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Virgin Atlantic and British Airways

At 9AM on August 23, 2007, Maria DaCunha, British Airways' head of legal affairs, took the stand at E Barrett Prettyman Courthouse in Washington. It was an unusually short hearing. Judge John Bates asked whether she understood the charges of price-fixing that British Airways was accused of (together with Virgin Atlantic); whether she was aware that price-fixing was a felony in the US; and whether BA had the money to pay the fine imposed by the court. DaCunha answered yes to all questions. Minutes later, she stepped down and the hearing was over.

British Airways had earlier agreed a plea bargain with the US Department of Justice (DOJ) which included a fine of $300m for taking part in two separate price-fixing deals related to fuel surcharges, one for airline passengers and one for cargo transportation.[1]

BA's nightmare had started three years earlier with an anonymous phone call.

The companies

Although British Airways began its operations in 1924, the modern era of BA dates back to 1980, when Prime Minister Margaret Thatcher appointed Sir John King (later Lord King) as the company's new chairman, giving him the mandate of preparing the company for privatization. King initiated a massive cost reduction campaign: unprofitable routes were discontinued and thousands of employees were laid off (in three years the work force was reduced from 60,000 to 38,000). BA's privatization finally took place in 1987.

Founded by Richard Branson, Virgin Atlantic (formally Virgin Atlantic Airways) began operations on June 22, 1984. It flew a leased Boeing 747-200 (formerly operated by Aerolineas Argentinas) from Gatwick to Newark. The airline became profitable during its first year. Over the next decades, Virgin added new routes and new aircraft; by 2006 it was carrying more than 4 million passengers a year. In March 2000 49% of Virgin Atlantic was sold to Singapore Airlines for £600.25 million.

The early history of Virgin Atlantic is one of intense rivalry with British Airways. BA tried all it could to keep the government from granting VA permission to fly from Heathrow. Allegedly, BA's CEO John King told his PR staff to "do something about Branson," thus triggering the so-called "dirty tricks" campaign of the early 1990s. One major opportunity for BA came in 1991, when Virgin Atlantic made a highly publicized mercy mission to Iraq to fly home Saddam Hussein's hostages. David Burnside, BA's PR director, published a story in BA's magazine arguing that Branson's mission was just another of his publicity stunts. Branson sued for libel and the case went to trial in 1993. Sensing defeat, BA settled by paying Virgin's legal fees, £500,000 to Richard Branson, and £110,000 to VA. (Branson divided the £610,000 among Virgin's employees, in what came to be known as the "BA bonus."[2])

In 1997, when BA proposed to merge with American Airlines, Virgin engaged in an

intense campaign to thwart its rival's plans — to the extreme of painting VA's aircraft with the clear message "BA/AA No Way." (The merger fell through when it failed to clear US review.) In 1999, when British Airways' announced it was removing the union flag from its tailfins (an unfortunate marketing move), Virgin painted a union flag design on its aircraft winglets (a fortunate marketing move).[3]

The relations between BA and Virgin improved when Rod Eddington became BA's chief executive in 2000. Shortly after taking over BA, Eddington paid a peace-making visit to Virgin's headquarters. In November 2004 the two airlines came to an agreement over a precious set of Heathrow runway slots for which VA had the rights but not the aircraft to make use of.[4]

The story

The first week of August 2004 was not kind to British Airways. The airline mislaid the bags of about 1,000 passengers traveling from Scotland to London, a story that tabloids did not miss. Suffering from rising fuel prices, BA was forced into another difficult consumer-relations move: a price increase, specifically, an increase of its "fuel surcharge" from £2.50 to £6.

Fuel surcharges, the extra tariff placed on tickets to compensate for high oil prices, had been introduced by BA and VA three months earlier. Now BA wanted to sound VA on the price increase. A call was made to Virgin on Friday, August 6, 2004. This would be the first of a series of contacts over the next 18 months between BA and VA regarding fuel surcharges. Of the six phone calls, three were initiated by BA, three by VA.

Although the details of the August 6 call are not known, the fact is that on the next Monday VA increased its surcharge by the same amount as BA.[1] Fuel surcharges would continue increasing in tandem from £5 to £60 ($10 to $110) per ticket as the two firms exchanged information between August 2004 and January 2006.[5]

In 2006, the European Commission and the US Department of Justice began investigating a claim of collusion among a group of international airlines regarding fuel surcharges to cargo clients. Exhibit 1 lists chronologically the main events in this investigation. It took off after Lufthansa decided to turn whistleblower and benefit from the European and American leniency programs. These programs, enacted during the 1990s, promise special treatment to price-fixing violators who approach anti-cartel authorities — if they are the first to do so. (See the section below for details on these programs.)

Virgin lawyers learned about the VA-BA secret contacts (while looking into the international cargo cartel) and read the writing on the wall: sooner or later, the investigation might lead into passenger fuel charges. After an anonymous phone call established that VA would gain immunity under the UK leniency program, Virgin provided UK's Office of Fair Trade (OFT) with large amounts of information, including phone records and interviews with staff members.[6] BA was beaten to the clock.

> They [BA] didn't find out about the passenger case — that was their mistake. If you are not first through the door, the next best thing is to be second and come forward with another cartel: Virgin did.[1]

The OFT and the DOJ began independent but parallel investigations into the BA-VA agreement. On February 14, 2007 the FBI raided BA's offices.[1]

From the start, BA decided to cooperate with the British and American authorities, admitting that it had colluded with Virgin. BA could have been fined up to 10% of its worldwide sales (£8.5bn in 2007). In the end, BA was fined $300m by the DOJ and £121.5m by the OFT (the highest fine ever on a price-fixing case).[7] Under the leniency program, Virgin received no fines.

Price fixing: the law

At the time of the OFT-DOJ investigations, BA's CEO Willie Walsh issued a statement that fuel surcharges "are a legitimate way of recovering costs and when set independently do not breach competition law."[1] The stress should be on "when set independently." Anytime a company communicates its pricing plans to a rival, or commonly agrees with a rival on what prices to set, it violates the law. In the US, price fixing violates the Sherman Act, the oldest law on this matter. In the EU, it violates Article 81 of the EU Treaty.

Other jurisdictions have enacted related laws. In fact, to the extent that a firm operates in several countries, it may be liable to several antitrust authorities (as was the case with BA and VA). Moreover, in some jurisdictions price-fixing is not simply illegal: in the US and in the UK (but not in the EU) it is also subject to criminal charges. Thus BA's troubles did not end with the payment of the fines imposed by the OFT and DOJ.

Scott Hammond, US deputy assistant attorney general for anti-trust at the time of the BA-VA investigation, had made it a personal crusade to bring to justice in the US those involved in foreign cartels and related white-collar crime. Before the BA-VA case, he had already extradited three British bankers for their suspected role in the collapse of Enron.[1]

As the global fuel surcharges case evolved, the heads started to roll. Bruce McCaffrey, a former executive of Qantas Airways pleaded guilty and was sentenced to serve six months in prison. Later Timothy Pfeil of Scandinavian Airlines and Keith Packer of British Airways also agreed to plead guilty.[8]

Leniency programs around the world

Although the original leniency program was instituted in the US, today many jurisdictions around the world have implemented their own programs, including the EC, the UK and Japan.

□ **The US program.** The Department of Justice was the first antitrust authority to introduce a leniency program, in 1978. The original program was greatly revised in 1993. In particular, the new program extends the possibility of leniency to firms who report cartel activity after an investigation into the cartel has started. Moreover, since 1993 amnesty is automatic rather than discretionary (amnesty is still discretionary if the report is received after an investigation has gotten under way).[9] In other words, the new regime decreases the level of legal uncertainty. Judging by its results, the 1993 revision was extremely fruitful: until then, the Department of Justice received an average of one report per year; since then, the rate increased to two per month.[10]

□ **The European Commission (EC) program.** The first European leniency program was introduced by the European Commission (EC) in 1996. Broadly speaking, it followed the

lines of the US program. However, it was criticized by being too uncertain, both in terms of levels of fines and in terms of the likelihood of an amnesty. With the benefit of a decade of experience, the Commission adopted a revised program in December 2006. The new regime attempts to enhance transparency and certainty of the conditions under which a reduction in fines will be granted; and increase efficiency in terms of detecting, destabilizing and terminating cartels. In particular, the Commission now commits itself to guaranteeing immunity from fines if the appropriate conditions apply.[11] In this sense, the EC reform parallels that of the US in 1993. Moreover, the new regime also allows for partial amnesty once an investigation is in place (again, in parallel to the US system).

The empirical evidence suggests that, just as in the US, the European system has improved the effectiveness of cartel discovery and punishment. Comparing the period 1990–1995 to the period 1996–2003 (pre and post-leniency program), total fines increased from €168 million to €839 per year. Reductions in fines increased from essentially zero to €326 million. While this is a large number, the net value is still a considerable increase with respect to pre-leniency years. Another area of improvement is the average length of an investigation, which decreased from 7.41 to 5.96 years.[12] See Exhibit 2 for a list of leniency cases since 1998.

□ **International comparison.** Following the US initiative, several countries have created their own leniency programs. For example, in January 2006, the Japanese Antimonopoly Act went into effect, introducing a corporate leniency program similar to those in the US and Europe.[1] Different programs provide different incentives for reporting illegal price fixing behavior. An important distinction is between the incentive to be the first to report and the incentive to report before an investigation has started. Exhibit 3 compares some of the features of the US, European, and Japanese leniency programs. Note that, in the US, only one firm can receive a reduction of fines under the leniency program. However, by means of plea bargaining, other firms can received a reduction in fines in exchange for a guilty plea.[1]

The UK leniency program, established by the Office of Fair Trade (OFT) in 1998, has one important similarity to the US program: it offers immunity from criminal charges. While price fixing is illegal in essentially all industries and countries around the world, the relevant antitrust authorities typically only have the power to impose monetary penalties on the guilty violators. In the US, Canada and (since recently) in the UK and Ireland, violators are also liable to criminal charges.[13] This adds an additional element of attractiveness to the leniency programs.

Is it fair?

Robert Peston, BBC business editor, echoes the views of many when he argues that leniency programs make for "rough justice." Referring to the VA-BA case, he explains that "Virgin was a willing participant in this shameful attempt to rig the market," and still only BA was punished.[1]

But Simon Williams, director of cartel investigations at the OFT, responds that

> I make no apologies about this outcome. Leniency is a very important enforcement tool. The stark fact is this policy works because it unearths cartels that would not otherwise see the light of day.[1]

Nor are the costs concentrated on the the party that is snitched on. While Virgin did not need to pay any fine, its image (and that of its CEO, Sir Richard Branson) is bound to have been stained in the process: Virgin can no longer claim the role of David battling the industry Golliahs and walking the high road of corporate morality. Not that Virgin did not attempt to defended its position:

> The law contains the mechanism that encourages you to report things to the authorities. If the mechanism was not there, what would be the incentive for companies? We did the right thing.[1]

As often is the case, the *Economist* summarizes the pragmatic view that the economics profession takes to this sort of issues:

> It grates to see one firm get away with something while another is punished, but leniency policies are, probably, a good thing. The ability to claim immunity gives a powerful incentive for businesses to police their own industries, which ought to improve things for consumers. After all, half a victory is better than none.[1]

From amnesty to reward

On February 29, 2008, the United Kingdom's Office of Fair Trade (OFT) announced a new policy under which it will pay financial incentives of up to £ 100,000 in return for information that helps identify illegal cartels. The UK's OFT pilot experiment, which was to run for 18 months, followed the pioneer initiative of South Korea's Fair Trade Commission. Simon Williams, OFT Senior Director of Cartels and Criminal Enforcement, said:

> Cartels are very damaging both to businesses and consumers and they are usually conducted in secret making them hard to detect. Cartels are ... bad for taxpayers, consumers and other businesses. We believe that it is in the public interest to offer financial incentives in the hope that it will encourage more people who have good information about the existence of hard core cartel activity to come forward.[14]

Endnotes

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7. "Q&A: BA price-fixing investigation," BBC News Channel, 1 August 2007.
8. "Ex-executive of British Airways to serve 8-month prison sentence, pay fine for cargo price-fixing," DWS Aviation, October 1, 2008.
9. Massimo Motta, *Competition Policy: Theory and Practice*, Cambridge University Press, 2004.
10. George Spratling, "Making Companies an Offer They Shouldn't Refuse," presented at the Bar Association of the District of Columbia, February 16, 1999.
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12. Steffen Brenner, "An Empirical Study of the European Corporate Leniency Program," forthcoming in *International Journal of Industrial Organization.*
13. Joseph Harrington, "Corporate Leniency Programs and the Role of the Antitrust Authority in Detecting Collusion," Competition Policy Research Center Discussion Paper, CPDP-18-E, January 2006.
14. http://www.oft.gov.uk

Exhibit 1
Chronology of main events

Date		Event
2006	February	EC and US launch investigation into cargo price-fixing raid. Airline offices raided.
		Lufthansa granted conditional immunity for early confession and co-operation in cargo probe
		Virgin Atlantic granted similar immunity in passenger fare probe
	March	Shippers and others file class actions against airlines over cargo charges
2007	August	BA and Korean plead guilty in UK and US in cargo cases BA settlement also covers passengers
	November	Qantas pleads guilty in US cargo case
	December	EU files preliminary cargo claims against at least 15 airlines
2008	April	JAL pleads guilty in US cargo case
	May	Singapore Airlines and Emirates sue to block offshore probe by Australia
		Qantas official sentenced by US to eight months in jail
	June	Air France-KLM, Cathay Pacific, Martinair, and SAS Cargo plead guilty in US cargo case
	July	Airlines sue to block offshore probe by New Zealand
	August	UK charges four BA executives over passenger surcharges
	October	Qantas and BA plead guilty in Australian cargo case, fined $20A million and $5A million respectively
		Qantas is the latest carrier to settle cargo price-fixing claims

Exhibit 2
European Commission leniency notice cases by year of decision.[15]

Year	Decision	Reduction of fine and number of companies
1998	Stainless Steel	40%: 2 companies; 10%: 4 companies
1998	British Sugar	50%: 1, 10%: 3
1998	Preinsulated Pipes	30%: 5, 0%: 3
1998	Greek Ferries	45%: 1, 20%: 6
1999	Seamless Steel Tubes	40%: 1, 20%: 1
2000	Lysine	50%: 2, 30%: 2, 10%: 1
2001	Graphite Electrodes	70%: 1, 40%: 1, 30%: 1, 20%: 2, 10%: 3
2001	Sodium Gluconate	80%: 1, 40%: 2, 20%: 3
2001	Vitamins	100%: 1, 50%: 2, 35%: 3, 30%: 1, 15%: 1, 10%: 1
2001	Brasseries Luxembourg	100%: 1, 20%: 3
2001	Brasseries Belges	50%: 1, 30%: 1, 10%: 4
2001	Citric Acid	90%: 1, 50%: 1, 40%: 1, 30%: 1, 20%: 1
2001	Zinc Phosphate	50%: 1, 40%: 1, 10, %: 4
2001	Carbonless Paper	100%: 1, 50%: 1, 35%: 1, 20%: 1, 10%: 3
2002	Methionine	100%: 1, 50%: 1, 25%: 1
2002	Industrial & Medical Gases	25%: 2, 15%: 2, 10 %: 2
2002	Fine Art Auction Houses	100%: 1, 40%: 1
2002	Plasterboard	40%: 1, 30%: 1
2002	Methylglucamine	100%: 1, 40%: 2
2002	Food Flavour Enhancers	100%: 1, 50%: 1, 40%: 1, 30%: 1
2002	Rond à Beton	20%: 1
2002	Speciality Graphite	100%: 1, 35%: 6, 19 %: 1
2003	Sorbates	100%: 1, 50%: 1, 40%: 1, 30%: 1, 25%: 1
2003	Carbon & Graphite Products	100%: 1, 40%: 1, 30%: 2, 20%: 1
2003	Organic Peroxides	100%: 1, 5 0%: 1, 25%: 1, 15%: 1
2003	Industrial Copper Tubes	50%: 1, 30%: 1, 20 %: 1
2004	Copper Plumbing Tubes	100%: 1, 50%: 1, 35%: 2, 15%: 1, 10%: 2
2004	Spanish Raw Tobacco	40%: 1, 25%: 2, 20%: 1, 10%: 1
2004	Needles etc	100%: 1
2004	Choline Chloride	30%: 2, 20%: 1
2005	Monochloroacetic Acid	100%: 1, 40%: 1, 25%: 1
2005	Industrial Thread	Some reductions
2005	Italian Raw Tobacco	50%: 1, 30%: 1
2005	Plastic Industrial Bags	30%: 1, 25%: 2, 10%: 2
2005	Rubber Chemicals	100%: 1, 50%: 1, 20%: 1, 10%: 1
2006	Bleaching Chemicals	100%: 1, 40%: 1, 30%: 1, 10%: 1
2006	Acrylic Glass	100%: 1, 40%: 1, 30%: 1

Exhibit 3
Fraction of government fines waived by corporate leniency programs.[1]

Order	US	Europe	Japan
Before investigation has started			
First	100	100	100
Second	0	30–50	50
Third	0	20–30	30
Fourth	0	$\leq$20	0
After investigation has started			
First	100	30–100	30
Second	0	20–30	30
Third	0	$\leq$20	30
Fourth	0	$\leq$20	0