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**THE EUROPEAN COMMISSION'S NEW FINING GUIDELINES AND HOW
THEY MAY AFFECT CARTEL ENFORCEMENT**

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Introduction

US corporations involved in secret price fixing cartels that rig prices across the world face serial prosecution in an increasing number of enforcement jurisdictions, especially now that so many have followed the example of the United States Department of Justice and introduced immunity or leniency programs¹. While the exposure is likely to be greatest in the United States, where both the company and individual executives will be prosecuted criminally under the Sherman Act, the fines imposed by the European Commission for breach of Article 82 of the EC Treaty may well make an even more sizeable hole in the balance sheet. The fact that the fines are “only” administrative rather than criminal will not be a consolation². Indeed, the inability of the Commission to secure jail terms for individuals, a power regarded by the Justice Department as by far the most effective deterrent of cartel behavior, has driven it to keep ramping up to corporate fines to ever-higher levels.

Since 1998, the Commission has had so-called “Guidelines” that set out the basic methodology it will adopt when assessing the penalties. Under the first set of Guidelines³, soon to be replaced, the general levels of fines rose to many times what they were in previous decades. But while these Guidelines provided a rudimentary formula for increasing or reducing the base fine, the selection of that start point –reflecting the “gravity” of the infringement and the main determinant of the final figure- was at the Commission’s discretion. New Guidelines were published in 2006 and will come into effect in September 2006⁴. The main change as compared with the old 1998 Guidelines is to move away from an arbitrary start point to a “volume of commerce” approach, with a more direct link to the value of the sales and the duration of the cartel.

The basic amount of the fine will be calculated by taking a proportion – up to 30 per cent - of the value of affected sales made by the undertaking in the last full year of the cartel and *multiplying* it by the number of years’ duration. Since the old method paid less

¹ At last count, the EC Commission and seventeen EU Member States, as well as fourteen jurisdictions outside the EU, had a cartels leniency program.

² Article 23 (2) of Regulation 1/2003 provides: “*The Commission may by decision impose fines on undertakings and associations of undertakings where, either intentionally or negligently: (a) they infringe Article 81 or Article 82 of the Treaty [...] For each undertaking and association of undertakings participating in the infringement, the fine shall not exceed 10% of its total turnover in the preceding business year.*” Article 23 (3) further provides that “*In fixing the amount of the fine, regard shall be had both to the gravity and to the duration of the infringement.*”

³ EC Commission Guidelines on the method of setting fines imposed pursuant to Article 15 (2) of Regulation No 17 and Article 65 (5) of the ECSC Treaty, [1998] OJ C9/3.

⁴ EC Commission Guidelines on the method of setting fines imposed pursuant to Article 23 (2) (a) of Regulation No 1/2003, available at: http://ec.europa.eu/comm/competition/antitrust/legislation/fines_en.pdf.

attention to duration – it only involved 10 per cent uplift for each year of duration, the new Guidelines are likely to mean a huge increase in the going rate for hardcore cartels.

The 1998 Guidelines

All the fines that have been imposed up to now since the Commission began to crack down more seriously on cartels in the past decade have been under the 1998 Guidelines. The Guidelines in fact did not only apply to hardcore cartel cases since the Commission may impose administrative fines on the sort of infringements which in the US might be treated as appropriate subjects for civil remedies rather than prosecution, and of course some of the highest fines have been imposed in abuse of dominance cases involving a single firm⁵. In tandem with the separate Leniency Notice (as amended in 2002)⁶ the Guidelines provided the basis on which fines have been calculated in cartel cases.

The regulatory basis for fines in competition cases was Article 14 of Regulation No 17/62, now Article 23 of the new “Modernization” Regulation, 1/2003⁷. This provision simply states that fines will be based on “gravity and duration” and caps the maximum penalty at 10 per cent of the company’s total sales in the previous financial year. Once it moved from purely “parking ticket” levels, the Commission’s technique was usually to fine each company in a cartel the same percentage (but never more than 10 per cent) of its sales in the affected product in the EC in the last full year of the cartel, a method which ensured that even on the largest players in a billion dollar market, the individual fine rarely exceeded \$10 million. As every company invariably appealed, a vast amount of court time was expended deciding whether the turnover in this or that marginal product should have been counted, or whether sales in Lichtenstein had inadvertently been included.

The old Guidelines were intended to loosen the link between the turnover in the product and the end fine.

Basically the calculation involved a series of steps:

- STEP 1: “Basic Amount”- $x + y$

Gravity

The Commission first selected a “start point”, x , (in euros) for each company, that was supposed to reflect the gravity of the violation. Gravity of the infringement is assessed by reference to three elements: (a) its nature; (b) value of the relevant geographic market affected; and (c) impact “where this can be measured”.

This start point was chosen without reference to the overall size of the group, but where there was a huge disparity in company size - say one player in a cartel was a huge

⁵ See Case COMP/C-3/37.792, *Microsoft*, Commission decision of 24 March 2004, not yet published.

⁶ EC Commission notice on immunity from fines and reduction of fines in cartel cases, [2002] OJ C45/3-5.

⁷ Council Regulation (EC) No 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty, [2003] OJ L1/1.

conglomerate and the others single-product firms, a “deterrence” uplift might be added to boost the start point and built in to the modified start point, but the increase was little more than symbolic.

In a cartel case, the start points for each company were differentiated to reflect their respective “market power”, so that a company with (say) 20 per cent market share would have a start point fine double that of a competitor with 10 per cent. However companies with similar market shares would be “grouped” and given the same start point in euros.

Duration

A duration uplift, y , was worked out based (in essence) on 10 per cent for each year.

Basic Amount

To use the formula in the Guidelines, $x + y = \text{Basic Amount}$. This meant that a ten-year cartel would have its start point doubled to give the basic amount. Duration was not thus the most crucial driver of the fining calculation, while x was essentially chosen on a discretionary basis.

- STEP 2: Aggravating and Attenuating Factors

The basic amount reached as above was then adjusted up and down in line with specified aggravating and attenuating circumstances. Aggravating circumstances- recidivism, leading role in the cartel, coercion of other participants and obstruction of the investigation- tended to outweigh mitigating effect of the attenuating circumstances like “passive role” or “non-implementation in practice” of the offending agreement, both of which were difficult for the company to demonstrate. In time, a standard 50 per cent increase for recidivism was applied to those with the worst records.

- 10 % Cap

The end fine may not exceed 10 per cent of the total worldwide turnover of the undertaking in the previous financial year before the adoption of the decision imposing the fine⁸, so in cases where the Guideline arithmetic led to this figure being exceeded, it was capped at 10 per cent⁹.

In the published decisions, the Commission went through each of the above steps in turn. Decisions are supposed to be reasoned, and while the Commission is required to give some general indication as to why it considers the infringement “very serious”, so as to justify imposing blockbuster fines, it is not obliged to give any specific reason of why it chose a particular start point, nor to indicate the method or formula it may have used to

⁸ Article 15 (2) of Regulation No 17, now article 23 (2) of Regulation No 1/2003.

⁹ As happened to a number of the undertakings fined in Case IV/35.691/E-4, *Pre-Insulated Pipes cartel*, [1999] OJ L 24/1. The 10 per cent cap applies to the fine before any leniency reduction.

calculate the figure it selected. There is no discernable pattern of logic in the earlier cases applying the Guidelines. In the first case, *Pre-Insulated Pipes*¹⁰, the choice of €100 million as the fine (before a leniency discount for cooperation) on ABB, the main actor, was clearly intended to convey a message, and is symbolic (in one sense of the word). Other fines imposed in the early years – *Vitamins*¹¹ is the most egregious example – also seem disproportionately high compared with those in later cases where the practice may have settled down and some effort is made to achieve consistency from case to case.

Comments

Any fine calculated as above was then subject to significant reductions of up to 50 per cent under the Leniency Notice if that applied, as it did in one form or another in every decided case.

The “first in” to qualify will get a zero fine, but since its “otherwise appropriate” fine might be crucial as the reference point for determining those of the other players, in the decision imposing fines, the Commission goes through the motions of calculating the penalty on the whistle-blower as well, only to remit it at the end of the decision.

The Guidelines were endorsed in principle by the Court of First Instance¹² which treated them as a self-imposed fetter on the Commission’s discretion to set the amount of fines: it was obliged to follow the methodology of its own Guidelines, though of course the Court would only interfere with its choice of the start point if this was totally unreasonable or was discriminatory as between the members of the cartel.

The 1998 Guidelines were open to the criticism that while they were “transparent” as to the methodology adopted in a rather mechanistic fashion for calculating the uplifts and adjustments at the various stages of the exercise, they were entirely opaque in their fixing of the most important element in the operation, namely the start point. To be sure, a non-scientific analysis of the later cases decided indicates a start point of something like one-third of EC sales of the product in the last financial year but whether the Commission ever consciously adopted the practice as a rule of thumb is unknown.

In a barnstorming speech within a few months of assuming office, Commissioner Neelie Kroes announced her intention to conduct a wide-ranging review of Commission practice in the cartel enforcement area, to include a redraft of the Guidelines¹³. One defect she

¹⁰ See note 9 *supra*.

¹¹ Case COMP/E-1/37.512, *Vitamins*, Commission decision of 21 November 2001, [2003] OJ L6/1.

¹² Case T-230/00, *Daesang Corp. and Sewon Europe GmbH v. Commission*, judgment of the Court of First Instance of 9 July 2000, [2003] ECR II-2733. See also Joined Cases C-189/02 P, C-202/02 P, C-205/02 P to C-208/02 P, *Dansk Røhrindustri A/S & others v. Commission*, judgment of the Court of Justice of 28 June 2005, [2005] ECR I-5425, where the ECJ confirmed the legality of the 1998 Guidelines and especially the application of the method of calculating the amount of fines.

¹³ “*The First Hundred Days*”, Speech delivered by Commissioner Neelie Kroes to 40th Anniversary Session of Studienvereinigung Kartellrecht 1965-2005, International Forum on European Competition Law, Brussels, Speech/05/205, 7 April 2005 available at:

saw was the tendency of the then system to hit one-product companies disproportionately hard as compared to conglomerates or larger groups, since many of these smaller or specialized companies found that their fines were as likely as not to be the maximum 10 per cent of turnover. Even if their multi-product competitors received a so-called “deterrence” uplift, it was never more than by a multiple of 3, and the end result would still only be a minute proportion, far less than 1 per cent, of total group sales. A number of companies that were fined did not survive or had to be restructured.

The new 2006 Guidelines

The new Guidelines significantly alter the basic methodology for setting fines, the idea being to pile on the “deterrent effect” that fines are supposed to have in hardcore cartel cases: fines should not only sanction the undertakings concerned (“specific deterrence”) but also dissuade other undertakings from engaging in illegal conduct that violates Articles 81 and 82 (“general deterrence”).

As an approximate proxy to reflect the “economic importance” of the infringement, the new Guidelines take a combination of the volume of sales to which the infringement relates and its duration (Point 6).

The introduction to the Guidelines however emphasizes (Point 2) that the Commission “enjoys a wide margin of discretion” within the limits set by Regulation 1/2003. The cryptic remark (Point 6) that “*reference to (the above) factors provides a good indication of the order of magnitude of the fine and should not be regarded as the basis for an automatic and arithmetical (sic) calculation method*” presumably means that the exercise will not be a wholly mechanistic operation. It is however made clear later (Point 23) that hardcore cartel cases will normally be heavily fined.

Subject to the above, the basic methodology is retained of first fixing a basic amount and then adjusting it upwards or downwards.

The Basic Amount

The Commission will as before determine a “basic amount” for each undertaking involved in the infringement, but the mechanism is significantly modified in basic respects and the exercise will in future operate as follows:

1. The Commission first ascertains the “value of sales” (goods or services) in the relevant geographic area within the EEA during the last full business year of the infringement (Point 13). This will presumably have to involve a determination of the exact geographical scope of the arrangements. Special provision is however made for the case of worldwide market-sharing arrangements, where some

- players may have agreed to stay out of or limit sales in the EU. The value of the company's European sales might even be zero, so a formula will be applied based on worldwide market shares.
2. Based on the gravity of the infringement, to be assessed on a "case-by-case" basis having regard to all the relevant circumstances, the Commission selects a "proportion" of the value of sales that will be the key to the whole operation (Points 19-20). This figure will be set at a level of "up to 30 % of the value of sales" (Point 21). In determining where on the scale the chosen proportion will be, factors like the nature of the infringement, its geographic scope, the combined market share of all the players and whether the arrangements were implemented will be factored in. The Notice however warns that hardcore cartel infringements will generally be set at the higher end of the range (Point 23).
 3. Next, the duration of the company's participation in the infringement is ascertained and the amount determined under the method described above will be **multiplied** by the number of years (Point 24).
 4. Moreover, irrespective of the duration, for all hardcore cartels, an "entry fee" will be added of 15-25 per cent of the value of sales to give the basic amount of the fine before adjustments for aggravation and mitigation (Point 25).
 5. The Commission will maintain the present practice of "grouping" cartel participants with similar market shares and giving them each the same basic amount (Point 26).

Adjusting the Basic Amount

The basic amount will be increased to take account of any aggravating circumstances and decreased for mitigating circumstances. The adjustment operation will involve an overall assessment balancing the aggravation and mitigation (Point 27).

Aggravating factors listed in Point 28 include (a) recidivism; (b) refusal to cooperate with or obstruction of the Commission in carrying out its investigations; and (c) a leading or instigating role, and particularly acting as an enforcer of the cartel.

The mitigating circumstances listed in Point 29, insofar as they are relevant to cartel cases, are (a) substantially limited involvement by avoiding applying the agreement and acting on the market in a competitive manner; and (b) effective cooperation outside the Leniency Notice.

A significant hardening in the Commission's attitude towards recidivism is marked by the warning (Point 28) that the basic amount will be increased by "up to 100%" for *each*

prior offence. Currently, the standard rate for offenders with as many as three or four previous infringements on their record sheet is 50 per cent¹⁴.

Specific Increase for Deterrence

“Deterrence” is a term that needs some explanation. Under this head, two situations are envisaged.

The first is where an undertaking has a particularly large turnover beyond the sales of goods or services to which the infringement relates (Point 30). The Commission will “pay particular attention” to the need to ensure that fines have sufficient deterrent effect. Given that in the Commission’s view, some multinational conglomerates with all-product worldwide sales running into the many billions might regard fines calculated as above as no more than an irritation, this provision leaves the Commission a free hand to increase the fine to what it considers a deterrent level, i.e. one that will hurt. No indication is given as to how that objective might be achieved. Currently, based on the somewhat obscure wording of a provision in the 1996 Guidelines, the Commission may apply a multiplier to the start point, x , of one or more of the participants where there is a large disparity between the overall sizes of those undertakings and the other players¹⁵. Up to now, the multiplier has been generally low, with the uplift kicking in (at x 1.25) when overall size is over 5 billion euro and going up to x 2.5 or x 3 in the case of groups with sales of 100 billion¹⁶. The provision for an unspecified uplift for “large turnover” will continue to fuel the controversy arising from the Commission’s recent policy of routinely fining the ultimate holding companies of the actual participant in the cartel on the basis of joint and several liability, even where the direct participant is already a major group and a large player in its own right¹⁷.

¹⁴ See e.g. Case COMP/E-1/37.773, *MCAA*, Commission decision of 19 January 2005, where Hoechst and Atochem had already been subject to prior Commission decisions in cartel cases. The basic amount of the fine was therefore increased by 50 per cent for each (Paras. 308-314). See also Case COMP/F/38.620, *Hydrogen Peroxide and Perborate*, Commission decision of 3 May 2006 (no public version available yet). See Commission Press Release IP/06/560 of 3 May 2006 available at: <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/06/560&format=HTML&aged=0&language=EN&guiLanguage=en>. The fines of Arkema (formerly Atofina), Solvay and Edison were increased by 50 per cent because they had been involved in previous cartels, including one relating to the production of hydrogen peroxide and perborate which was prohibited by the Commission in 1984.

¹⁵ See e.g. Case COMP/E/36.212, *Carbonless paper*, [2004] OJ L115/1, where the Commission considered that the need for deterrence required that the starting amount for the fines be increased by 100 per cent as regards AWA, Bolloré and Sappi in order to take into account “*their size and their overall resources*” (Paras. 410-412).

¹⁶ See e.g. Case COMP/E-1/37.773, *MCAA*, note 14 *supra*, where the starting point of the fine was increased by a multiplier of 2.5 for Atofina/Elf Aquitaine (total worldwide turnover of €84.5 billion) and by a multiplier of 1.5 for Akzo (total worldwide turnover of €13 billion) (Paras. 298-300).

¹⁷ See e.g. the treatment of Elf Aquitaine SA, the parent company of Arkema SA in Case COMP/E-1/37.773, *MCAA*, note 14 *supra*, where Elf Aquitaine SA was held jointly and severally liable for the participation of Arkema SA (formally Atofina SA) in the cartel.

The next example of “deterrence” in fact relates to disgorgement: the Commission may increase the fine in order to exceed the amount of gains improperly made as a result of the infringement “where it is possible to estimate that amount” (paragraph 31). Again, the notice is tantalizingly short on detail.

Final Adjustments

The Notice points out (superfluously perhaps) in Point 32 that the final amount may not exceed the 10 per cent of total turnover specified in Regulation 1/2003.

The Commission will in very limited circumstances take account of “ability to pay” but insists that a reduction will only be accorded where there is objective evidence that the otherwise appropriate penalty would irretrievably jeopardize the economic viability of the undertaking and “cause its assets to lose all their value”. A loss-making situation will not warrant a cut in the fine (Point 35).

The parting shot is the announcement (Point 37) that while the Guidelines present the general methodology, the “particularities of a given case” or “the need to achieve deterrence” may justify departing from that methodology or even the 30 per cent limit specified for setting the proportion of sales that determine the basic amount.

The new Guidelines, on which there was no public consultation, will be applied in all cases where a Statement of Objections is issued after the date the Guidelines are officially published in the Official Journal in September 2006.

Formula

The methodology can be simplified as follows:

$(VOS \times \text{gravity percentage of up to } 30\% \times \text{Duration in years}) + \text{Entry ticket (VOS} \times 15\text{-}25\%) = \text{Basic Amount (BA)}$.

$(BA + \text{Adjustment for aggravation /mitigation}) \times \text{Deterrence uplift} = \text{Fine before leniency}$.

An example:

To take a concrete example and applying the “worst case scenario”:

Assume that in a “hardcore cartel” case for which the Commission considers the top of the scale 30 per cent is the appropriate “proportion of sales”:

- Volume of affected sales is €100 million in last full year of cartel;
-

- Duration is 7 years;
- Undertaking has total worldwide all-product €25 billion total turnover, worth (say) a x 2 deterrence factor;
- Undertaking is a third time offender;
- No mitigating factors.

2006 Guidelines

- Stage 1:
 1. Proportion of sales: 100 million x 30 % = €30 million;
 2. Apply duration multiplier (30 x7) = €210 million;
 3. Add: “Cartel entry ticket” (25 % x 100 million) of €25 million.= Basic Amount (BA) of €235 million.
- Stage 2:
 1. BA + (BA x 200%) (100 % per prior infringement) = €705 million;
 2. Apply “Specific deterrence” multiplier for size of company (say) x 2.

End Fine (before leniency) = €1410 million.

1998 Guidelines

By way of comparison, the notional fine under the old 1998 Guidelines could well have been:

- Start point $x = €30$ million;
- Adjusted Start point for “deterrence” x 2 = €60 million;
- 60 million + (60 x 70% for 7 year duration) = €102 million Basic Amount;
- Aggravation uplift Basic Amount = 50 %.

End Fine (before leniency) = € 150 million.

Impact on Fines

Any prediction on how the new Guidelines will be applied in practice would be guesswork at this stage: the Commission has hedged its position with the usual riders and reservations. The above is perhaps an extreme example of a worst case scenario that would require a special concatenation of circumstances- and some nerve on the part of the Commission.

However, modeling the application of the new Guidelines on previous decisions (to the extent permitted by the fact that Commission decisions are sometimes only rendered public years after adoption and relevant market data are sometimes omitted from the published version) confirms the obvious conclusion that fines in hardcore cartel cases are going to go up – and go up substantially. A recently published study¹⁸ concludes that fines under the new Guidelines are on average double those imposed until now. For many firms, the fines recalculated under the new Guidelines are in some cases as much as 5, 6 or even up to 8 times greater.

On the face of it, the “proportion of sales” selected is not likely to be radically different from the old start point (before any deterrence uplift). The Commission itself says that for cartel violations the percentage will normally be at the top end of the scale. The basic assumption of the Case study- that for a “very serious infringement” the proportion of sales selected would be 30 per cent corresponds closely enough to the pattern that can be discerned from reverse-engineering the more recent decisions under the old Guidelines, namely that after a good deal of fluctuation without any obvious rationale in earlier cases, the start point selected had stabilized at roughly one-third of EU/EEA sales.

The new 15-25 per cent “entry fee” is a one-off charge added only after the basic fine has been calculated and is not subjected to the duration increase.

Where the really huge difference comes is in the new treatment of duration, which could lead to astronomical fines in the most enduring violations. The “*Bleaching products*” cartel is a particularly egregious example whose members should perhaps count themselves lucky the decision did not take the usual four years to emerge¹⁹.

Some of the usual suspects that have featured regularly in Commission cartel decisions as recidivists would also do well to ensure that they have put their house definitively in order, since the current standard 50 per cent uplift could in their case easily become an additional 200 per cent.

¹⁸ “*New EU Penalty Guidelines – Will the 2006 penalty guidelines decrease fines?*”, Case Associates, Competition and Regulatory Economists, Case notes, July 2006, available at: <http://www.casecon.com/data/pdfs/casenote43.pdf>.

¹⁹ See Case COMP/F/38.620, *Hydrogen Peroxide and Perborate*, note 14 *supra*.

How this will affect enforcement

How the new Guidelines will affect the handling of cases is an interesting exercise in crystal-ball gazing.

The huge increase in potential exposure may bring some companies that have not already bought into the program to the Commission's door with immunity applications. However, given the increasing difficulty some practitioners have experienced in securing conditional immunity, where the cartel is confined to Europe, and no US criminal proceedings are likely to cause individuals to apply for individual immunity, it is possible that rather than provoke huge upset to the industrial status quo, and possibly provoke tit-for-tat denunciations, other companies engaged in cartels will cease their involvement, and if they have already done so, lie low until the limitation period has expired and count on their competitors to do the same.

As regards the defense of cases brought by the Commission, especially those where the primary source is an immunity applicant, and independent evidence in short supply, the huge increase in the stakes might well result in an increased tendency to contest the charges line by line. Rather than cooperation, the potential also-rans in the leniency race might decide that their best strategy in such cases might even be to fight. In particular, defense lawyers might seek to prevent the Commission joining up examples of cartel behavior over an extended period so as to form a continuous conspiracy of long duration. If a sufficient break could be established, defendants might be able to invoke limitation for earlier cartel conduct going back more than five years.

The new Guidelines might of course be the prelude to the introduction of a system of negotiated settlements. The Commission is inundated by immunity applications and under its present procedure, which does not permit a negotiated settlement, is only able to get five or six decisions out a year. The idea of US-style plea agreements has already been floated by the Commissioner but concrete proposals have yet to appear. If such a system of negotiated settlement is introduced, the new Guidelines will, like the US Organizational Sentencing Guidelines, provide a principled basis for any negotiation, something the old Guidelines did not. Recipients of a Statement of Objections must be hoping that they can prolong the proceedings until the Commission makes good on its proposals.
