OFT: Consultation on Leniency and Penalties

Consultation response from the ESRC Centre for Competition Policy

University of East Anglia, Norwich Research Park, Norwich NR4 7TJ

Contributing authors:

- Anna Rita Bennato
- Morten Hviid
- Bruce Lyons
- Peter Ormosi
- Sebastian Peyer
- Andreas Stephan
- Scott Summers
- Frederick Wandschneider

This consultation response has been drafted collectively by the abovementioned academic members of the Centre, who retain responsibility for its contents. The document has been edited by Andreas Stephan following discussions held in the Centre and it has the broad agreement of the group of contributors.

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1. Introduction

The OFT's revised guidance notices for Leniency and Penalties clarify how firms will be treated, where an infringement decision is made with a view to imposing corporate fines. This is to be welcomed as a positive step in improving transparency and efficacy in competition law enforcement. Rather than discussing every aspect of the revised guidance, this submission to the consultation process seeks to identify key issues which remain unresolved in relation to Leniency and Penalties.

2. The Treatment of Ringleaders

The OFT has decided not to propose widening the test of 'coercer' as a category of applicants that should be ineligible for immunity. They explain that, "although it can in some circumstances be uncomfortable to give immunity to large firms that have initiated cartel activity, whilst leaving smaller firms open to penalties, the OFT is not persuaded that a change to the test would be justified, noting that the coercer test allows for greater clarity and certainty for applicants, greater detection (and hence termination and destabilisation) of cartels and benefits from alignment with other regimes internationally." (OFT803 at 6.3).

In the past, the European Courts of Justice have heard cases where leniency applicants have submitted exaggerated or misleading evidence in relation to their cartel partners.[1] This would suggest there is a danger of firms enticing competitors into anti-competitive agreements, only then to seek immunity so as to put the other firms at a disadvantage. Yet the role of ringleaders within cartels is diverse. We may typically consider the ringleader to be the largest firm party to the collusive agreement, acting as the main 'administrator' of the cartel. There are also cases where there is more than one ringleader over the duration of a cartel. Indeed, it is

[1] A Stephan, 'The Direct Settlement of EC Cartel Cases' (2009) ICLQ vol 58, pp627-654, p 649

unclear whether one firm can generally be said to have instigated an infringement; the inception of collusive practices is often more complicated than that.

A recent CCP working paper finds that excluding the ringleader from immunity can create adverse effects, especially where it is the largest firm party to the cartel which is taken out of the race to the authority.[2] Widening the test of 'coercer' would require some kind of but-for test, seeking to determine whether the cartel would have formed without the firm in question. Such a test is likely to reduce the predictability of leniency and may determine multiple 'coercers' in some cases. If it is not possible to clarify exactly when a 'coercer' will be excluded from immunity, then one must question the practical value of retaining the present test at all. Perhaps there could be a retained role where there is clear evidence that the cartel was instigated with the main purpose of harming rivals – but this would be difficult to prove. Finally, it is worth noting that if the ringleader intends to harm their competitors, this will lead to distrust between cartel members and will therefore have a destabilising effect on future infringements.

3. No-action Letters and Immunity from the European Commission

The OFT proposes that, where a firm gains immunity from the European Commission but is beaten to immunity in the UK, a no-action letter will also be issued in relation to the employees of that firm. On the one hand, this proposal bridges a crucial gap between UK and EU cartel enforcement, which could potentially dissuade employees located in the UK from reporting cartel infringements. On the other hand, this doubles the level of protection on offer from criminal prosecution. Cartel members may take advantage of this by striking deals; one agreeing to apply to the OFT, the other to the Commission. Presumably, the promise of a second no-action letter will apply regardless of whether the case is taken up at the EU or UK level. The move could also create public relations problems similar those experienced during the failed BA trial.[3] Where three firms are involved, only a *minority* of cartelists will be convicted, while the majority carry on working in the industry. It would be more straightforward to improve coordination between the two authorities so as to ensure that a firm receiving immunity from one cannot be beaten to immunity from the other. In any case, the model ECN leniency notice should make this possibility unlikely and the

[2] I Bos and F Wandschneider, 'Cartel Ringleaders and the Corporate Leniency Program' CCP Working Paper 11-13. Available: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1910000
[3] See for example: A Stephan, 'How Dishonesty Killed the Cartel Offence' [2011] Crim LR 446-455

ECN should eventually adopt a one-stop-shop system. In the meantime, a requirement to notify both authorities within one working day would seem sensible.

4. Using a Measure Other than Turnover when calculating the Starting Point

The OFT has indicated that, in exceptional circumstances, a measure other than turnover may be used. This might include cases concerning industries such as construction recruitment, where recruitment fees may be more appropriate than turnover. However, we urge a note of caution because the type of product for which turnover may be deemed inappropriate is likely to be one characterised by 'derived demand'. Ever since the analysis by Alfred Marshall in 1890, it has been appreciated that demand for an essential input that accounts for a small fraction of the price of a final product is highly inelastic. This suggests that a cartel of such inputs has a disproportionate ability to raise price (through quantity distortions may be small). This will be mitigated inasmuch as the threat of entry limits the cartel's price rise, but acknowledgement of this possibility should be included in the guidelines so an appropriate adjustment can be made in such cases.

The OFT should clarify which cases are likely to fall under these 'exceptional circumstances'. For example, they offer the *CRF* case as an example because turnover is a poor proxy for harm (OFT 423 at 1.09). Yet the same is arguably true of the cover pricing cases, such as *Kier*, where talk about duration is not really meaningful and where the value of the contract in question might have provided a much more reliable starting point.

5. Financial Hardship Assessment as a Mitigating Factor

An assessment of ability to pay or financial hardship clearly involves sensitive corporate information which cannot be disclosed in an OFT decision. However, a total lack of transparency in the way this mitigating factor is applied raises two concerns[4]: First, firms will have a number of years in which to prepare themselves for the imposition of corporate fines. They may use this time to structure their finances in such a way as to make a more convincing case for financial hardship; Second, the lack of transparency could affect the legitimacy of enforcement. Firms not benefiting from financial hardship discounts may feel the OFT are picking favourites or having the wool pulled over their eyes by less scrupulous firms. It is difficult to ensure the

[4] Discussed in detail in: A Stephan, 'The Bankruptcy Wildcard in Cartel Cases' (August 2006) JBL pp. 511-544

first concern is overcome without meaningful external scrutiny of this element of an OFT decision. The competition authority could ignore financial hardship altogether and leave any assistance to state aid. Alternatively, it could propose a discount and this could be assessed under state aid rules. Any reduction in fines on the grounds of hardship could also be balanced by the use of a competition disqualification order. Indeed, it would be interesting to see whether such a policy would significantly reduce firms' propensity to argue financial constraints. The second concern, on the other hand, may be dealt with by setting out the process of assessing financial hardship, by identifying 'danger factors' which trigger a discount, and by setting out what the size of the discount is proportionate to.

6. Recidivism and the Relationship between Parent and Subsidiary Companies.

The OFT proposes increasing penalties by up to 100 per cent for each prior same or similar infringement by an undertaking, where the OFT or another European competition authority has found an infringement of competition law in the preceding 15 years (OFT 423 at 5.40). Connor (2009)[5] and Werden (2011)[6] paint very different pictures of how widespread recidivism is, in relation to US cases. Connor uses the word to refer to firms that are "convicted a second time for cartel conduct, no matter where or when the earlier violation took place." Werden on the other hand use the more restrictive definition of having been sanctioned previously for the same offence. The OFT therefore needs to be careful about how it defines recidivism. To be consistent with the Commission's approach, contemporaneous infringements should not be treated as instances of recidivism. That is to say, fines should not be increased where there is no clear break between the infringements, in which the firm had the opportunity to 'put its ship in order'.

Careful thought should also be given to the relationship between parent and subsidiary companies. The General Court's decision to annul a €36.6m fine on *Grolsch*, earlier this year, could lead to fundamental rethinking of when parents and subsidiaries are treated as a single undertaking for the purposes of calculating fines.[7] In relation to recidivism, separate infringements may occur within entirely different

[5] JM Connor, 'Recidivism Revealed: Private International Cartels 1990-2009' (2009), *Competition Policy International*, 6(2).
[6] GJ Werden, *et al*. 'Recidivism Eliminated: Cartel Enforcement in the United States since 1999' SSRN: http://ssrn.com/abstract=1927864
[7] See: 'Grolsch Cartel Fine Annulment: Should Parent Companies Pay for the Anti-Competitive Conduct of a Subsidiary?' (18 Sept 2011) Competition Policy Blog http://competitionpolicy.wordpress.com/2011/09/18/grolsch-cartel-fine-annulment-should-parent-companies-pay-for-the-anti-competitive-conduct-of-a-subsidiary/

divisions, managerial levels or subsidiaries of the same corporation. Given that many infringements will have been caused by a small number of determined individuals, it may be unfair to significantly increase the penalty on the grounds of recidivism in these circumstances. The OFT should also clarify whether the previous conduct of a firm acquired by a competitor could invoke an increase for recidivism in relation to the newly formed undertaking. It would seem unfair if this was the case.

7. Starting Point and 'Specific' Deterrence

The OFT proposes an increase in the maximum starting amount from 10 to 30 percent of relevant turnover, in order to improve the deterrent effect of enforcement and bring UK fining policy in line with the Commission and a number of other Member States. This welcomed alignment should also give the OFT greater flexibility in setting an appropriate starting point for conduct at the fringes of object agreements under Article 101 TFEU / Ch 1 CA98 – such as cover pricing.

However, references to deterrence in the proposed guidance still suggest that the decision to form a cartel is made at an institutional level, and that those responsible are able to undertake some form of cost-benefit analysis as to the likely profits, fines and probability of detection. It is becoming increasingly accepted that this economic paradigm of deterrence, whilst useful in theoretical studies, has little practical application. Many infringements are instigated by a small number of individuals, acting outside the firm's decision making processes, many of whom will have left the firm by the time corporate fines are imposed. This is why a mixed approach to cartel enforcement – in which criminal sanctions and competition disqualification orders are applied alongside corporate fines – is so important to achieving deterrence.

In reality, firms are unable to accurately predict the likely fine – even with the help of an experienced competition lawyer. Moreover, the 'cost' of the cartel will also include factors which are equally hard to estimate, such as legal costs, the cost of damages and any loss of reputation. Their perceptions about probability of detection may largely be determined by media coverage and other information dissemination of previous OFT decisions. This perception will be higher where the OFT or EC have previously fined an industry the firm operates in, or is somehow connected to. Firms may actually be entirely unmoved by any increase in the level of fines. This is because even if they were set at the 10 per cent turnover cap (in reality they are closer to 1 per cent), they would still fail to exceed the illegal profits potentially earned

by the cartels.[8] Preliminary results from a CCP study by Ormosi and Davies, suggest that the introduction of leniency in EU cartel policy had a significantly greater deterrent effect than the sizeable increase in the level of fines.[9]

8. The Importance of Recognising and Encouraging Compliance

The OFT's clarification of compliance as a mitigating factor, along with the publication of valuable compliance materials for businesses earlier in the year, demonstrate a pro-business approach to enforcement. Compliance programmes can help firms prevent infringements or detect them early, thus averting harm. It is therefore counterproductive to treat meaningful compliance as an aggravating factor or to have a purely ex post approach to enforcement, similar to that of the European Commission and US Department of Justice.

[8] See for example: E Combe & C Monnier, 'Fines Against Hard Core Cartels in Europe: The Myth of Over Enforcement' (2009) *Cahiers de Recherche PRISM-Sorbonne Working Paper* SSRN: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1431644

[9] Work in progress. Preliminary results presented at CCP Research Seminar, 11 November 2011.