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LATIN AMERICAN COMPETITION FORUM

Session I: Criteria for Setting Fines for Competition Law Infringements

Contribution from Spain (CNC)

3-4 September 2013, Lima, Peru

The attached document from Spain (CNC) 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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LATIN AMERICAN COMPETITION FORUM

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

Session I: Criteria for Setting Fines for Competition Law Infringements

CONTRIBUTION FROM SPAIN (CNC)

1. Introduction

1. The Spanish Competition Authority (Comisión Nacional de la Competencia –CNC-) published in February 2009 a Communication ¹ on the Quantification of Sanctions arising from violations of Articles 1, 2 and 3 of the Spanish Competition Act (Ley de Defensa de la Competencia –LDC-) 15/2007 of July 2007 and Articles 81 and 82 –presently 101 and 102- of the European Community Treaty.

2. In the sphere of the sanctioning system, the Competition Act is a significant advance in legal certainty insofar as it makes a graduation of the various infringements set out in it and clarifies the maximum penalties of each type, set in terms of a percentage of the total turnover of the offenders. Similarly, the criteria that shall determine the specific fine in each case are specified, in line with current trends in the European arena. It also envisages the publicity of all of the penalties imposed in application of the Act, which will strengthen the deterrent and exemplary power of the resolutions that are adopted.

3. The LDC specifically refers to the sanctioning scheme and mentions the three basic aspects that support the CNC's punitive action:

- The graduation of the sanctions depending on the type of infringement.
- The limitation of the main amount to each type of infringement.
- The non-exhaustive list of the indicators considered while quantifying each sanction. The Statement also makes it mandatory to publish the sanctioning resolutions.

4. Nevertheless, aiming at improving the deterrent effect, the CNC decided that it was necessary to elaborate a method for the quantification of fines good enough to fully meet the requirements.

¹ http://www.cncompetencia.es/Inicio/GestionDocumental/tabid/76/Default.aspx?EntryId=30716&Command=Core_Download&Method=attachment

5. The third additional provision of the LDC enables the CNC to issue communications clarifying the principles that guide its action in applying the Act. The reason why the CNC dedicated this first communication to the development of guidelines on the quantification of sanctions was motivated by internal and external reasons.

6. Regarding external reasons, the shaping of “*optimal penalties*” to competition infringements has attracted international debate along the past few years. The *European Competition Network* (ECN) formed a working group that analyzed how penalties were referred to by the different national competition jurisdictions and elaborated a document titled “*Pecuniary sanctions imposed on undertakings for infringements of antitrust law. Best practices*”. A general consensus² led to agree that the fining schemes in force lay in excess on qualitative criteria more than on the damage caused by the infringement or on the benefits that the infringers have obtained. Fines were many times too low to produce a deterrent effect, reducing the effectiveness of the punishing scheme. Academics started to demand more clarification for the criteria fines were set and stressed that in some circumstances a more quantitative approach could be considered.

7. The theory of the *optimal penalty* has been taken into account by economists while aiming at setting up deterrent fines. Although the direct application of such theory is seldom feasible (because of the difficulties involved in obtaining the information needed in order to apply it) it has produced some important criteria that have encouraged several competition authorities (Germany, United Kingdom, Netherlands and Poland, among others) to elaborate Guidelines in order to set objective and transparent clarification tips for the quantification of sanctions. It is worth mentioning that in 2006, the European Commission reformed its 1998 Guidelines for calculating the fines imposed on firms which infringe European Union (EU) rules prohibiting cartels and other restrictive business practices and abuses of dominant position³. Such reform refining the calculation method has been broadly welcomed by the academics⁴.

8. According to the above exposed double motivation (external and internal), the CNC has drafted and published the *Communication on the Quantification of Sanctions* with a content that corresponds to the following scheme.

2. The legal framework

2.1 General principles

9. The above mentioned LDC articulates the legal framework. In general terms, fines to sanction competition infringements may achieve, at least, the following goals:

- The punishment of the infringement; and
- The deterrent effect for future infringements.

10. The deterrent effect has been part of international discussion within the past few years. A discipline such as “Competition”, where infringements produce significant and immediate effects, requires

² Among some others: *Wils* (2006); *Buccirossi y Spagnolo* (2005); *Wehmhörner* (2005); OECD (2002, 2003 y 2005); *Rey* (2006) and *Harrington* (2006).

³ Guidelines on the method of setting fines imposed pursuant to Article 23(2)(a) of Regulation No 1/2003.

⁴ Padilla & Zoido (2007); Motta (2007); Allendesalazar (2007); Van Cayseele & Camesasca (2007) and Contract DG Comp (2007).

of a sanctioning policy not only to punish the anticompetitive conduct but to produce a general deterrent effect among the market operators. Like in many other disciplines, in this case prevention is better than cure.

11. Deterrence and compensation have been deeply analyzed by Academics. Discrepancy persists on whether compensation must be exclusively sought by in the civil jurisdiction (individually requested) as private enforcement of the antitrust law, or if it can be part of the general goals of the competition policy applied by competition authorities. Some authors argue that an administrative competition authority should tend to be more dissuasive than compensative as long as the safeguarding of competition is a public interest matter, while the compensation may be obtained by private enforcement, and, in the end, double fining of infringements should be avoided.

12. In the European and the Spanish competition laws and policies, competition private enforcement by compensation of damages is not yet effectively implemented in Europe.

13. In Spain, Article 64 LDC introduces criteria directly linked to deterrence:

- a) The dimension and characteristics of the market affected by the infringement.
- b) The market share of the undertaking or undertakings responsible.
- c) The scope of the infringement.
- d) The duration of the infringement.
- e) The effect of the infringement on the rights and legitimate interests of consumers or on other economic operators.
- f) The illicit benefits obtained as a consequence of the infringement.
- g) The aggravating and mitigating circumstances that exist in relation to each of the responsible undertakings.

14. Therefore, the CNC assumes that deterrent elements must be taken into account while calculating the fine.

15. In order to achieve the deterrent effect: the level of the penalty has to be sufficient. Thus, a principle of sufficiency must be met, for the operators to know that the profits that may result from the infringement will be clearly outbalanced by the fine that the competition authority may impose.

16. Proportionality is another key element, as noted by the Spanish Supreme Court in many of its resolutions. According to such principle, fines must not exceed the amount strictly necessary to achieve the objective of deterrence; otherwise they could pose a disproportionate overestimation. However, the Supreme Court argues that “*infringements should not be more beneficial to the offender than compliance with the rules infringed*”⁵, i.e. suggests the application of a principle of sufficiency.

⁵ Supreme Court, Judgment of 23 March, 2003 [RJ\2005\2613].

3. The economic literature

17. Many economists have essayed on the quantification of the so-called “**optimal sanction**”, which is the one set at the minimum level eligible to produce a deterrent effect. The infringer - who is supposed to act rationally- will take decisions depending on whether the benefit to be obtained by the infringement is higher or not than the alleged penalty for infringing (i.e. the amount of the fine). Logically, the deterrent effect will be achieved if a fine higher than the illegal benefit is a credible threat. From the paper “*Crime and Punishment: An Economic Approach*” by the Nobel Price winner Gary Becker in 1968 - which includes the first formal analysis of the optimal sanction-, to “*Optimal Sanctions for Antitrust Violations*” by William Landes in 1983 -which applies such analysis to antitrust infringements-, the basic structure of the optimal sanction is that such sanction (**F**) has to outweigh the illegal benefit -the expected profit from the infringement- (**B**)⁶.

18. The idea is simple: to achieve the desired deterrent effect it is sufficient to impose sanctions when $F > B$ holds. Nevertheless, this simple formula does not take into account that not all the infringements are noticed and punished. Actually, it should be modified in order to include the variable that measures such uncertainty. This variable is the probability estimated by the potential infringer that the infringement will eventually be sanctioned (**p**). How to incorporate this new variable in the scheme? Let’s consider a borderline in a theoretical scheme in which all infringements are punished (i.e. $p=1$). How high should the fine be in order to persuade the operator not to infringe? At least, as high as the expected profit. Thus, if a rational operator is certain that his anticompetitive conduct will be noticed and that his gain will be gone, his rational decision will be not break the law. On the contrary, if the infringer perceives that the probability of getting caught is very small, the incentive to break the law will be very high; except if, despite of low odds of being sanctioned, the amount of the fine is huge, in which case the rational decision would be not to infringe. Therefore, in order to achieve deterrence, the probability must be inversely proportional to the benefit that may result from the infringement. Ergo, the resulting formula is $F > (B/p)$ ⁷.

19. This theoretical formulation for quantifying optimal sanctions is very attractive because of its apparent simplicity, but its practical application results in a major problem: variables **B** and **p** are not directly observable and, thus, must be estimated.

20. In addition, there are no unique and stable values for **p**. This is due to exogenous factors such as complaints from customers or competitors, as well as to endogenous circumstances such as the competition authority’s budget, the existence of a leniency program and the possibility to prioritize sectors or types of infringement.

21. As regards **B**, there have been different approaches to estimate this rarely observable value. The initial presumption is that the amount of the benefit derived from the infringement can be estimated by calculating the number of units sold and the increased price at which they have been sold. Thus, it is necessary to calculate the sales volume in the relevant market and the difference between the monopoly price and the price in perfect competition (i.e. the increase in price that results from the infringement, also called *mark-up* [$\Delta P = (P_m - P_c)/P_c$]). The values that can be obtained by applying this estimation vary depending on the database used. The table that follows shows how scattered the results can be. Nonetheless, if a value had to be chosen, it would be in the range 25-30%⁸.

⁶ This is the argument that the Supreme Court applies to the Judgment cited under footnote no. 6.

⁷ Where **F** is the sanction, **B** is the illegal benefit and **p** is the probability estimated by the potential infringer that the infringement will eventually be sanctioned.

⁸ Regarding the measure used, the first reaction would be to simply quantify the illegal benefits, but this distribution has only few and very high values (asymmetric to the right) that result in an excessively high

Empirical evidence of mark-ups				
AUTHORS (YEAR)	EUROPE		USA	
	MEDIAN	MEAN	MEDIAN	MEAN
Griffin (1989)	44	46		
Cohen y Scheffman (1989)	7,8-14	7,7-10,8		
Werden (2003)	18	21		
Posner (2001)	38	49		
Levenstein y Suslow (2002)	44,5	43		
OECD (2003)	12,75	15,75		
Connor y Lande (2006)	22-25	31-49		
	EUROPE		USA	
Connor (2006)	42,7		20,3	
Connor (2007)	29	49	21	30

22. The comparison of outcomes resulting from the model of perfect competition and the monopoly model was useful for the CNC to estimate levels of price increments, and to estimate the relative size of the other concepts included in the criteria acknowledged in the LDC. Such criteria can be summarized as “illicit gains” and “damage to third parties” (Article 64.1, Sections e) and f)). Thus, the comparison of outcomes resulting from both models makes it possible to identify and to compare:

- the transfer of income from consumers to producers,
- the efficiency loss that affects consumers and the industry itself, and
- the illicit profit obtained by the industry as a result of the anti-competitive infringement.

4. The communication

23. The application of the elements of the economic analysis previously discussed to the legal framework within which the CNC is circumscribed, has resulted in a methodology for quantifying sanctions that is structured in three phases, similar to that applied by other competition authorities. The first phase is to determine the base amount of the fine (**BA**), applying graduation criteria established by article 64 LDC. The second is to apply to the base amount an Adjustment factor (**Af**), that results from considering existing aggravating or mitigating circumstances based on article 64.2 and 64.3 LDC. Finally, the third phase is to adjust the resulting amount to the limits set by law.

24. The methodology adopted by the Communication derives from the structure established by Article 64 LDC:

- Section 1 contains the criteria to be applied to the quantification of sanctions
- Sections 2 and 3 contain a non-exhaustive list of aggravating and mitigating circumstances.

mean. The median (a value that places the same number of observations on each side) can become more representative. Since the value of the mean may be too high to be representative, the value of the median has to be also taken into consideration.

25. As it happens in most of the countries that count on similar quantification guidelines, the Communication includes a formula to calculate the base amount of the fine with three parameters: the sales volume in the market affected, the severity and the duration of the infringement:

$$BA = p(\%) \cdot \sum_{i=1}^T VMA_i \cdot \alpha_i$$

Where **BA** is the Base Amount, **p(%)** is the percentage according to severity and type of product or service, **VMA_i** is the Sales Volume in the Market Affected by the Infringement in year **i**, **T** is the duration of the infringement in years, and **α_i** is the weighting coefficient in the year **i**.

26. The sales volume in the market affected by the infringement (**VMA**) aims at measuring the influence caused by the infringement where the infringement has produced effects, which does not necessary have to be coincident with the relevant market, nor with the total turnover of the incumbent. In order to obtain this value, it is necessary to calculate the sales reported during the entire period of the infringement. If it is not possible to calculate the sales on a given year, an estimation of the turnover will be done for each year based on existing data⁹. Moreover, if there were not enough data available to make a correct estimation, the sales volume of the annual accounts approved for the last business year will be the reference.

27. As regards the duration of the infringement, present effects caused by the infringement weight more than past effects. A weighting coefficient is applied starting in year 1 (the last year in which the infringement caused effects and includes the total sales volume), and is reduced in clusters of 25% until the fourth year. From the seventh year backwards the weight will be 5% for each year.

28. The percentage **p(%)**, which is to be applied to the sales calculated as indicated above, up to 10%, but it may be cumulatively incremented up to ten percentage points if the infringement is categorized as very serious or if the market or markets affected by the infringement represent a production input capable of producing cascading effects in different markets. Thus, the base amount can achieve 30% of the sales volume affected by the infringement, which is similar to what is being done by other competition authorities and in line with the quantification of the price increments applied to cartel cases.

29. On the second step, the base amount of the sanction will be increased or reduced as a function of the existing aggravating or mitigating circumstances. The presence of each of aggravating or mitigating circumstance will imply increasing or decreasing the base amount by a percentage of between 5 and 15%.

30. On the third step, once the sanction has been quantified, the resulting amount must be adapted to the limits set by the LDC. According to Article 63.1 the fine for “serious infringements” cannot exceed “5% of the total turnover of the infringing undertaking in the business year immediately preceding to that of the imposition of the fine”. Such percentage goes up to 10% if the infringement is considered to be very serious. Moreover, if the illegal benefit can be quantified, the amount of the fine must be higher than such benefit in order to achieve deterrence, provided it doesn’t exceed the percentage of the total turnover, above mentioned.

31. The method set by the Communication not only refers to the criteria to be applied to the quantification of the sanctions listed in Article 64 LDC, but clarifies some other issues related to the

⁹ Normally, the figure known from the last year in which the infringement occurred will be assigned to that one. However, other methods can be used to make this estimation, based on the evolution of the turnover of the companies or the information available to the company/industry.

quantification methodology, such as the repeated commission of infringements or the definition of the concept of “*recently liberalised market*”. Article 64.2a LDC provides that “*the repeated commission of infringements defined in this Act*” will be considered an aggravating circumstance. The Communication specifies that the commission of an infringement prior to the commission of the sanctioned violation will be considered an aggravating circumstance if there is a final administrative resolution or court judgment declaring proven the infringement or if the previous sanctioning resolution was handed down within the last ten years before the commission of the infringement subject to sanction. Article 62.4b categorizes the abuse of dominant position in a “*recently liberalized market*” as a very serious infringement. The Communication states that such concept will be understood to apply to “*all markets undergoing a liberalization process that are supervised by regulatory authorities or markets affected by a regulatory project aimed at promoting the entry of new competitors*”.

32. Article 61.1 LDC, states that offenders shall be natural or legal persons. The second section of the same Article adds that “for the purposes of the application of this Act, the action of an undertaking is also attributable to the undertakings or persons that control it, except when its economic behavior is not determined by any of them”. Article 63.2 LDC places an upper limit of €60,000 on the fine to be levied on the legal representatives or members of management bodies who participated in the sanctioned agreement or decision, but there are no further references to the way that such limit must be applied. The Communication clarifies this point and states that the penalty actually imposed in this case will be fixed at between 1% and 5% of the sales volume affected by the violation, taking into account the duration, and in accordance with the individual’s degree of responsibility in committing the infringement, and, must be paid by the legal representative or member of the management body who participated in the sanctioned agreement or decision on whom was levied.

5. Conclusion

33. In general terms, the CNC Communication aims at establishing a link between severity of the infringement and the amount of the fine in order to achieve a deterrent effect and to make the punishing scheme more clear and predictable. Such transparency will surely help to harmonize the whole sanctioning system whose elements, closely related, require consistency and coordination. Elements of the sanctioning scheme such as fines, leniency programs, private actions for antitrust damages, are somehow connected and, thus, have been taken into account while elaborating these guidelines.

34. The Communication sets out a clear methodology for the quantification of sanctions but, as it has been previously stressed from a dual legal and economic perspective, since it is not always possible to exactly quantify all the variables applicable to the criteria set, nor is possible to meet all the criteria in every single case, the CNC retains a small margin of discretion on grounds of the principle of proportionality. Sometimes, given the unique characteristics of the market or the infringement, it will be necessary to apply some flexibility and discretion. Thus, the Communication tries to bring together the objectivity of a quantification method that assigns a value to each applicable criterion and the discretion necessary to take into account circumstances that either have not been foreseen by the Communication itself or that taken together make the fine tilt towards higher or lower values.

35. To summarize, the CNC has produced guidelines based on the LDC and taking into account the past experience, the case law and the comparative doctrine aiming at making the scheme to quantify sanctions more clear, uniform, transparent and predictable, and, above all, effective as a deterrent and compensatory tool. Thus, these guidelines help to ensure the legal certainty and the transparency of the fines imposed by the CNC, and they constitute a step forward in the development of the competition law and policy in Spain.