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LATIN AMERICAN COMPETITION FORUM

Session I: Criteria for Setting Fines for Competition Law Infringements

Contribution from UNCTAD

3-4 September 2013, Lima, Peru

The attached document from UNCTAD 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 UNCTAD¹

1. Introduction

1. Competition law and policy is a cornerstone of the prosperity of a market economy where competitive pressure encourages efficiency in production and stimulates innovation in products and processes, which is essential for international competitiveness and economic growth.

2. However, competition law and policy can only produce the desired effects if applied effectively. A law that only exists on paper is of no great value. The effective enforcement of competition law entails significant challenges, particularly for newly created authorities with jurisdiction in this area. This may be due to insufficient resources, the evolving level of expertise of its staff, lack of political support from other government agencies and the general lack of knowledge about competition law and policy in the business world.

3. Since the objective of competition laws is to protect the market from anticompetitive behaviour by economic agents, sanctions and appropriate remedies are crucial for its effective implementation. Indeed, safeguarding competition, a key objective of the laws governing this area, requires companies to comply with provisions of a procedural or substantive nature. However, experience has shown that companies only comply with obligatory norms where non-compliance could have negative consequences for them. As a result, the threat of sanctions is a basic requirement to encourage compliance with competition law. With regard to the main objective of most of the laws in this area, namely the protection of the competitive process, the measures or remedies are complementary to the sanctions, since their purpose is to safeguard or restore competition in cases where companies have distorted competition. In this sense, both sanctions and measures are two complementary elements towards the achievement of the main objective of competition law, that is, the protection of the competitive process, though their nature and mode of operation are different.

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4. In compliance with the provisions of Chapter XI of UNCTAD's Model Law on Competition, sanctions are intended to deter unlawful conduct in the future, force those who violate the law to return the illegally obtained profits and compensate victims. Its purpose is to punish past and present illegal behaviour and deter non-compliance with the law in the future. Deterrence seeks to prevent repeat offending and to serve as an example for other potential criminals. According to several studies, in the field of competition law the objective of deterrence outweighs the punitive aspect. By contrast, the remedies that seek to maintain or restore competition in the future are not punitive in nature. Their main field of application is the area of merger control. Usually, the parties offer remedies to a proposed merger in order to eliminate the problems associated with competition and obtain proper authorization from the competent authority in this area. Unlike sanctions, which are unilaterally imposed on those who violate competition law, measures are often negotiated between the affected party and the competition authority.

5. The analysis of the issue of sanctions and appropriate remedies not only requires an assessment of its application in practice; it is also necessary to reflect on the meaning of the term "appropriate" in this context. The suitability of the sanctions and remedies involves a decision where the search for balance is to the fore. The objectives sought by such measures should be evaluated in light of the restrictions imposed on the rights and freedoms, taking into account the principle of proportionality.

2. Overview of different types of sanctions

6. Sanctions are imposed both in respect of substantive violations of competition law and breaches of procedural rules. Administrative or economic sanctions, such as fines, are the most common in rulings made against cartels and other violations of antitrust law. Such sanctions may be imposed on companies involved in anticompetitive activities and sometimes also on individuals acting on behalf of these. This is, for example, the case of Germany, Spain, Chile and other countries where the liability of a company in relation to an infringement of competition law may lead to the determination of personal responsibility on the part of its directors or employees. Other competition laws only establish the possibility of fining the respective companies (this is the case of the European Union). Together with the fines, administrative sanctions may also include other administrative measures that are highly dissuasive in certain cases, such as bans on holding public office or the inclusion of the company on a blacklist of companies involved in bid-rigging cases for future public tenders.

7. Unlike the administrative sanctions that may be imposed by competition authorities, the only bodies that can make the decision apply to civil or criminal sanctions are the courts. Some countries that have opted for a system of administrative sanctions provide for criminal penalties in certain cases related to competition, for example in the case of cartels or bid-rigging in connection with public tenders. Such is the case of Australia, Canada, Hungary and Germany.

8. The administrative, civil and criminal sanctions together comprise the category of sanctions designed to enforce competition law. Public authorities, competition authorities or courts are responsible for enforcing the provisions of competition law within their relevant jurisdictions.

9. It should be noted that recently, private application of the law has begun to play an important role in the field of competition law. Private application of the law implies the possibility that persons affected by a breach of competition law submitting a claim for damages to a civil court, independently of public enforcement proceedings that only seek to defend the overall interest. In the case of the initial legal action, the plaintiff needs to prove the existence of a violation of competition law and the damages resulting from this infringement, which in practice is very difficult. Follow-up actions are a more specific form of private application of the law, in which the plaintiff's claim for damages is based on a previous and firm ruling issued by the competition authority and only require proof of the damage caused. In addition, some countries allow collective legal action (class actions), in respect of which a plaintiff may file a claim for

compensation for damages on behalf of an entire group of people affected. Apart from compensation for damages, which is awarded only in a small number of countries, these forms of private application of the law do not meet the requirements to be regarded as sanctions, strictly speaking. However, they complete the picture regarding the implementation of competition law, and it is therefore appropriate to mention them in this context.

3. Determining the appropriate sanction

10. There are significant variations among the sanctioning systems of States that possess antitrust regulations. It should first be noted that in determining sanctions it is necessary to distinguish between the legislative side, that is, the provision set out in Law in general terms in relation to the type of sanction, and where appropriate the amount of the sanctions to be applied, which can sometimes leave little room for discretion to the competent authority to establish the final sanction (administrative, civil or criminal); and the executive side, in which the authority possesses executive power to deal with and determine a sanction in a particular issue related to a breach of competition law.

3.1 Legislative provisions

11. In connection to the application of administrative fines, one of the most pressing topics of discussion is related to the amount of fines necessary for these to have a deterrent effect not only for sanctioned companies but also for other companies operating in the market. In the last 15 years the amount of economic sanctions imposed in this discipline has increased substantially in many jurisdictions, especially in the United States and the European Union (the increase exceeds 2500% in some cases). However, the number of companies that reoffend in commissioning of antitrust violations is striking, despite having been punished with heavy fines. This reopens the debate on the appropriateness of the amount of fines and there are many supporters of increasing fines to increase their deterrence factor.

12. However, given the impossibility of increasing the current level of fines imposed on companies in these jurisdictions, because of the need to respect the principle of proportionality or to avoid irreversible economic damage in times of financial crisis, and considering that the fines would ultimately impact on consumers, it seems necessary to establish a greater degree of deterrence through other means. In this sense, one of the measures that is currently gaining ground relates to the personal liability of directors and employees who act on behalf of the infringing companies. In this context it is argued that the imposition of financial penalties on individuals is not enough to achieve the desired level of deterrence, since there is a risk that companies take care of the fines on behalf of their employees. This risk could be mitigated by prohibiting such behaviour by the company (as in the case of South Africa, Chile and Spain, among others).

13. Finally, there is a certain tendency towards the criminalization of breaches of antitrust law, especially in the fight against cartels. Traditionally, it has been the United States that has imposed criminal penalties including incarceration of persons convicted in trials for violation of competition law, although a number of other countries had provisions in force that permitted, even if these were not applied with the same rigor. Currently countries such as Canada, Israel, Japan and the United Kingdom impose criminal penalties on people in order to fight against hard core cartels, and there is a lively debate on this issue. Proponents of criminal sanctions on individuals argue that such punishments are significantly more effective, given the degree of deterrence resulting from deprivation of liberty. However, the criminalization of violations of competition law may not be consistent with social norms and laws in force in a particular country (for example, in the EU and Spain criminal sanctions are not considered an applicable legal deterrent in the field of antitrust law). Furthermore, the costs of criminal sanctions, particularly imprisonment, may be too high compared to the costs associated with other types of penalties. Another concern that has been raised in relation to criminal sanctions in cases related to competition concerns the

tougher procedural requirements to be observed in criminal proceedings, as the rules in the field of the right to defence and the evaluation of standard of proof are more stringent. This may complicate the prosecution of violations of competition law and reduce the number of cases resolved successfully. There are, therefore, valid arguments for both approaches.

14. In any case, it should be noted that any sanction, regardless of its nature, will only produce the desired deterrent effect if the probability of detection and prosecution of unlawful conduct is sufficiently high, and if the fines imposed on offenders are also significant. The legal framework should ensure the fine is at least equal to the financial gains that may be obtained through anti-competitive conduct. In this context, it should be noted that peer reviews of competition law and competition policy among Member States of the United Nations Conference on Trade and Development have repeatedly recommended increases to the level of fines imposed. In countries where there are problems of corruption, it could prove beneficial not to confer a high degree of discretion to the competition authority on the level of fines imposed, but establish these by law as a fixed percentage of the market volume that has been affected by the anticompetitive conduct (some countries such as Turkey and Armenia have opted for this approach).

15. Finally, it bears mentioning that apart from the trend towards criminalization of certain violations of competition law, private application of the law has also begun to play an important role in various legal systems in this area. Proponents of the private application model emphasize that the principle of equity requires that it is the violators of competition laws, and not their victims or law-abiding businesses, who bear the costs of their behaviour. They also propose effective compensation mechanisms for private bodies in order to increase the likelihood of detection and prosecution of anti-competitive behaviour. Therefore, restorative justice by its very nature would also produce beneficial effects in terms of deterrence. However, it should be noted that private application of competition law can only complement, and never replace public enforcement mechanisms. The main problem that arises in the discussion of the interaction between public and private mechanisms of enforcement is the concern about whether private application has any impact on the effectiveness of leniency programs.

16. Indeed, there are concerns that these programmes may lose their appeal and thus, part of their success, if those calling for clemency are confronted with mass follow-up actions to claim compensation for damages based on the requests made to the competition authority and the decision of the latter. This issue can be addressed in the legislative framework if leniency applicants not only benefit from a reduction in fines, but also a protection against claims for damages. However, it has been argued that the public prosecution and private claims for compensation for damages have different objectives and legal frameworks, such that public leniency can have no bearing on private actions. Moreover, it should be stressed that developing countries have weak judicial systems, and it should also be noted that private claims for compensation for damages require a higher degree of technical expertise on the part of the judges dealing with those issues. In particular, the assessment of the amount of damage resulting from anti-competitive behaviour is a complicated task that requires deep knowledge of economic matters, in addition to specialization in the legal field.

3.2 *The determination of the appropriate sanction in a particular case*

17. Experienced competition authorities, such as the Federal Cartel Office of Germany (*Bundeskartellamt*), consider determination of the appropriate level of fines a complex exercise. As mentioned above, it assumes that, to actually have a deterrent effect, the fine should be at least equal to the financial gains resulting from the anticompetitive conduct.

18. The laws of most countries do not provide for a fixed amount for the fines, but only a maximum amount that a rule is usually set between 5% and 20% (or even 30% in the case of Brazil) of the turnover of the company in question in the preceding financial year, depending on the seriousness of the offense.

Therefore, in these cases the law confers a certain degree of discretion to the competition authority to determine the appropriate level of fines, taking into account the particular circumstances of each case.

19. Many competition authorities have adopted a series of guidelines or notices (soft law) that explain and set out the method to be followed by the authorities when determining the amount of the fines. The guidelines serve the objectives of providing greater transparency, predictability and equal treatment in the imposition of sanctions. Often these guidelines take the value of the sale of goods or services directly or indirectly connected to the offense as the starting point for determining the appropriate fine. The criteria for the calculation of fines usually encompass the gravity of the infringement, its duration, the market share of the company or its turnover. Moreover, they specify and clarify the importance of the presence of aggravating factors, such as continuity or repetition of an offense, or the fact of playing a leading role in commissioning the behaviour, which may lead to the imposition of a higher fine. Likewise, they establish the criteria applicable in the event there are extenuating circumstances that may result in a reduction in the initial fine (assistance in the investigation, guilty pleas, etc.)

20. Another aspect of note is the cooperation by an offender party with the competition authority as part of a leniency programme, which justifies the granting of a waiver or reduction of the corresponding fine. In addition, the competition authorities may offer a reduction of a fine as a reward to a company that is willing to reach an agreement on an open case against a cartel or other offense, accepting the charges made (settlement), since such acceptance helps reduce the duration of the legal process, thus saving resources. In exceptional cases, a competition authority can also take into account the inability or financial difficulties of a company to cover the payment of the fine, in a specific social and economic context, and consequently reduce the fine or permit more flexible payment arrangements. The imposition of a fine on a company for a breach of competition should not take it into bankruptcy, and thus remove it from the market, as this would defeat the main purpose of competition law, which is to protect the competitive process and not eliminate competitors.

21. Finally, it is important to note that some recently-created competition authorities report they are encountering difficulties in gathering sufficient evidence to prove all relevant aspects of this exercise, such as, for example, the duration of an anti-competitive agreement or the calculation of the profits earned by the offending company. In the case of groups of companies, it can be difficult to determine which legal entity has the ultimate responsibility for the anticompetitive conduct (the subsidiary or the parent). In Switzerland and a number of other countries, this affects the maximum amount of the fines, which depends on the global turnover of the entity responsible for the violation of competition law.

4. Difficulties in enforcing compliance with sanctions

22. Sanctions can only achieve their objective if they are effectively enforced. However, recently-created competition authorities, especially in developing countries, have great difficulty in enforcing their rulings.

23. Firstly, in some cases of non-compliance with sanctions, some competition authorities do not have the necessary legal powers to enforce their decisions. This applies, for example, in Indonesia and Mauritius, where competition authorities have to resort to court action if a company does not pay a fine and have no enforcement procedures of their own that allow them to proceed to freeze bank accounts or assets. In a situation like this, the efficiency of a country's judicial system also affects the prospects for implementation of the competition authority's rulings.

24. Indeed, inefficient or slow court systems can generate an obstacle to the effective implementation of competition law. Peru, for example, has indicated that the duration of court proceedings, during which the judge may order the cancellation of a ruling, is a serious problem for effective implementation of

competition law. Meanwhile, Kenya has indicated that its competition authority is not even empowered to make binding decisions that confirm substantial breaches of competition law, as it depends on the further action of the competent ministry. Even where a competition authority has been granted the power to enforce its decisions, it may be that in practice it lacks the knowledge or the resources to do so. Sometimes obstacles can arise due to legal uncertainties regarding the status of the competition authority. For example, the Competition Commission of Pakistan often faces measures that question its constitutional legitimacy for imposing sanctions. The recently-established regional competition authorities, such as the Competition Commission of the Caribbean Community (CARICOM), may face additional difficulties resulting from the uncertainty regarding jurisdictions and the applicable law in each case (regional or national).

25. Finally, it should be noted that the competition authorities in developing countries may encounter political resistance when enforcing sanctions against multinational companies or against key national institutions. The threat of a large company leaving the market or announcing layoffs can have a negative impact on the political spectrum, enough to prevent the implementation of certain sanctions.

26. Therefore, there arises the question of how to address these challenges. Measures in defence of competition may be hampered by obstacles of a legal, procedural, executive or political nature; it is to be hoped that greater awareness-raising about the benefits of competition will prevent the creation of pressure groups by those who break the laws governing this matter in order to avoid enforcement of sanctions against them. The promotion of voluntary compliance may also play a key role. Companies may be more willing to comply with the sanctions imposed by anti-competitive behaviour if they know that their non-compliance will impact on their reputation. Moreover, it is necessary that policies to punish anticompetitive actions are complemented by other policies to promote competition in a gentler and more educational manner, designed to raise awareness among economic agents about the benefits of competition for the public interest and for the social economy. These policies should promote the implementation of programmes in accordance with competition law (compliance), for the purpose of enjoining companies to respect the rules in the knowledge of the negative effects entailed by anticompetitive behaviour both for themselves (for breaking the rules) and for the economy and the public interest.

5. Final considerations

27. Competition policy contains a series of repressive and preventive instruments whose purpose is to protect the markets from restrictive behaviours, effectively applying the law through the prohibition of actions by economic agents who violate its provisions both in procedural and substantive terms and, in parallel, acting as a deterrent to prevent further infringements and to avoid reoffending by companies that have previously been sanctioned.

28. Globally, if we analyse the regulatory systems of the various states and international organizations with coercive policies in relation to the protection of competition (such as the EU), we may conclude that all such systems incorporate a sanctions regime aimed at prohibiting and punishing anticompetitive behaviour, although there is considerable variation regarding the types of sanctions applicable.

29. Administrative sanctions (fines, injunctions and disqualifications) are the most common. Fines are set by all the competition authorities against companies that break the rules in relation to antitrust policy. There are significant variations between the fines imposed by one system and another, based on various factors (the recipient of the fines, the maximum amount, the criteria for calculating and the application of leniency programmes) set forth in the respective regulations. Injunctions are also imposed by most of the authorities to force offending companies to abandon their restrictive practices and to restore the competitive conditions in place prior to the commission of the offense. Finally, disqualifications are a less frequent instrument but one that is very effective against offenses committed in public procurement

procedures (bid rigging). In the administrative sphere the greatest concerns arise in relation to the most appropriate amounts for fines to have an effective deterrent effect.

30. Criminal sanctions are applied by a small number of authorities. The United States and Canada are the most ardent supporters of this type of sanction. It is true that its deterrent effect is very strong and that its application entails imprisonment for company directors who commit certain offenses, but most competition authorities have not included these in their arsenal of measures due to their social cost. For them to do so, it is necessary for societies to understand and be able to assess the great harm caused by violations to competition (at least insofar as cartels are concerned) in order for these to enter the category of criminal offenses.

31. Finally, another instrument that is not widespread at the moment but very effective for the purposes of granting a greater deterrent power to antitrust rules is the encouragement of private application of competition law. It is necessary to encourage the application of competition law to the private sphere by pursuing claims for damages suffered by individuals and businesses, as a result of the commission of breaches of antitrust law, in the courts. In this area, at present it would appear that there is more will than action, in the sense that a large number of competition authorities want to involve the judiciary more in the defence of competition to increase the level of restorative justice. However, in view of the results (at least within the EU), it would appear that it is necessary to work in a more coordinated manner with the various institutions of the judiciary.

32. Ultimately, all systems for defending competition seek the same goal, which is simply to protect the market from anticompetitive conduct and deter companies from employing these. The efficiency of each system must be evaluated separately according to the results obtained. Most likely no system is perfect but what is clear is that the constant effort of the international community and international organizations and forums working in this area to improve the instruments available to competition authorities is incontestable.