Just and Optimal Fines for Competition Law Enforcement

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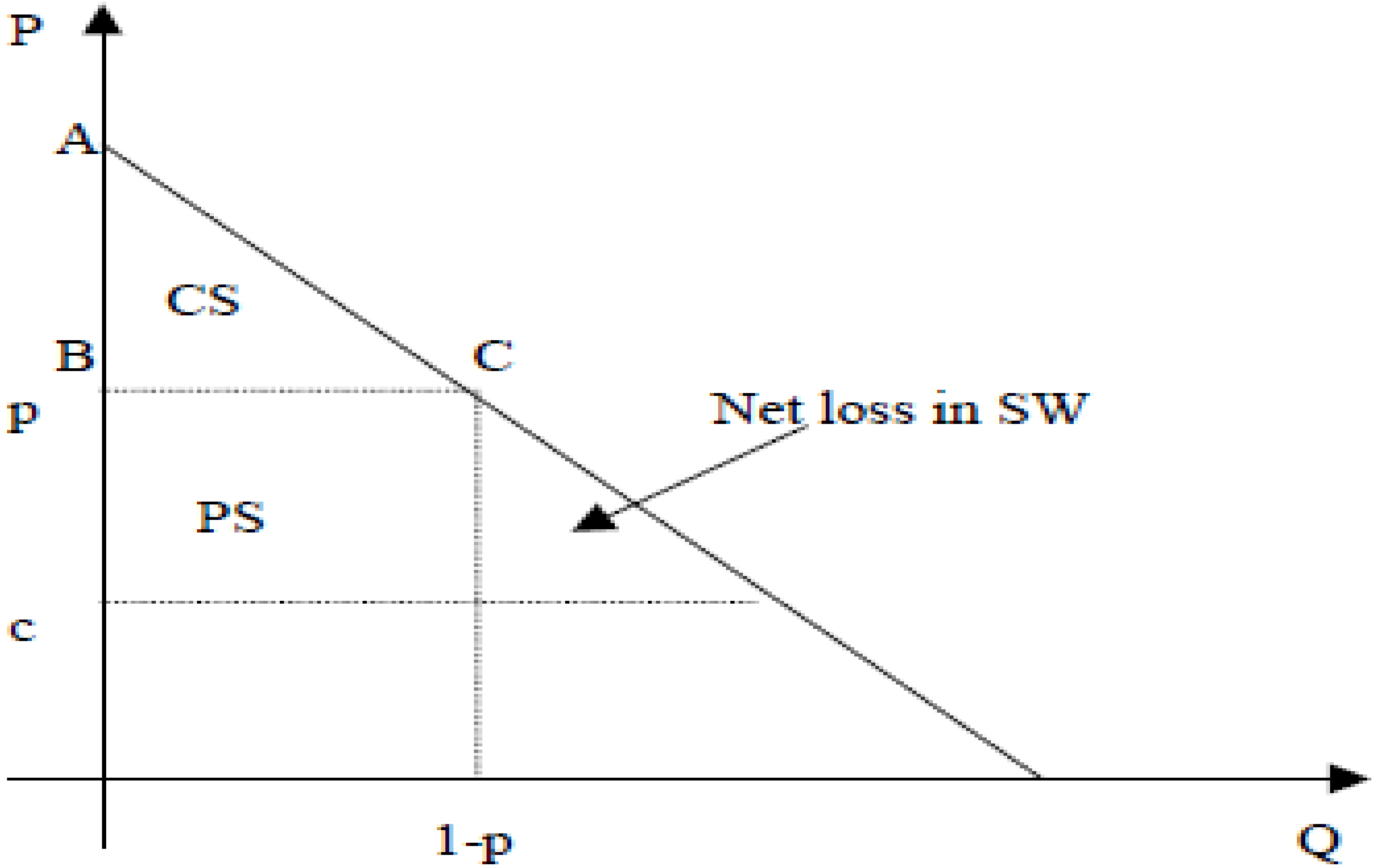
The centrality of sanctions in competition law enforcement

- Sanctions <u>should be part of all legal regimes</u> and this is also true for competition law

- Because of the severe harm that can be created by competition law infringements, <u>sanctions for such infringements must be sufficiently strict to ensure deterrence</u>

- <u>BUT</u> are corporate fines the most effective way to improve compliance with competition law?

Optimal enforcement system and fines



Harm from cartels: a static picture

Designing a system of “optimal” sanctions and remedies

- An **optimal sanction** will correspond to the harm caused by the violation of the law, divided by the probability of detection, to which should be added the administrative costs of law enforcement, that is the amount needed to impose and collect the sanction
- In order to maximize social welfare, policy makers may act on the following fronts:
  - increase enforcement expenditures and hence the probability of detection;
  - increase the level of fines or sanctions and alter their form so as to increase deterrence;
  - impose a liability rule that would maximize social welfare.
- As few as one in six or seven cartels are detected and prosecuted, implying the probability of detection roughly between 0.14 and 0.17
- Combe & Monnier (2007) the optimal sanction is 6.6 times higher than the loss of consumer surplus, that is, for a five year cartel this represents more than 300% of the turnover

Fines in the EU

Year	Case name	Amount in €
2012	TV and computer monitor tubes	1 470 515 000
2008	Car glass	1 189 896 000
2013	Euro interest rate derivatives (EIRD)	1 042 749 000
2014	Automotive bearings	953 306 000
2007	Elevators and escalators	832 422 250
2010	Airfreight	799 455 000
2001	Vitamins	790 515 000
2008	Candle waxes	676 011 400
2007/2012	Gas insulated switchgear (incl. re-adoption)	675 445 000
2013	Yen interest rate derivatives (YIRD)	669 719 000

Do high fines lead to over-enforcement or over-deterrence?

Combe and Monnier (2009)

"(...) The level of fines compared to the illegal gain made by cartels members remains low as at best only half of the fines reach this value. This implies that fines regularly fall below the minimum illegal profits of cartels. Thus, fines imposed against cartels by the European Commission are suboptimal even considering a 100% probability of detection. It means that even if we do not consider the fact that some cartels remain undetected, the level of fines is insufficient. Hence, these fines cannot deter price fixing if decisions maker are risk neutral, as the probability of detection is clearly below 100%. (....) the Commission has never imposed a dissuasive fine given the low probability of detection and a low price elasticity of demand. For all these reasons, the risk of over enforcement is actually nonexistent and should be considered as a myth".

Allain, Boyer, Kotchoniz, and Ponssard (2013)

"The comparison of our benchmarks to the actual level of fines imposed by the European Commission in recent cartel cases (from 2005 to 2010) shows that, according to the different competitive scenarios, approximately 30% to 80% of the fines are deterrent, while 50% to 80% are compensatory. These empirical results could indicate that recent fines are closer to their deterrence and compensation objectives than they used to be. However, a striking feature of our results is the dispersion of the fines: some seem to be much too high, while others are much too low"

Are these deterrence-focused perspectives compatible with the legal approach focusing on justice and the principle of proportionality?

- Deterrence is also a corrective justice principle/retribution view of sanctions
- Risk that review courts (adhering to the legal principle of proportionality and the implicit “retribution approach” or “moral acceptability approach” to sanctions) may find sanctions imposed (or requested) by competition authorities (adhering to the economic principle of deterrence and the implicit “cost minimization approach” to sanctions) disproportional and therefore tend to reduce the amount of the sanctions to non-deterring levels.
- The principle of proportionality of penalties reflects the retributive view of punishment
- The economic objectives of competition law

Statutory limits

Jurisdiction	Statutory limits
United States	• USD $ 100 million (~ €76 million) under the Sherman Act, or • under the Alternative Sentencing Statute fines up to twice the gain derived from the criminal conduct or twice the loss suffered by the victims
European Union	• 10% cap of the total worldwide turnover
United Kingdom	• 10% cap of the total worldwide turnover
Germany	• 10% of the annual worldwide turnover of the undertaking. This has been interpreted by German courts not as a cap (as under EU law), but as a maximum fine.
France	• 10% cap of the highest worldwide pre-tax turnover
Brazil Canada Chile	• 30% of the gross revenue of the last financial year • $10 million Canadian dollars • The TDLC can impose fines for fiscal benefit up to 30,000 annual tax units (UTA), (approximately US$30,000,000).

Effects-based approach versus formalism I

- Fines should be at least equal to the expected illegally earned profits divided by the probability to be caught, hence they should relate to “the *ex ante* extra profits originating from the violation and not to the extra profits actually gained that may be higher or lower than those expected at decision-making time”
- The impossibility of a full-effects based approach in determining fines
  - “expected” profits are difficult to observe
  - great diversity of market configurations
  - Administrability costs
- Yet, a more formalistic approach, relying on presumptions or proxies, such as a percentage of the affected sales or volumes of commerce, may not also be perfectly compatible with the principle of proportionality and corrective justice

Effects-based approach versus formalism II

- Recourse to some presumptions or proxies that would reduce the costs of estimating the fines may be necessary in instances where these administrative costs would cover an important part of the amount of the fine imposed.
- OFT on predictability of fines: “(t)heoretically, there appear to be more arguments against than for predictability of fines. In practice, however, the two main jurisdictions (US and EU) have strived to make their fining decisions more transparent and more predictable. It enhances leniency which […] can have a powerful effect on deterrence. On balance, predictability may be an advantage if fine levels are on average very high but a disadvantage otherwise”

Towards a Structured Effects-based approach

Heimler & Mehta (2012)

	Value of the Lerner Index		
Elasticities	0.3	0.5	0.8
0.5	12.26%	10.69%	8.31%
0.8	10.67%	8.01%	4.00%
1.2	8.19%	3.97%	<1%

Different steps in setting financial penalties

- Base fine
- Adjustments (including aggravating and mitigating circumstances)
- Limits (maxima and minima)
- Leniency and Settlements

Different steps in setting financial penalties I

- ***Step 1: Determination of the basic amount of the fine:***

  a. ***The FNE should be offered the choice between three options, among which it may choose the one leading to the greatest financial penalty:***

  – Estimate the excess illegal gains from the offense (that is 100% of the overcharge), **or**

  – Estimate the pecuniary losses to a person other than the defendant (100% of these losses) to the extent the loss was caused intentionally, knowingly, or recklessly or, unless the above options would unduly complicate orprolong the sentencing process, or would not reflect the harm caused by the anticompetitive conduct if this harm may not be quantified in the form of pecuniary losses,

  – *Use a proxy based on a percentage of affected sales (on the basis of e.g. 10-15% as an overcharge estimate)*

Different steps in setting financial penalties II

b. *Apply a multiplier equal to the inverse of the estimated detection probability (e.g. 6 if the detection probability is estimated as 1/6).*

c. *In order to take duration into account, the base fine should be multiplied by the number of years of participation in the infringement.*

d. *The Statutory maximum should be revised to 10% of the global turnover. Second best:Where the fine so calculated exceeds the statutory maximum of 30,000 [UTA] Annual Tax Units, it should be possible to apply a higher fine disgorging the gains where the gains actually made can be calculated.*

Different steps in setting financial penalties III

- ***Step 2: Adjustments to the basic amount***

a. ***Aggravating circumstances (upward adjustment)***

- *Repeat offenders*
- *Refusal to cooperate*
- *Role of leader in the infringement*

b. ***Mitigating circumstances (downward adjustment)***

- *Sufficient cooperation with authority*
- *Limited involvement in the infringement*
- *Effective corporate compliance (may be considered)*
- *Application for leniency (downward adjustment or full immunity)*

c. ***Application for leniency (downward adjustment or full immunity)***

Different steps in setting financial penalties IV

d. ***Inability to pay – bankruptcy considerations (downward adjustment)***

e. ***Adjustment according to the legal maximum****: it is suggested to replace the legal maximum of* 30,000 [UTA] Annual Tax Units, which might lead to under-deterrence *with a percentage of the worldwide turnover of the infringing undertakings, for instance, a percentage of 10%, as it is the case in the EU, UK, Germany and France. It is suggested for this percentage to operate as a maximum fine, not a cap (see our discussion of the debate in Germany). However, it is suggested that a better way forward would be remove the statutory maximum, or as a second best, render it operational only if the FNE makes use of proxies, such as 30% of the affected sales, in order to define the base fine, instead of estimating the excess illegal gains. Hence, the FNE should be free to request fines that are higher than the statutory maximum of 30,000 UTA, and for the TDLC to award them, if the FNE opts instead to put forward an estimation of the excess illegal gains.*

Effective deterrence beyond fines

COMBINATION OF CORPORATE FINES

WITH PRIVATE ENFORCEMENT

- Damages actions or public compensatory function
- Interaction of public and private liabilities

COMBINATION OF CORPORATE FINES

WITH SANCTIONS TO INDIVIDUALS

- Effective deterrence requires a <u>combination of corporate sanctions and individual penalties</u>:
  - Sanctions that directly hurt employees are likely to make them more hesitant to breach competition rules
  - The risks of such sanctions may also lead employees to reject orders to engage in anti-competitive behaviour coming from their superiors and even encourage them to blow the whistle
- Sanctions on employees could include <u>imprisonment</u>, <u>director disqualifications</u>, <u>personal fines</u>, etc.

Effective Deterrence