New Criminal Regime, New Merger Controls:
Introduction to the Competition Act 2002.

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The Great Cartel Crackdown:
Aims and Effectiveness of the New Criminal Definitions.

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Introduction.

It is hard to avoid a sense of déjà vu when addressing a conference on the subject of new tough legislation to clamp down on anti-competitive behaviour. After all this is the third Competition Act in just eleven years. It is fair to say that the results to date have been somewhat disappointing to put it mildly. I have been asked to speak to you today about the aims and effectiveness of the criminal provisions in the legislation. One assumes that the aims are relatively straightforward - to make competition legislation more effective. As to their effectiveness, I have to say that I am not very optimistic that the results under the new legislation are likely to be any better than those experienced under the 1996 Act. This is primarily because, in my view at least, the criminal provisions are fundamentally flawed.

There are three major changes with regard to the criminal offences in the new Act compared with the Competition (Amendment) Act, 1996.

- Penalties for 'Hard-Core' Cartels Increased to Five Years Imprisonment
- Jail No Longer Applies for Non-Cartel Offences - But Criminal Sanctions (Fines) Remain.
- New Penalty for Abuse of Dominance – Court Can Order Break-up of Company.

I am going to focus primarily on the first of these issues but I will also make a couple of comments about the other two. It might appear surprising to include the third element, since the Act provides that this remedy may be imposed in the case of civil actions under s.14. My understanding as a non-lawyer is that penal sanctions can only be applied in the case of criminal offences and that penal sanctions are normally considered to comprise fines and imprisonment. It seems to me that having your business broken up by a Court amounts to a penal sanction according to any reasonable definition of the term. It is certainly likely to reduce the firm's revenues. I do not propose to get into a legal debate on that particular point. Certainly as an economist it seems that it is a new form of penalty introduced in the Act and therefore one that merits some consideration.

Experience under the Previous Legislation.

Before focusing on these three issues I would like to make some comments regarding the results under the previous legislation, particularly the 1996 Act which gave the Authority enforcement powers and introduced criminal penalties. By any standards the results have been abysmal. Three civil actions were settled on terms favourable to the Authority. There has been one summary prosecution where the defendant pleaded guilty and the Authority's most recent Court 'success' in late 2000 saw it secure an injunction against a handful of farmers. We have seen no obvious progress in respect of a number of files that were referred to the DPP, one in 1998 and two in 1999.

Last January the Authority Chairman in a reference to these cases reportedly stated that:

> 'We have sent some very serious files to the Director of Public Prosecutions three years ago. It's a concern that he has not been resourced to deal with them expeditiously.'[1]

Several civil actions have also been pending for some years now. In an apparent reference to these the Authority Chairman remarked:

> 'It's a huge burden to resurrect files from 1997-99. A lot of stuff eventually can't be brought forward because of lack of continuity…..It shows a large policy cost for the savings that were made in resources a few years ago.'[2]

The results of the 1996 Act have implications for the credibility of the Authority and the new legislation. It also provides support for those who argue against any criminal penalties since they can argue that such an approach has not worked. To paraphrase Chesterton, its not that criminal penalties have not worked, it is just that they have not been tried, at least in any meaningful sense.

Criminal Penalties Necessary in Cartel Cases

[1] *Competition,* Vol.11(1), p.9.
[2] *Ibid.*

Cartels essentially involve managers and employees of rival businesses secretly agreeing to raise prices to their customers for the goods and services that they supply. They are a conspiracy to defraud consumers and to deny them the benefits that should result from firms having to compete with one another to win customers. Unlike many violent crimes, participation in a cartel is not the result of a moment's passion or transient rage. Cartels are organised and operated by individuals and companies who coolly calculate that they stand to earn substantial profits from such behaviour. Those who engage in cartels are not petty crooks; they are clever sophisticated business executives who have risen to senior management positions in their companies.

Given the substantial profits that can accrue to parties engaging in cartels, it is obvious that the only effective deterrent is a system of competition law enforcement that contains serious penalties. Given the provisions of the Irish Constitution that means criminal penalties. It is quite clear that civil proceedings resulting in injunctions would be a totally inadequate deterrent to cartels. The Report of the Competition and Mergers Review Group commenting on a presentation some of its members made to the OECD Committee on Competition Law and Policy noted that:

> 'The question of criminal sanctions was one of the issues debated and the relevant members of the Review Group were struck by the very large measure of agreement that criminal sanctions were necessary in a system which does not otherwise allow for the imposition of fines or penalties.'[3]

The Increased Penalties for 'Hard-Core' Cartels.

The Act increases the maximum jail term for individual managers and directors involved in 'hard -core' cartels from two to five years. This represents a very significant change. It suggests a view that engaging in cartels constitutes a serious criminal offence and the legislation therefore sends a message, not just to businesses, but to the judiciary that such matters should be regarded as such. Of more immediate concern to individual managers

and directors, it makes participating in a cartel an arrestable offence, i.e. Gardai may detain and question individual managers and directors suspected of involvement in a cartel.

The absence of powers to question such individuals was a major stumbling block in cartel investigations under the 1996 Act. The CMRG recommended that there should be a power of arrest although it proposed a somewhat more cumbersome procedure than the one adopted in the Act. Speaking on this point in a personal capacity the Attorney General observed that:

> 'If businessmen suspected of criminal offences under competition law were not merely to tell investigators, "See my lawyers", then there had to be indictable offences and – for police to have powers of arrest and questioning – sentences had to be five years or more.'[4]

The Act includes three significant provisions in respect of 'hard-core' cartels:

- Such practices are presumed to have the object of effect of preventing, restricting or distorting competition unless the defendant can prove otherwise.
- The Act removes the defence contained in the 1996 Act that defendants did not know that what they were doing was anti-competitive.
- It provides that defendants may argue that the cartel contributes to improving the production or distribution of goods or provision of services or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit, while not imposing terms which are not indispensable to the attainment of those objectives and affording undertakings the possibility of eliminating competition in respect of a substantial part of the products or services in question.

[3] Final Report of the Competition and Mergers Review Group, p.80.
[4] *Competition* Vol.9 (9), p. 222.

The first problem arises in respect of the presumption which attempts to reverse the burden of proof. I do not propose to comment on the constitutionality of such a provision, as I'm sure other speakers may have a view on that. Suffice to say that, in my view, it represents a very unwieldy approach and one that certainly involves an unnecessary risk, namely that it will not stand up to constitutional challenge.

The second problem is the 'economic progress' defence. Juries will be required to assess complex economic arguments and to be satisfied beyond a reasonable doubt that at least one of the four tests is not satisfied. Let us be clear, contrary to popular misconception, economists generally agree that cartels are harmful to consumers, impose unnecessary costs on society and do not produce any benefits. The problem is that the prosecution will be required to prove this point beyond a reasonable doubt in every case. At the very least it will greatly increase the length and complexity of cartel cases unnecessarily, and create considerable scope for confusion or if you like doubt.

According to *Competition Press* the Authority Chairman has criticised the failure to set out a good definition of hard core cartel offences observing that 'In the US you can't offer the sort of defences under section 6(4) of the Bill.' It is also worth noting the comments of the present Attorney General at the time the 1996 Act was being debated in the Dail.

> 'Price-fixing, bid rigging and market sharing offences would have to be specifically created. One cannot simply criminalize all anti-competitive agreements or practices as such. Still less could one imagine criminalizing all behaviour which amounted to abuse of dominant position.
>
> In short, the offence has to be one which any Joe or Josephine Soap sitting in a jury box can easily see falls on the wrong side of a clearly established line. We can't have the situation in which companies are in perpetual conclave with their legal advisors as to what aspect of their behaviour does or does not fall within the

> ambit of any proposed offence. Any new offences must be simple, obvious, and generally understood.'[5]

This is the line that has been adopted in the UK Enterprise Bill which is also proposing to introduce criminal penalties including jail terms of up to five years for those engaged in cartels. However, the UK Government has chosen to create a specific cartel offence, which is outlined in s.179 of that Bill, to avoid the need to have complex economic evidence presented to juries in such cases.

In the US cartels are deemed illegal *per se.* The prosecution is required to prove that there was a cartel agreement. They are not required to prove why that is bad. In the case of robbery the prosecution is required to prove that the accused carried out the robbery, it does not have to prove that robbery is bad. The defence cannot introduce theologians, economists, sociologists or any other 'experts' to argue that there is some theoretical basis to believe that a particular robbery was beneficial.

It seems to me, as an economist at least, that there is a simple alternative solution namely to make operating a cartel a specific offence. In other words to provide that it shall be an offence:

- For competing undertakings to enter into or implement an agreement;
- For an association of undertakings to make or implement a decision; or
- For competing undertakings to engage in a concerted practice

The purpose (object or effect) of which is to

(a) directly or indirectly fix prices with respect to the provision of goods or services to persons not party to the agreement, decision or concerted practice,

(b) limit output or sales, or

(c) share markets or customers.

Criminal Sanctions Not Appropriate for Non-Cartel Behaviour.

[5] *Competition* Vol.4(10).

It is important to stress that there is a fundamental difference between cartels and other types of anti-competitive behaviour. In the case of 'hard-core' cartels there is virtually no room for debate regarding their object and effect. Economic analysis is clear in concluding that cartels are virtually always harmful and produce no offsetting benefit. The same is not true of other practices. In the case of non-price vertical restraints, such as exclusive distribution agreements, it is generally recognised that these cannot automatically be described as either pro or anti-competitive and that a detailed analysis based on the individual market circumstances in each case is required. Similarly it is recognised that there is frequently a fine line between aggressive competition and abuse of dominance. Criminal sanctions are therefore inappropriate in non-cartel cases because:

- The dividing line between competitive and anti-competitive behaviour is not clear and depends on the specific circumstances of the individual case;
- This effectively makes successful prosecution unlikely;
- Threat of criminal sanction might have a 'chilling effect' on competition.

The new Act makes some moves in this direction by removing penalties for individual managers and directors (both fines and jail sentences) for non-cartel offences including abuse of dominance. Nevertheless such practices still constitute criminal offences and firms found guilty of such offences are still exposed to substantial fines. One really has to question the point of such provisions. Unlike the case of cartels where, in my view, it would be possible to create a clear definition of an offence in the legislation, this cannot be done for other practices including abuse of dominance. Any attempts at criminal prosecution in such matters are highly unlikely to succeed because of the highly complex economic evidence that the jury would be required to consider and the fact that, again in contrast to cartels, there is very real disagreement among expert economists. The Authority Chairman has reportedly admitted that 'these cases will only rarely achieve the burden of proof required for criminal fines'.[6]

Vertical restraints can sometimes be anti-competitive. Similarly dominant firms may, on occasion overstep the line between aggressive competition and abuse. In most instances I

[6] *Competition,* 11(1), p.10.

think civil remedies that effectively order firms to discontinue such practices are likely to prove sufficient to deal with such problems.

In the case of alleged predatory pricing it would be essential to bring actions for injunctive relief before the predatory behaviour has succeeded. That means that the Competition Authority is going to have to become more active and respond quickly in the face of allegedly predatory behaviour and actively seek interim injunctions in such cases. I recognise that such actions will expose the Authority to potential damages actions if it is unsuccessful at a full hearing. However, protecting competition means ensuring that predatory behaviour does not succeed and I think the only way to do that is to stop it before it can achieve its objective. Not only is action after the event of no benefit to the victim, it is of no benefit to consumers. As Kahn observed 'a few dead bodies outside the door' provides a clear message to other would-be entrants.

The UK authorities have on occasion sought to counter predation by securing undertakings from firms to maintain lower prices and higher output levels for a fixed period of time, usually a period of years, a response to predatory behaviour suggested by Baumol.[7] The idea here is that, even if the dominant firm eliminates its rival, the costs of doing so are increased considerably and it must wait much longer to secure any payoff from such behaviour. Such measures might therefore deter firms from predatory actions, provided firms believed that prompt action by the Authority was likely. They benefit consumers by ensuring low prices are maintained and avoid a situation where action by the Authority to protect competition has the effect of increasing prices to consumers in the short-term. In seeking injunctive relief the Authority might consider accepting undertakings of this type. If a firm were prepared to commit to maintaining its lower prices for a sufficient period of time, this of itself would suggest that it was not engaged in predation and it might not be necessary to pursue the matter further.

Breaking-Up Dominant Firms.

[7] W. Baumol, (1979), Quasi-Performance of Price Reductions: A Policy for Prevention of Predatory Pricing, *Yale Law Journal,* Vol.89, 1-26.

The other addition to the Authority's arsenal in the Act is the power to seek a break-up of a firm found to have abused its dominant position. Obviously this is an extreme remedy. It is one that has a long history in US law. Standard Oil and AT&T are just two famous examples where such measures have been imposed. The latter case heralded a virtual revolution in the telecommunications industry. In recent years we have seen Microsoft successfully resist demands for a break-up.

Dominance means that prices will be higher and output lower than would be the case under a more competitive market structure. The EU Commission has frequently sought to address this by finding that charging 'excessively high' prices constituted an abuse of dominance. The problems with this approach are two-fold.

- How can one establish that a price is 'excessive';
- To amount to anything more than an occasional rap across the knuckles, such an approach requires almost constant monitoring of dominant firms' pricing behaviour.

The logic of the US approach is that it is better to 'take once and for all whatever structural actions are needed to restore effective competition and then stand back and let market processes do their job.'[8]

While such a remedy is appropriate and necessary in certain cases, of necessity it is one that should be exercised rarely. As Justice Wyzanski observed in *United Shoe:*

> 'In the antitrust field the courts have been accorded…an authority they in no other branch of enacted law…They would not have been given, or allowed to keep, such authority in the antitrust field, and they would not so freely have altered from time to time the interpretation of its substantive provisions, if courts were in the habit of proceeding with the surgical ruthlessness that might commend itself to those seeking absolute assurances that there will be workable competition.'[9]

[8] F.M. Scherer and D. Ross, (1990), *Industrial Market Structure and Economic Performance,* p.486.
[9] *United States v. United Shoe Machinery Corporation,* 110 F.Supp. 295, 348 (1953).

Conclusions.

As I noted at the outset, this is the third Competition Act in eleven years. I suggest that it is not too much to expect that we might have managed to get it right at this stage. Again speaking at the time the 1996 Act was before the Dail, the current Attorney General observed that:

> 'It seems to me that if modern procedures, rules of evidence and evidential presumptions are introduced, it should be possible to simplify serious offences of price fixing, bid rigging or market sharing into a form that can be easily prosecuted, easily understood by the jury and the public, and in which the court is not weighed down with a mass of documentation and technical evidence which makes the trial unduly long or cumbersome.' (Michael McDowell).[10]

Unfortunately this legislation which has been rushed through the Oireachtas on the eve of the Election without adequate scrutiny fails to do that. It fails to provide a properly defined cartel offence, opting instead for a provision which may well prove to be unworkable. As the Authority Chairman has pointed out unless such offences can be successfully prosecuted 'there would be very little for anyone to fear from this Bill,'[11] The UK Government has recognised and come forward with a worthwhile proposal to address the problem. I think in the race to see whether Ireland or the UK are the first to send someone to prison for operating a cartel, it would be worth putting a few Euro on the UK with Paddy Power, even though their legislation has not been enacted yet.

[10] *Competition* Vol.4(10).
[11] *Competition,* Vol.11(1), p.9.