Trust Us We're Regulators:
Why Civil Fines in Competition Cases Are a Bad Idea.[1]

Introduction.

There has been some discussion in recent months regarding the possible introduction of civil fines as a remedy for breaches of competition legislation. It was reported in a recent edition of *Competition*, for example, that the idea was discussed at a seminar in July 2002 and the Competition Authority chairman indicated in a recent interview in *Competition* that the Authority was examining the issue. In an *Irish Independent* interview dated 23rd December 2002 the Chairman was reported to have said that the Authority had consulted widely on the issue and would be drawing up proposals that would be submitted to the Tanaiste for a system of civil fines.

The current article argues that such proposals are ill conceived and may even be damaging both for business and competition policy in Ireland.

Civil Fines - How Would They Work?

In spite of the *Irish Independent* story the Authority has not published any information on its proposals for civil fines on its website. Consequently, there is little detailed information available regarding any proposed scheme for civil fines. There are a number of aspects of any such scheme which need to be addressed.

The first question that arises is the issue of what types of behaviour would be subject to civil fines. In the interview which appeared in *Competition* the Authority Chairman referred to the idea of having civil fines for non-"hard-core" breaches of the Act. Price fixing and market sharing cartels are generally considered to come within the definition of "hard-core" breaches. In other words, this suggests that civil fines would apply to non-cartel breaches of section 4, such as vertical restraints, and to abuses of dominant positions contrary to Section 5. Elsewhere in the interview, however, the Chairman referred to the difficulty involved in criminal prosecutions of cartels.

[1] This article appeared in *Competition* 12(5) under the heading: Why Fingleton's idea of civil fines for competition offences is a bad idea.

The second issue that arises is who would be responsible for imposing civil fines; the Courts or the Authority. At EU level civil or administrative fines apply in respect of breaches of the competition rules. Similar provisions apply in many, if not all, EU Member States except Ireland. In virtually all cases, fines are imposed by the relevant competition authority. Under the EU regime fines are imposed by the Commission. It appears that some industry regulators in Ireland have included provision for civil fines in their licence conditions. In other words, the norm elsewhere is to have the competition agency investigate such breaches and to decide both whether there has been an infringement and the appropriate penalty for such an infringement. The *Irish Independent* report referred to the Authority Chairman saying that civil fines would be imposed by the courts but "the Authority would have a role in calculating the economic damage done due to the anti-competitive actions of the company or companies…"

A third issue to be addressed is the standard of proof that would be required. Effectively the apparent advantage of civil fines is that they would be subject to the civil rather than the criminal standard of proof, i.e., balance of probabilities rather than beyond reasonable doubt. This raises the obvious question of whether the courts would go along with the idea of imposing penalties at the lower burden of proof. In the UK the Competition Commission has stated that an intermediate test of proof, i.e., somewhere between the civil and criminal burden should apply.

Price Fixers Should Go to Prison.

Many areas of competition law constitute grey areas. In the case of 'hard-core' cartels, however, there is virtually no room for debate regarding their object and effect. 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. The US Department of Justice estimates that a cartel will result in prices on average being ten per cent higher than would otherwise be the case.[2]

[2] Department of Justice, (1998), *Sentencing Guidelines Manual,* p.231.

Cartels are organised and operated by individuals and companies who 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.

Fining only the companies involved is unlikely to be effective in preventing cartels. It must be borne in mind that it is the individual human persons who run companies who actually make the decisions to engage in cartels. Such individual frequently stand to gain directly from such decisions. The benefits to individual executives as a result of the higher profits generated from participating in a cartel include higher salaries, performance related bonuses, enhanced promotion prospects and other benefits. If only the company is subject to a fine when a cartel is detected, it is the shareholders rather than the executives responsible who are penalised. Fining the company in those circumstances will therefore have little deterrent effect.

Effective deterrence of cartels requires that the individuals within a company responsible for the decision to participate in cartels must face penalties. Fines for such individuals are one option. Such fines face the obvious difficulty that the individual's employer may reimburse them, thus negating the deterrent effect. In New Zealand consideration has been give to the idea of making it illegal for firms to reimburse employees fined for competition law breaches. This in turn raises the question of how such measures can be enforced. In contrast, however, individuals cannot pass a prison sentence on to their company.

More Reasons to Favour Prison Sentences.

There are other reasons for believing that imprisonment is likely to provide a strong deterrent to cartel behaviour. Unlike many violent crimes, participation in a cartel is not the result of a moment's passion or transient rage. Thus, unlike, many criminal actions undertaken in the heat of the moment, those contemplating participating in a cartel are far more likely to weigh the benefits from such participation against the consequences of getting caught and therefore take the threat of imprisonment into account. In addition,

imprisonment may be a stronger deterrent for white collar individuals, as they have more to lose if convicted, than many individuals who engage in traditional criminal activities. The UK Department of Trade and Industry reported that 83% of UK competition law exports favoured the introduction of criminal penalties for cartels.[3]

There are other limitations on the effectiveness of fines on companies for engaging in cartels. US research indicates that, in the case of almost half of all firms found to have engaged in cartels, imposing the optimal level of fines would have bankrupted them. The idea of effectively closing firms down and putting their employees, the vast majority of whom are not responsible for price fixing, out of work by so doing is clearly a non-runner. If such considerations mean that fines on companies end up being set below the optimal level, their deterrent effect is reduced further. Fines that are set too low are akin to a one-off lump-sum tax on cartel profits. In certain circumstances such a lump-sum tax may simply be passed on to consumers, which makes them somewhat self-defeating.

Until the mid-1970s price fixing was classed as a misdemeanour in the US. Since the early 1980s the US authorities have engaged in what has been described as a "crusade" against cartels. During the 1990s, the Department of Justice successfully prosecuted an average of thirty-five people a year. The US authorities believe that such action has been successful, a view borne out by the success of their cartel immunity programme which has resulted in many firms coming forward, admitting their participation in cartels and providing evidence against their co-conspirators. The fact that roughly fifty percent of immunity applications involve cartels that were previously unknown to the authorities suggests that increased prosecutions of individual executives for participating in cartels are having a deterrent effect.

Civil Fines Provide Bad Incentives All Round.

There are several reasons why civil fines are inappropriate in non-cartel or rule of reason cases. Unlike cartels, it is generally recognised that non-price vertical restraints, such as exclusive distribution agreements, 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 widely recognised that there is frequently a fine line

[3] Department of Trade and Industry, (2001), *A World Class Competition Regime*, London: HMSO.

between aggressive competition and abuse of dominance. The idea of penalising such behaviour therefore raises some serious questions.

As there is no consensus as to what does and does not constitute anti-competitive behaviour in such cases, there is a likelihood that fines would sometimes be imposed for behaviour that some would argue is not anti-competitive.

If civil fines really do have a deterrent effect, as their proponents would suggest, then, when the dividing line between what is and is not harmful is unclear, there must be a strong likelihood that firms would play safe and avoid competing too aggressively for fear of overstepping that line. In other words, if civil fines have a deterrent effect, they will not only discourage anti-competitive behaviour, but they will also deter firms from competing, which would appear to be counter-productive.

Poor Incentives for Competition Authority, too.

A system of civil fines would also provide poor incentives for the Competition Authority. Consider the situation facing the Authority if there is a system of civil fines for "rule of reason" offences and criminal penalties for "hard-core" offences. In setting enforcement priorities, the Authority would face a choice between pursuing serious infringements with a very high burden of proof and less serious infringements with a lower burden of proof. Faced with such choices, an agency wishing to be seen to be doing something is likely to channel resources into less serious cases because they have a higher chance of success. If this were to happen, then it would also over time create a perception that civil penalties were "working" while criminal ones were not. Pressure to substitute civil for criminal penalties for "hard core" offences would grow, although, as previously argued fining companies is unlikely to deter them from engaging in cartels.

It should be noted that, in the United States, criminal sanctions only apply to "hard-core" cartel behaviour. Rule of reason matters including monopolisation cases, which are the US equivalent of abuse of dominance, are dealt with by civil actions which do not involve fines. Yet the US is generally regarded as having the most effective competition laws in the world. In his interview in *Competition* the Authority Chairman refers to the fact that, in the US, private litigants can sue for treble damages in abuse of dominance cases and the prospect of such damages provides an effective deterrent. Irish legislation

allows for parties harmed by anti-competitive behaviour to sue both companies and their directors for damages including exemplary damages. The Authority Chairman notes that, thus far, there has been no successful action for an abuse of dominance in Ireland.

It is unnecessary for the purposes of the present article to go into the rights or wrongs of the various court judgements in such cases. It is far from clear, however, how the introduction of civil fines for such infringements would improve matters.

If such matters are to be decided by the Courts, then the case for civil fines rests on an implicit assumption that the Authority would be more successful in bringing civil actions for breaches of section 5 than private litigants have been hitherto. Perhaps it would, although there is no need to change the law in order to test that hypothesis. The Authority could bring civil actions under the present legislation. On the other hand, if one believes that the Authority is unlikely to be any more successful before the courts than private litigants, then civil fines will not make any difference.

Adminstrative Fines Would be Even Worse.

The alternative is to take the view that the Authority should be given the power to make decisions on such cases and to impose civil fines. It is claimed that this would not be possible under the Constitution as it stands due to the requirement that only Courts can impose fines. Undoubtedly there are good reasons for this. Experience of competition laws in other jurisdictions shows that, where decisions are made by administrative bodies rather than the courts, the risk of false positives, i.e. incorrect findings of wrongful behaviour are more likely. This seems to be an inevitable result of human nature. It is extremely difficult for someone closely involved in a matter to view the facts with a dispassionate eye. This is the rationale behind the common law principle that one should not act as prosecutor and as judge and jury.

In the US the competition agencies must go to court and seek an injunction in order to prohibit a merger, in contrast to the EU where the decision is made by the Commission. Several authors who have compared the US and EU merger control regimes report that the requirement to go to court imposes a higher evidential standard on the investigating authorities. It has been pointed out that in some instances the Commission has blocked mergers on the basis of evidence that would have been thrown out by a US court, e.g.

newspaper reports and uncorroborated claims of rivals of the merging parties. Similarly, US regulatory agencies, which can block mergers without having to go to court unlike the antitrust agencies, have been found to prohibit mergers on the basis of evidence that would have been considered insufficient by the antitrust agencies.

Similarly, a number of commentators have pointed out that the European Commission has, on a number of occasions, made wrongful findings of anti-competitive behaviour. In *Wood Pulp,* for example, the Court of First instance rejected the Commission's findings on the grounds that there was insufficient evidence to prove collusion. Similarly, in *Airtours* the Court found that the economic evidence simply did not support the Commission's decision that the merger would be anti-competitive.

Traditionally the Irish justice system has favoured defendants, reflecting a basic underlying philosophy that it is better to sometimes wrongfully acquit guilty parties than to wrongfully convict the innocent. The introduction of a system of civil fines to be imposed by the Authority would considerably tilt the field in a way that is likely to result in incorrect findings of anti-competitive behaviour, known as type one errors in the economics literature. This in turn would worsen some of the problems arising from having civil fines imposed by a Court that have been outlined previously. That is to say that it would increase the risk that competitive behaviour would be deterred and encourage the pursuit of less serious offences at the expense of more serious ones.

Protections Likely to Prove Inadequate.

It could be argued that the difficulties just outlined could be overcome by the creation of "Chinese walls" within the Authority so that those responsible for investigations are not involved in decisions to impose fines. Further it might be said that genuinely innocent parties would be protected by having the right of appeal to the courts. I would suggest that both these views are mistaken.

An administrative body like the Authority differs from a court in one very important respect. Unlike judges the Authority would not be totally disinterested in the outcome of cases before it. Like any bureaucratic agency it is likely to face pressures to be seen to be doing something. At the end of the day its performance inevitably is likely to be judged

in terms of the fines it has imposed during the course of the year, something that does not apply to the courts.

The appeal argument is flawed because essentially it suggests that being wrongfully found guilty by the Authority does not matter as it can be overturned on appeal. It ignores the fact that the firm may suffer harm to its reputation as a result of the original decision which may not be capable of being made good afterwards. It also ignores the additional cost both in time and money that the firm would have to incur in order to prove its innocence.

Conclusions.

It is somewhat surprising to see calls for civil fines emerging literally within weeks of the passage of the Competition Act, 2002. Given that the Competition and Mergers Review Group had proposed a form of administrative fines, one would have expected that the pros and cons of the matter would have been fully considered before the new legislation was enacted. While a system of civil, possibly administrative fines, may appear to have some merit, in reality it has some rather serious downsides which suggest that it would be rather undesirable.

There is an important element missing in this debate. If the Authority wishes to see civil fines introduced for rule of reason cases, it seems to the current author that it is incumbent on it to show why they are necessary. Simply arguing that the criminal burden of proof is too high is not good enough. Rather the Authority should produce details, based on its investigative experience, of the sort of cases where it believes such fines should have been imposed. It should be possible for the Authority to provide practical examples without disclosing details of the parties involved to show why such penalties are necessary. This would allow a properly informed public debate on the issue which could decide, in particular, whether the behaviour in question was so undesirable as to justify tilting the playing field so heavily in the prosecutor's favour.

For now, at least it would seem that the most appropriate conclusion regarding the introduction of civil fines for breaches of competition law is the extremely useful option provided by the Scottish verdict - Not Proven!