCREENS TO  
DETECT CARTELS**

-- Note by the United States--

*This note is submitted by the United States to the Competition Committee FOR DISCUSSION under Item X at its forthcoming meeting to be held on 30-31 October 2013.*

**JT03345184**

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## **ROUNDTABLE ON EX OFFICIO CARTEL INVESTIGATIONS AND THE USE OF SCREENS TO DETECT CARTELS**

**-- Note by the United States --**

### **1. Cartel Detection by the U.S. Department of Justice**

1. In the United States, hard core cartels are prosecuted as criminal offenses. Because the Department of Justice's Antitrust Division ("DOJ"), but not the Federal Trade Commission, is empowered to prosecute criminal violations, the DOJ investigates and prosecutes these cases and can use the tools of U.S. federal criminal investigation to detect cartels. In DOJ cartel investigations, grand juries compel the production of documents and sworn testimony from witnesses, and with probable cause, the DOJ can obtain search warrants and seize documents. DOJ cartel investigations can use "consensual monitoring" in which audio or video recordings of cartel discussions are made with the consent of a participant. DOJ cartel investigations are supported by the FBI and other U.S. government agencies (such as agency inspector general offices), and coordinated with competition agencies in other countries.

2. DOJ cartel investigations are initiated by information suggesting the possible existence of cartel activity ("leads"), and for international price-fixing cartels, these leads mainly come from leniency applications. Since 1993, avoidance of all criminal sanctions has been automatic for qualifying corporations that come forward before the DOJ has other information indicating a cartel's existence. All officers, directors, and employees of these corporations are protected from criminal prosecution, provided that they cooperate in the investigation. Avoidance of criminal sanctions is potentially available even if cooperation begins after the DOJ has acquired information indicating the existence of the cartel.

3. In addition to leniency applications, DOJ often uncovers cartels when one investigation generates a lead for another. This occurs through the cooperation of leniency applicants and through the work of grand juries. The result can be a series of prosecutions for cartel activity within the same industry or at times stretching into new industries when a company is involved in multiple, unrelated conspiracies. Illustrative are recent prosecutions for bid-rigging and fraud in real estate foreclosure auctions in Northern California. To date, 36 individual plea agreements have been entered in connection with this investigation.

4. Other sources of leads are non-cartel investigations and outreach efforts. The DOJ solicits leads on its public website,<sup>1</sup> inviting contacts by e-mail, letter, and telephone. Customers and employees of firms engaged in cartel activity sometimes report suspicions of such activity to the DOJ. As discussed below, the DOJ has long reached out to procurement officials.

5. An indication of how DOJ cartel enforcement would operate without a leniency program is provided by data on the period before the first leniency program was instituted. A study of DOJ cartel cases filed and won during 1962–73 categorized the origin of many. The lead came from the complaint of a competitor, customer, or employee in 46% of the cases; from another cartel investigation in 24%; from a

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<sup>1</sup> The website offers guidance on identifying cartel activity: Price Fixing, Bid Rigging, and Market Allocation Schemes: What They Are and What to Look For—A Primer, *available at* <http://www.justice.gov/atr/public/guidelines/211578.pdf>.

non-cartel investigation in 12%; from a government procurement agency in 12%; and from other sources in 6%.<sup>2</sup>

6. Because the DOJ prosecutes cartels criminally, it must be prepared to prove guilt to a jury beyond a reasonable doubt. Criminal cartel investigations are not begun absent a reasonable expectation that they will uncover sufficient evidence of cartel activity. Leads from the leniency program likely satisfy this standard because the DOJ will have cooperating co-conspirator witnesses. Consequently, leads from leniency applications typically are the most promising and are given the highest priority.

7. In practice, the distinction between reactive and proactive cartel enforcement is artificial when proactive steps generate the leads to which the agency then reacts. Creating an effective leniency program and agency outreach efforts are both proactive steps resulting in reactive cartel enforcement. The DOJ does not employ the term “ex officio investigation” but does initiate cartel investigations based on internally generated leads. The DOJ has no obligation to initiate cartel investigations in response to complaints but often does so.

## 2. The Use of Screens by the U.S. Department of Justice

8. The earliest attempt at cartel screening likely was that begun by the DOJ in 1936.<sup>3</sup> President Franklin Roosevelt ordered all federal agencies to send the DOJ any “evidence regarding instances where there has been collusive or identical bidding.” In this event, however, the evidence typically turned out to be “so sketchy as to be worthless.”<sup>4</sup>

9. Cartel screening of a sort was facilitated in the late 1940s by separate federal statutes applicable to military and civilian federal procurement. Both provided: “If, in the opinion of the agency head, bids received after advertising evidence any violation of the antitrust laws, he shall refer such bids to the [DOJ] for appropriate action.”<sup>5</sup> Lacking expertise in antitrust law, agencies referred many identical bids to the DOJ.<sup>6</sup>

10. In 1960 a DOJ investigation culminated in a federal grand jury in Philadelphia charging egregious cartel activity involving heavy electrical equipment, including bid-rigging in sales to the federal government.<sup>7</sup> In reaction, President Kennedy ordered federal procurement officials to report identical bids to the DOJ and ordered DOJ to report on the information received.<sup>8</sup> The DOJ invited state agencies to participate, and many did.<sup>9</sup> “The principal purpose” of the Presidential order was to “make more effective the enforcement of the antitrust laws by insuring that the [DOJ has at its] disposal all information which

<sup>2</sup> See George A. Hay & Daniel Kelly, *An Empirical Survey of Price Fixing Conspiracies*, 17 JOURNAL OF LAW & ECONOMICS 13, 21 (1974).

<sup>3</sup> See TEMPORARY NATIONAL ECONOMIC COMMITTEE, GOVERNMENT PURCHASING—AND ECONOMIC COMMENTARY, MONOGRAPH NO. 19, at 113 (1940).

<sup>4</sup> Robert A. Bicks, *The Federal Government’s Program on Identical Bids*, 5 ANTITRUST BULLETIN 617, 617 (1960) (This article is a speech delivered by Mr. Bicks as Assistant Attorney General, Antitrust Division.).

<sup>5</sup> Armed Services Procurement Act of 1947, § 2(d), Public Law 80-413, 62 Stat. 21 (1948); Federal Property and Administrative Services Act of 1949, § 302(d), Public Law 81-152, 63 Stat. 397 (1949).

<sup>6</sup> See U.S. DEPARTMENT OF JUSTICE, IDENTICAL BIDDING IN PUBLIC PROCUREMENT: REPORT OF THE ATTORNEY GENERAL UNDER EXECUTIVE ORDER 10936, at 3 (1962).

<sup>7</sup> See generally CHARLES A. BANE, THE ELECTRICAL EQUIPMENT CONSPIRACIES (1973).

<sup>8</sup> Executive Order 10936 (Apr. 24, 1961), 26 *Federal Register* 3555.

<sup>9</sup> See IDENTICAL BIDDING, *supra* note 6, at 6.

may tend to establish the presence of a conspiracy in restraint of trade and which may warrant further investigation.”<sup>10</sup>

11. In 1983 the identical bid reporting program was terminated by order of President Reagan, who concluded that the program was “ineffective” and “consume[d] resources that could be employed in a more effective manner to prevent antitrust violations.”<sup>11</sup> The DOJ explained to procurement officials that identical bidding, standing alone, was not “a sufficient indication of possible collusion to warrant formal investigation of all such instances” and that selecting which bids to investigate required “more meaningful data and advice from procurement agencies.”<sup>12</sup> The DOJ explained to Congress that “the program did not materially assist [it] in detecting unlawful price fixing among bidders on procurement programs. . . . We have been unable to document even one case that resulted from a lead generated by the identical bid reporting program.”<sup>13</sup>

12. In 1977 the DOJ initiated the “shared monopoly” program, in which a structural screen was first applied, then industry knowledge was applied to select industries for investigation<sup>14</sup> with an eye toward practices facilitating pricing coordination.<sup>15</sup> The senior DOJ official who initiated the program later explained that it had not made the DOJ “able to develop the kind of sensible collusion case based on an agreement to use facilitating practices that could successfully have been prosecuted under section 1 of the Sherman Act.”<sup>16</sup>

13. Over the years, economists have proposed several ideas to detect collusive behavior from observed price and quantity data. There are two issues with these methods. First, they cannot distinguish between cartel behavior and tacit collusion that leads to prices above “competitive” levels. So even if there were easy screens for what looks like collusive pricing they might still lead to many false positives. Second, obtaining and compiling the data is apt to be difficult and expensive, and the DOJ does not believe that it has the authority to compel production of data solely for screening purposes. For these reasons, it has not been seen as cost effective to employ such screens on a large scale, given limited agency resources.

14. The methods proposed in the literature can be divided into several non-mutually exclusive groups.<sup>17</sup> First are methods that ask whether observed behavior is more consistent with collusion than

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<sup>10</sup> Executive Order 10936.

<sup>11</sup> Executive Order 12430 (July 6, 1983), 48 *Federal Register* 31371.

<sup>12</sup> Letter from William F. Baxter, Assistant Attorney General, Antitrust Division, Oct. 3, 1983. This is true even though identical bids can be an optimal cartel strategy. See Susan Athey, Kyle Bagwell & Chris Sanchirico, *Collusion and Price Rigidity*, 71 *REVIEW OF ECONOMIC STUDIES* 317 (2004); R. Preston McAfee & John McMillan, *Bidding Rings*, 82 *AMERICAN ECONOMIC REVIEW* 579 (1992).

<sup>13</sup> Letter from Robert A. McConnell, Assistant Attorney General, Legislative Affairs to Peter W. Rodino, Jr., Chairman, Committee on the Judiciary, House of Representatives, Jan. 24, 1984.

<sup>14</sup> See Ky P. Ewing, Jr., Deputy Assistant Attorney General, Antitrust Division, Remarks on Shared Monopoly and Concentration, 18th Annual Advanced Antitrust Seminar of the Practising Law Institute, Dec. 1, 1978.

<sup>15</sup> See John H. Shenefield, Assistant Attorney General, Antitrust Division, A Section 1 Approach to Shared Monopoly Prosecution: Facilitating Devices (May 26, 1978).

<sup>16</sup> *Remarks of John H. Shenefield, Former Assistant Attorney General*, 39 *ANTITRUST BULLETIN* 883, 888 (1994) (on the occasion of the 60th anniversary of the creation of the Antitrust Division).

<sup>17</sup> For further discussion see Joseph E. Harrington, Jr., *Detecting Collusion*, in *HANDBOOK OF ANTITRUST ECONOMICS* 213 (Paolo Buccirossi ed., 2008), and references therein.

competition.<sup>18</sup> The basic idea underlying these methods is to use estimates of demand and cost to derive the equilibrium price and quantity predicted by different models, and statistically test which model best fits the data. The second and third groups of models follow a similar theme and ask if the observed behavior is consistent with competition,<sup>19</sup> or if the behavior of the firms suspected of collusion differs from the behavior of competitive firms.<sup>20</sup>

15. All the above methods, while popular in the academic literature, are time- and data-intensive and therefore hard to implement on a large scale. The fourth group of methods focuses on breaks in the time path of bid or price data that could be associated with cartel formation or collapse. These breaks could be in the level of bids or prices, or in the variance of bids or prices.<sup>21</sup> U.S. federal procurement officials are required to report to the DOJ “events that may evidence violations of the antitrust laws” including a “sudden change from competitive bidding to identical bidding” and “[s]imultaneous price increases or follow-the-leader pricing.”<sup>22</sup>

16. Little is known about the rates of false positives and false negatives for any of the methods. As noted, departure from competitive performance does not necessarily imply prosecutable cartel activity, and effective cartels could foil screening tools.<sup>23</sup> For these reasons, DOJ thus far has not found these methods to be a good use of its limited resources.

### 3. Guidance for Procurement Officials

17. In a long series of cases beginning in late 1979, the DOJ prosecuted over 300 corporations and over 300 individuals for bid-rigging in public construction projects, mainly road-building. In 1982, the DOJ and the U.S. Department of Transportation teamed up in an effort to instruct procurement and audit officials on how to deter and detect bid-rigging. The training manual that was produced suggested numerous practices and procedures for identifying possible bid-rigging.<sup>24</sup> The DOJ also began more widely distributing a paper titled *Think Antitrust: The Role of Antitrust Enforcement in Federal*

<sup>18</sup> See, e.g., Robert H. Porter, A Study of Cartel Stability: The Joint Executive Committee, 1880–1886, 14 BELL JOURNAL OF ECONOMICS 301 (1983); Timothy F. Bresnahan, Competition and Collusion in the American Automobile Industry: The 1955 Price War, 35 JOURNAL OF INDUSTRIAL ECONOMICS 457 (1987); Timothy F. Bresnahan, Empirical Studies of Industries with Market Power, in 2 HANDBOOK OF INDUSTRIAL ORGANIZATION 951 (Richard Schmalensee & Robert D. Willig eds., 1989); Aviv Nevo, Measuring Market Power in the Ready-to-Eat Cereal Industry, 69 ECONOMETRICA 307 (2001).

<sup>19</sup> See, e.g., Patrick Bajari & Lixin Ye, Deciding between Competition and Collusion, 85 REVIEW OF ECONOMICS & STATISTICS 971 (2003).

<sup>20</sup> E.g., Robert H. Porter & J. Douglas Zona, Ohio School Milk Markets: An Analysis of Bidding, 30 RAND JOURNAL OF ECONOMICS 263 (1999).

<sup>21</sup> See Rosa M. Abrantes-Metz et al., A Variance Screen for Collusion, 24 INTERNATIONAL JOURNAL OF INDUSTRIAL ORGANIZATION 467 (2006), or Yuliya Bolotova, John M. Connor & Douglas J. Miller, The Impact of Collusion on Price Behavior: Empirical Results from Two Recent Cases, 26 INTERNATIONAL JOURNAL OF INDUSTRIAL ORGANIZATION 1290 (2008).

<sup>22</sup> 48 C.F.R. § 3.303.

<sup>23</sup> A cartel screen based on the distribution of bids was proposed in 1983 along with the warning that bidders “might arrange to have future bids fall outside” the identified criteria. Interdepartmental Bid Rigging Investigations Coordinating Committee, Suggestions for the Detection and Prevention of Construction Contract Bid Rigging (Feb. 1983), available at <http://www.fhwa.dot.gov/programadmin/contracts/dotjbid.cfm>.

<sup>24</sup> Suggestions for Detection, supra note 23.

*Procurement*,<sup>25</sup> which identified many indicators of possible collusion. In 1984, a DOJ official noted that such “instructional programs have proven fruitful, and have led to a number of successful prosecutions.”<sup>26</sup>

18. One example is a case in which two vendors rigged the bids for the sale of nylon filaments to a federal prison, where prisoners used them to make paint brushes. Auditors discussing the matter over lunch became concerned that each bidder had been awarded half the contracts in each year, and they reported their concern to the DOJ. The DOJ investigated and successfully prosecuted the vendors and their executives for bid-rigging.<sup>27</sup> Another example is a case in which ostensibly independent bids were accompanied by letters containing a common typographical error (“Please give us a call *us* if you have any question.”). Federal officials overseeing the contracting had attended training by the DOJ and recognized the significance of the common error. This led to a DOJ investigation and successful prosecutions for bid-rigging.<sup>28</sup> A more recent example is a series of bid-rigging prosecutions involving the sale of real estate. The lead came from an audience member in a presentation made by a DOJ staffer to state officials.<sup>29</sup>

19. Over the past decade, the DOJ has assisted in the training of thousands of federal, state, and local officials responsible for procurement and grant awards.<sup>30</sup> The objective was to make prevention and detection of collusion part of their daily work by instilling a healthy scepticism about those seeking to profit from government contracts. The training has used concrete examples of procurement cartels DOJ had prosecuted. The DOJ website includes a page titled “Training on Collusion and Fraud Awareness” and identifies an electronic mailbox to which requests for training can be sent.<sup>31</sup>

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<sup>25</sup> An updated version is available on the OECD website at <http://www.oecd.org/daf/competition/prosecutionandlawenforcement/2491618.pdf>.

<sup>26</sup> Letter from Robert A. McConnell, *supra* note 13.

<sup>27</sup> *United States v. Jack Spector, Inc.*, Criminal No. 87-200084 (D. Kan., Sept. 11, 1987).

<sup>28</sup> *United States v. Kenneth Koo Lee*, Criminal Case No. 00-00091 (D. Guam, July 14, 2000); *United States v. Young Soo Yoon*, Criminal Case No. 00-00092 (D. Guam, July 14, 2000); *United States v. Primitivo Duque Carlos*, Criminal Case No. 00-00123 (D. Guam, Oct. 24, 2000); *United States v. Il Young Cho*, Criminal Case No. 01-00008 (D. Guam, Jan. 31, 2001); *United States v. Jessie S. Pendon*, Criminal Case No. 01-00071 (D. Guam, July 25, 2001). A local government official was convicted of multiple offenses, including bribery, and was sentenced to a prison term of 100 months. *United States v. Austin J. “Sonny” Shelton*, Criminal Case No. 01-00007 (D. Guam, Jan. 31, 2001).

<sup>29</sup> *United States v. Isadore H. May*, Criminal No. 11-562-1 (D.N.J., Aug. 24, 2011); *United States v. William A. Collins*, Criminal No. 11-563-1 (D.N.J., Aug. 24, 2011); *United States v. Richard J. Pisciotta, Jr.*, Criminal No. 12-561 (D.N.J., Aug. 24, 2011); *United States v. David M. Farber*, Criminal No. 12-139-1 (D. N.J., Feb. 23, 2012); *United States v. Robert W. Stein*, Criminal No. 12-140-1 (D.N.J., Feb. 23, 2012); *United States v. Robert E. Rothmann*, Criminal No. 12-210-1 (D. N.J., Mar. 27, 2012); *United States v. David Butler*, Criminal No. 12-273-1 (D.N.J., Apr. 23, 2012); *United States v. Stephen E. Hraby*, Criminal No. 12-263-1 (D.N.J., Apr. 17, 2012); *United States v. DSBDB, LLC*, Criminal No. 12-274-1 (D.N.J., Apr. 23, 2012); *United States v. Crusader Servicing Corp.*, Criminal No. 12-644 (D.N.J., Dec. 19, 2012); *United States v. Mercer S.M.E., Inc.*, Criminal No. 12-832-1 (D.N.J., Dec. 19, 2012); *United States v. Norman T. Remick*, Criminal No. 13-252 (D.N.J., Apr. 25, 2013).

<sup>30</sup> Most of this training was part of an initiative to protect stimulus funds provided under the American Recovery and Reinvestment Act of 2009. For details, see Statement of Scott D. Hammond before the Committee on Homeland Security and Governmental Affairs of the U.S. Senate (Sept. 10, 2009), available at <http://www.justice.gov/atr/public/testimony/250274.pdf>.

<sup>31</sup> The link is <http://www.justice.gov/atr/public/criminal/recovery-training.html>.

20. The DOJ also teaches procurement officials the Red Flags of Collusion—warning signs grouped into categories with the acronym MAPS.<sup>32</sup> The M is Market; trainees are taught to consider the structure of the market and its susceptibility to collusion. The A is Applications; trainees are taught to look for suspicious similarities in bids or proposals, such as common typos. The P is Patterns; trainees are taught to look for suspicious patterns in bidding and awards. They should consider both whether awards are oddly unchanging over time and whether they change in a predictable manner. And the S is Suspicious Behavior; trainees are taught to examine what vendors say and do for signs that they may have colluded.

21. U.S. law provides that: “If the head of [a federal] agency [engaged in procurement] considers that a bid or proposal evidences a violation of the antitrust laws, he shall refer the bid or proposal to the [DOJ] for appropriate action.”<sup>33</sup> The implementing regulation<sup>34</sup> states that “[a]ny agreement or mutual understanding among competing firms that restrains the natural operation of market forces is suspect” and “identifies behavior . . . sufficiently questionable to warrant notifying” the DOJ. Questionable behavior includes: market conditions, e.g., “an industry price list or price agreement to which contractors refer in formulating their offers;” application attributes, e.g., “the appearance of identical calculation or spelling errors in two or more competitive offers or the submission by one firm of offers for other firms;” bidding patterns, e.g., “[r]otation of bids or proposals, so that each competitor takes a turn in sequence as low bidder, or so that certain competitors bid low only on some sizes of contracts and high on other sizes;” and suspicious behavior, e.g., “[a]ssertions by the employees, former employees, or competitors of offerors, that an agreement to restrain trade exists.”

#### 4. Conclusion

22. As this submission explains, DOJ has employed several methods for cartel screening and found that those methods did not produce solid leads for cartel investigations. At this time, the DOJ has no plans to redeploy investigative resources into screening for indications of cartel activity. The DOJ has had continuing success with the many other means for generating investigative leads. The DOJ, however, is interested in the experience of other jurisdictions.

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<sup>32</sup> The two-page card provided to trainees is attached as an appendix. The content of the card is available at <http://www.justice.gov/atr/public/criminal/red-flags-collusion.html>.

<sup>33</sup> 10 U.S.C. § 2305(b)(9); 41 U.S.C.A. § 3707.

<sup>34</sup> 48 C.F.R. § 3.303.