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**LATIN AMERICAN COMPETITION FORUM**

**Session I: Criteria for Setting Fines for Competition Law Infringements**

**Contribution from Peru**

**3-4 September 2013, Lima, Peru**

*The attached document from Peru is circulated to the Latin American Competition Forum FOR DISCUSSION under Session I at its forthcoming meeting to be held on 3-4 September 2013 in Peru.*

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English - Or. English



## LATIN AMERICAN COMPETITION FORUM

-- 3-4 September 2013, Lima (Peru) --

### Session I: Criteria for Setting Fines for Competition Law Infringements

#### CONTRIBUTION FROM PERU

1. In Peru, Indecopi<sup>1</sup> has acquired significant experience in both the development of appropriate criteria to identify and prove the commissioning of collusive practices and abuses of dominant position (*substantive analysis*), and in the definition of penalties and corrective measures. Together with a legal amendment aimed at improving the deterrent capability of the competition agency, in recent years more objective criteria have been developed for imposing fines and there has been an increase in the level of fines imposed. Moreover, Indecopi has proposed a methodology for determining fines that is currently being debated, and which could have an impact on future decisions made by the authority.

2. Since its inception, Indecopi was granted the power to impose fines on economic operators as an important tool for deterring unlawful conduct that threatens free and fair competition,<sup>2</sup> consumer rights and intellectual property. This is the outcome of recognition that prevention and control activities alone are not sufficient or effective if fines are not properly calculated and actually imposed when offenses are detected and verified by the authorities.

3. With regard to penalizing anti-competitive behaviour, the first article of Legislative Decree 1034, Law on Suppression of Anticompetitive Conduct is instructive, as it reflects the importance of sanctions to ensure the effectiveness of national competition policy:

*Article 1. - The purpose of this Law - This Law prohibits and penalizes anticompetitive conduct in order to promote economic efficiency in markets for the benefit of consumers.*

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<sup>1</sup> Acronym for the National Institute for the Defence of Competition and Protection of Intellectual Property (Instituto Nacional de Defensa de la Competencia y de la Protección de la Propiedad Intelectual), Peru's competition agency.

<sup>2</sup> **Legislative Decree 1033, Indecopi Organization and Functions Law. Article 2.- Functions of INDECOPI.-** 2. INDECOPI is the autonomous body responsible for: b) Protecting free and fair competition, sanctioning anticompetitive and unfair behaviour and ensuring that there is effective competition in markets.

4. Faced with the commission of an anticompetitive act, the bodies responsible in the first and second instance for the implementation of Legislative Decree 1034—the Commission for the Defence of Free Competition (hereinafter, “the Commission”) and the Special Tribunal for the Defence of Free Competition (hereinafter, “the Tribunal”)—can take two types of measures: a) fines b) corrective measures. While the former are intended to deter future infringements (deterrent purpose), the latter are aimed at restoring the competitive process (compensatory purpose).

5. The fines that the Commission may impose—and that the Tribunal may confirm, reduce or dismiss—follow from its demonstration of anticompetitive conduct in the disciplinary proceedings initiated for this purpose. In this sense, both abuse of dominant position and horizontal and vertical collusive practices are liable to sanction.

6. The procedure for calculating fines for violations of competition laws, like that of other jurisdictions that are members of the OECD, broadly corresponds to the following sequence: 1) establish a base fine; 2) apply criteria for graduation; 3) apply the statutory cap where appropriate; and 4) reduce the fine as the result of a penalty waiver request (leniency program).

7. To define the base fine, the expected profit resulting from the commission of the offense is determined. The usual procedure is to calculate the extra profit derived from the behaviour and to apply a factor that reflects the probability of detection. The extra profit calculation is usually performed using the differences between the price resulting (or expected) from the behaviour and the competitive price.<sup>3</sup> For the calculation, a period is defined during which the investigated behaviour was, or could have been, carried out effectively.<sup>4</sup>

8. The application of criteria for graduation derives from the provisions of Article 44 of Legislative Decree 1034,<sup>5</sup> which include repeat offenses and the level of damage caused (based on the length of time and the damage to competitors or consumers), in addition to the conduct of offenders during the investigation. This analysis provides the basis for rating the severity of the offense (as mild, severe or very severe) and increase (or where applicable decrease) the amount of the base fine previously calculated.

9. Once the base fine has been determined and the criteria for graduation applied, legal caps (thresholds) will be used to establish the final fine. These caps are designed to prevent confiscatory fines and to ensure they do not lead to an undue loss of market operators. The caps simultaneously reflect two circumstances: a number of tax units (TUs) and the gross income received by the offender over the previous year, according to the seriousness of the offense:

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<sup>3</sup> Data on prices and quantities actually traded is usually used. In certain cases where it is not possible to determine the variation in the amounts, in the case of highly concentrated markets or those related to basic goods, it is normally assumed that demand is relatively inelastic.

<sup>4</sup> When disciplinary proceedings are initiated with regard to conduct that is still on-going, the period between the commission of the conduct and the date of the initiation of these proceedings is usually taken into account.

<sup>5</sup> **Legislative Decree 1034, Law on Suppression of Anticompetitive Conduct. Article 44.- Criteria for establishing the seriousness of the offense and graduating the fine.-** The Commission shall take the following criteria into account in determining the gravity of the offense and the application of appropriate penalties: (a) the unlawful profit expected by the commission of the offense; (b) the probability of detecting the offense; (c) the form and scope of the restriction of competition; (d) the size of the affected market; (e) the market share of the offender; (f) the effect of restricting competition on actual or potential competitors, on other actors in the economy and on consumers; (g) the duration of the restriction of competition; (h) previous incidences of prohibited conduct, and (i) the conduct of offenders during the investigation.

| Severity    | Cap in TUs <sup>a</sup> | Cap in income <sup>b</sup> |
|-------------|-------------------------|----------------------------|
| Mild        | 500 TUs                 | 8%                         |
| Severe      | 1000 TUs                | 10%                        |
| Very Severe | --                      | 12%                        |

a. TU for 2013 = S/.3700 nuevos soles ≈ \$1330 US dollars

b. Sales or gross income of the offender or economic group, from all economic activities in the fiscal year immediately preceding the decision of the Commission

10. Finally, in the event the offender has submitted a penalty waiver procedure (leniency program), the appropriate reduction will be applied to the company, in accordance with the applicable legal framework.<sup>6</sup>

11. It should be noted that individuals who, acting on behalf of the companies under investigation, have participated in the commission of the offenses identified, may also be fined up to 100 TUs. Furthermore, where recidivism is identified in offenders, the new fine shall not be less than the one previously imposed. Finally, it is important to note that a discount of 25% will be applied to offenders who pay the fine within the appeal period pertaining to the decision of the Commission.

12. In relation to the experience of the Commission and the Tribunal in respect of penalties, we can take the cases of Medical Oxygen (2010) and Maritime Pilots (2007) as examples.

13. The Medical Oxygen case is one of the most significant in the recent history of Indecopi. Following a thorough investigation, the Commission detected the existence of a cartel among major producers of medical oxygen to divide up the national public procurement market for this product amongst themselves. In this case no direct evidence was available for the existence of a market-sharing agreement between the companies, so analytical tools such as indicators, assumptions and event analysis were used.

14. Considering the form of the infringement (market sharing), the importance of the product (directly related to life and health), the continuous nature and duration of the behaviour (1994-2004) as well as its geographic scope (at national level), the violation was classified as “very severe”. The fines imposed, estimated in light of the expected profit<sup>7</sup> and the probability of detection,<sup>8</sup> and reduced according to the legal cap then in effect, amounted to a total of 5,749 TUs (approximately \$7.6 million USD in 2010).<sup>9</sup>

15. In the Maritime Pilots case, the Commission identified the existence of an abuse of dominant position by a company that gathered all the providers of maritime pilotage at the Callao Port Terminal

<sup>6</sup> Pursuant to Article 26 of Legislative Decree 1034, in the event several economic operators submit requests for exemption from punishment, a waiver of the fine will be applied to the first one to have provided evidence of the existence of the behaviour and the fine laid down for the other applicants will be reduced, providing they comply with legally enforceable conditions.

<sup>7</sup> The extra profit was calculated as the equivalent to the price difference between the price determined for each selection process (agreed price) and the price that should have emerged in conditions of competition (competitive price), multiplied by the amount of medical oxygen allocated to each company investigated in the selection process during the period of the infringement.

<sup>8</sup> The probability of detection was described as medium-high, and assigned a value of 0.75, because the complaint was submitted to the National System of Control (Indecopi subsequently took over the investigation) and also due to the specific characteristics of the conduct investigated (the strategy of “defensive positions” and abstentions by geographical area).

<sup>9</sup> This decision, pending resolution by the second administrative body, can be found at: [http://www.indecopi.gob.pe/RepositorioAPS/0/2/par/RES\\_051\\_2010\\_CLC/Res051-2010.pdf](http://www.indecopi.gob.pe/RepositorioAPS/0/2/par/RES_051_2010_CLC/Res051-2010.pdf)

(CPT), consisting of the implementation of a series of behaviours conducive to establish a monopoly for reasons other than economic efficiency, to impose monopoly prices and to raise barriers to entry to the market for maritime pilotage services.

16. The behaviours that constituted an abuse of dominant position were: i) signing open-ended and exclusive contracts with all the licensed maritime pilots; ii) unjustified refusal of training to aspiring maritime pilots; iii) predation through administrative and judicial mechanisms (sham litigation); and iv) unjustified refusal to provide services. These behaviours were designed to maintain the position of dominance held by the pilotage company, and together constituted a clear strategy of illegal monopolization of the market, which resulted in the practice of exclusionary conduct with regard to actual and potential competitors, and resulted in the increase in the price of marine pilotage services at the CPT. The offense was described as “severe”.

17. Considering the expected extra profit resulting from the behaviour investigated,<sup>10</sup> the probability of detection,<sup>11</sup> and applying the legal cap then in effect,<sup>12</sup> the fine amounted to a total of 81.2 TUs (approximately \$90,000 USD in 2007). This amount includes, in addition to the penalty imposed on the pilotage company, the fine for individuals who occupied directorship and management positions at the company, due to their direct involvement in the commission, management, coordination and continuation of the offenses identified.<sup>1314</sup>

18. In the same vein, it is worth noting the increase in the amount of the fines imposed by the Commission in the past five years (2008-2012), compared to the previous five (2003-2007). As may be seen in the chart below, the total fines imposed in the last five years was more than 40 times the total of the fines imposed over the previous five years:

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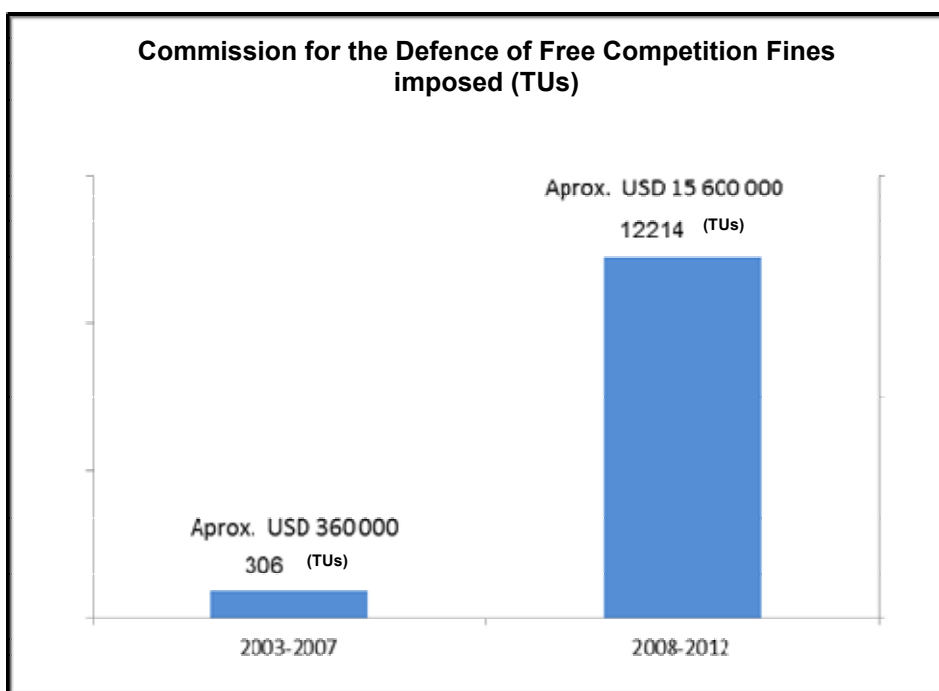
<sup>10</sup> The extra profit was calculated based on the increase in the price of pilotage services and the period during which the pilotage company managed to maintain a monopoly in the relevant market.

<sup>11</sup> The probability of detection was assigned a value of 1 (100%), since the Commission considered that its intervention was inevitable because: i) the market for maritime pilotage at CPT had already been under analysis by the Commission in 2001; ii) according to Resolution 0131-2003/TDC-INDECOPI, the Tribunal instructed the Commission to closely monitor the activity of the maritime pilotage services market at the CPT, to prevent the use of illicit mechanisms for maintaining economic concentration in a single company in that market; and iii) the case involved a variety of forms of abuse of dominant position that together constituted an illegal monopolization of the pilotage services market at the CPT.

<sup>12</sup> The base fine amounted to 299.4 TUs. However, considering that the fine should not exceed 10% of sales or gross income received during the year immediately prior to the Commission’s decision, this was reduced.

<sup>13</sup> These individuals directly benefited from anticompetitive behaviour implemented through directors’ allowances, salaries for management positions, salaries for pilotage services, distribution of profits as shareholders, among others. Furthermore, no one recorded their opposition to the anticompetitive conduct of the pilotage company, and as a result were fined between 2.3 and 9 TUs.

<sup>14</sup> The decision of the Commission, ratified by the Tribunal, can be found at: <http://www.indecopi.gob.pe/RepositorioAPS/0/2/par/RES037-2005/Res037-2005.pdf>



Graph prepared by: Technical Department of the Commission for the Defence of Free Competition

19. Finally, it is important to refer to a recent proposal made by the Economic Research Division of Indecopi to unify the criteria for determining fines in all areas,<sup>15</sup> premised on the economic theory of the optimal method of public enforcement of law,<sup>16</sup> while respecting the criteria laid down in legislation and case law. Thus, with the aim of deterring unlawful conduct, and respecting the principle of reasonableness set out in the General Administrative Procedure Law (Article 230), the proposal seeks to assist the different departments of Indecopi in determining fines that effectively meet their purpose as a deterrent, and that may be applied without requiring changes to the existing legal framework, or adjustments to the maximum ceilings for fines, as in the cases cited for the defence of free competition.

20. The proposal establishes a formula for determining the fine according to the illegitimate profit that to some extent reflects the experience of the Commission and the Tribunal. The proposal developed incorporates three elements, which are combined in the following manner:

$$Fine = \left( \frac{Illegitimate\ profit}{Probability\ of\ detection} \right) * F$$

Where:

Illegitimate profit refers to the profit (income minus costs) obtained by the offender through the practice.

<sup>15</sup> Working Document 01-2012/GEE: methodological proposal for determining fines by Indecopi. Available at: <http://www.indecopi.gob.pe/repositorioaps/0/0/jer/docstrabajo/DocTrabN01-2012.pdf>

<sup>16</sup> See for example: BECKER, Gary, *Crime and Punishment: An Economic Approach*, University of Chicago Press: *Journal of Political Economy*, Vol. 76, 1968, pp. 169-217; POLINSKY, A. Mitchell and Steven SHAVELL. *The Economic Theory of Public Enforcement of Law*, *Journal of Economic Literature*, Vol. XXXVIII, No. 1, March 2000, pp. 45-46.

The probability of detection and punishment of the offense by Indecopi acts as a weighting for the illegitimate profit. This means that the greater the difficulty of discovering the illegitimate practice, the higher the fine will be, while if the behaviour is easily identifiable (detection probability close to 100%), the fine will be closer to the value of illegitimate profit.

$F$  is a factor that reflects the balance of all the mitigating and aggravating circumstances of the offense and ranges between 0.75 and 2. The value of  $F$  is determined by the Commission based on a qualitative analysis of the circumstances related to the commission of the offense and the conduct of offenders during the investigation.

21. It is possible that situations arise where it is not possible to estimate the illegitimate profit generated by the offense, or, having estimated this benefit, it is substantially less than the damage caused by the offense. In this situation, a fine based on the profit could be disproportionately low in relation to the severity of the damage resulting from the offense. Such is the case of offenses affecting the life, health, physical integrity or property of consumers. In these circumstances, the proposal states that the fine should be calculated according to the damage generated by the offense as shown in the following formula:

$$\text{Alternative fine} = \left( \frac{\text{Damage}}{\text{Probability of detection}} \right) * F$$

22. As a complement to the previous proposal, the working document also contains references to estimating the illegitimate profit, detection probability tables for the most common offenses and recommendations on how to proceed when the fine is greater than the maximum that can be imposed. The adoption of this proposal also seeks to contribute to the transparency and certainty regarding the imposition of sanctions by Indecopi. To this end, the document reflects not only the views and comments of Indecopi decision-making bodies but also those of law firms and private sector associations and companies.

23. In short, the Peruvian legal framework has enabled Indecopi to develop and apply objective and transparent criteria to punish the commissioning of collusive practices and abuses of dominant position. This is reflected both in the case law of Indecopi and in the increase in the amount of sanctions in recent years. Finally, the proposed methodology of the Economic Research Division for determining fines, aimed at providing greater transparency and certainty, could have an impact on future decisions made by the authority.