CLEARY GOTTLIEB STEEN & HAMILTON LLP

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Administrative Penalties: Statement of Policy on the CMA's Approach

Response To Consultation

This paper sets out the response of Cleary Gottlieb Steen & Hamilton LLP to the CMA Transition Team's consultation on *Administrative Penalties: Statement of Policy on the CMA's Approach* (the "Consultation" and "Draft Statement").

1. Do you consider that there are any other roles or objectives that should be taken into account when considering the CMA's approach to administrative penalties?

3. Do you agree with the approach in chapter 4 of the Statement to determining whether to impose a penalty, the level at which penalties should be set and the various factors to be taken into account? Please give reasons for your views.

Our comments below apply to both Question 1 and Question 3 of the Consultation.

The Draft Statement focuses on the role of the CMA's penalty powers in "*incentivising compliance*" to reduce the risk of "*adverse consequences for the CMA if a person fails to comply with Investigatory Requirements.*"[1] We think the Draft Statement over-emphasises the importance of deterrence at the expense of its correlative principle, proportionality,[2] which has been engrained in U.K. law since at least the entry of the U.K. into the European Community in 1973 and the coming into force of the Human Rights Act 1998.[3]

The Supreme Court has set out the following criteria for determining whether measures are proportionate (the *Huang* test):[4]

i. The objective is sufficiently important to justify limiting a fundamental right;

ii. The measures designed to meet the objective are rationally connected to it;

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1 Paragraphs 3.2 and 3.3, Draft Statement.

2 *See, e.g.*, Calvino, N., "Public Enforcement in the EU: Deterrent Effect and Proportionality of Fines," published in Ehlermann, C-D. and Atanasiu, I. (eds.), *European Competition Law Annual 2006: Enforcement of Prohibition of Cartels*, Hart Publishing, Oxford/Portland, Oregon (2006); Wils, W., "Optimal Antitrust Fines: Theory and Practice," *World Competition*, 29, No. 2 (2006); and Motta, M., "On cartel deterrence and fines in the EU," European University Institute, available at http://www.barcelonagse.eu/tmp/pdf/motta_carteldeterfines.pdf (2007).

3 *See, e.g., De Freitas* v *Permanent Secretary of the Ministry of Agriculture, Fisheries, Lands & Housing* [1999] 1 AC 69 (PC); *R (Daly)* v *Secretary of State for the Home Department* [2001] 2 AC 532. Article 49 of the Charter of Fundamental Rights of the European Union provides that "*[t]he severity of penalties must not be disproportionate to the criminal offence.*"

4 *Huang & Ors v Secretary of State for the Home Department* [2005] EWCA Civ 105 (in the context of the Charter of Fundamental Rights of the EU).

iii. The means used to impair the right are no more than is necessary to accomplish the objective; and

iv. The measures achieve a fair balance between the interests of the individual affected and the wider community.

The Consultation rightly recognises "*the CMA's obligation to act proportionately*," and observes that "*it would not necessarily serve the CMA's intended policy objectives to punish disproportionately minor failures*."[5] We do not think, however, that this caution has been adequately reflected in the Draft Statement such that the factors relevant to the *Huang* test would be properly weighed, in respect of either the factors affecting whether to impose penalties or the factors affecting the level of the penalty imposed.

Factors affecting whether to impose penalties

- The principle of proportionality is recognised implicitly in the Enterprise Act 2002 and Competition Act 1998: penalties may be imposed only where a person fails to comply with investigatory requirements either "*without reasonable excuse*" or "*intentionally*."[6] The Draft Statement, however, deals only sparingly with the meaning of "*reasonable excuse*," in comparison with the fuller treatment of factors relating to deterrence.[7] We think that the meaning of "*reasonable excuse*" is crucial to the interpretation of the CMA's powers, and the CMA's policy in this regard should be set out more clearly. We appreciate that the Draft Statement cannot set out exhaustively the circumstances that may be considered a "*reasonable excuse*," but we think that the treatment in the Draft Statement falls short and should be re-considered. For example, we think it should be considered a reasonable excuse that the person penalised ("P") did not have the corporate power and authority to ensure the investigatory requirements were complied with.

- The principle of proportionality is also recognised implicitly in the Draft Statement's indication that the CMA may be more likely to impose a penalty if "*the failure to comply is significant and/or flagrant*."[8] We think, however, that the importance of proportionality in the CMA's determination of whether to exercise its penalty powers should be set out more explicitly and in more detail. In particular, we think that the circumstances identified in paragraph 4.1 of the Draft Statement as affecting whether the CMA may impose an administrative penalty should include not only aggravating circumstances, but also mitigating circumstances. For example, circumstances that should be considered to argue against the imposition of a penalty include: where a less restrictive measure would be effective; and where a balance of interests suggests that the penalty is too burdensome give the specific situation of the punished person.

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5 Paragraphs 3.8 and 4.13, Consultation.

6 Sections 110(1) and 174A(1) of the Enterprise Act 2002 and Section 40A(1) of the Competition Act 1998. All references to the Enterprise Act 2002 and Competition Act 1998 are as amended by the Enterprise and Regulatory Reform Act 2013.

7 Paragraphs 4.3-4.4, Draft Statement.

8 Paragraph 3.1, Draft Statement.

Factors affecting the level of penalty imposed

- The Draft Statement lists, at paragraph 4.10, "*factors affecting the level of penalty imposed*." This paragraph acknowledges the need to "*determin*[e] *an appropriate and proportionate penalty*," the only express reference to proportionality in the Draft Statement. We think that this section of the Draft Statement is broadly appropriate in recognising the type of circumstances that should be considered, but should be more balanced and clearer in specifying mitigating circumstances. For example, the Draft Statement identifies as a relevant factor "*the nature and gravity of the failure*," but lists only the aggravating circumstances "*including whether the failure was intentional and whether there was any attempt to conceal the failure from the CMA*" without express reference to the type of circumstances in which the "*gravity of the failure*" should be deemed less severe.[9]

- We also note that the list of relevant circumstances includes "*the size and administrative and financial resources available to P.*" While this may be relevant in some cases, we do not think the CMA should presume that a larger enterprise with greater resources is necessarily able to respond more quickly or more completely to Investigatory Requirements than a smaller enterprise. For example, it may be more difficult for a larger enterprise to find the relevant information than a smaller enterprise.

2. Do you agree that the level of detail in the Statement is appropriate?

Other than the areas identified in our responses to the other questions, yes.

4. Do you agree with the approach in the Statement to assessing the turnover of enterprises owned or controlled by P? In particular, do you have views on whether turnover based on material influence should be used in all cases?

Under the Enterprise Act 2002, the CMA may impose on P, for failing to comply with merger interim measures, a penalty of up to 5% of the turnover of the enterprises P owns or controls.[10] The Draft Statement indicates that turnover will be calculated based on (a) a controlling interest, (b) *de facto* control, and/or (c) material influence, in accordance with the Draft Interim Measures Order.[11]

The Consultation notes, however, that "*there may be some benefit to an approach of including turnover based on material influence only in cases where it is necessary to do so, for example where the business structure is such that only the material influence test would capture sufficient turnover under P's control to give rise to a deterrent penalty.*"[12]

We agree with the Consultation that it will be important for the CMA to be able to "*make decisions on penalties for failure to comply with Merger IMs quickly and efficiently*."[13]

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9 Paragraph 4.10, Draft Statement.

10 Section 94A(2) of the Enterprise Act 2002. The Secretary of State may by order specify that the maximum percentage of turnover to be considered is less than 5%, but may not increase it above 5%.

11 Paragraph 4.12, Draft Statement.

12 Paragraph 4.18, Consultation.

13 *Ibid.*

We also agree with the Consultation that assessing material influence is not "*a straightforward exercise and may take more time and resources to assess compared to de facto control and controlling interest*."[14] We also think that including turnover based on material influence would undermine legal certainty, due to the difficulty of assessment and the scarcity of precedent.

Accordingly, we do not agree with the approach in the Draft Statement, which does not distinguish between turnover based on a controlling interest or *de facto* control and turnover based on material influence. We think that turnover based on material influence should be included for purposes of calculating the statutory maximum penalty only in exceptional circumstances where turnover based on controlling interest and *de facto* control is so negligible that it would clearly be insufficient to give rise to a deterrent penalty.

5. <u>Is the Statement sufficiently clear to assist you in understanding how the CMA will set administrative penalties for failure to comply with the relevant investigatory requirements?</u>

According to paragraph 5.6 of the Draft Statement:

> "*Where it appears that P has failed to comply with an Investigatory Requirement, before making a final decision to impose a penalty the CMA will generally write to P, describing the apparent failure to comply and inviting that person to specify in writing the reasons for that failure. If the CMA is not satisfied that P had a reasonable excuse, and considers that enforcement by means of imposition of a penalty is appropriate, it will issue a provisional decision setting out the reasons for its proposed action and the approach that it proposes to take in imposing a penalty. However, if the CMA considers that P does not have any reasonable excuse for its failure to comply with the Investigatory Requirement, the CMA may issue its provisional decision, without first requesting that the person concerned provides its reasons for the failure.*"

Firstly, we think P should always be given the opportunity to give its reasons before a provisional decision is reached. Delaying P's opportunity to defend itself until after the provisional decision has already been made, particularly in circumstances where the period for representations after a provisional decision would "*not usually exceed one week*,"[15] would risk confirmation bias ushering through, from provisional to final, a decision that had been written without having given P any right to defend or explain itself.

Secondly, it is unclear in what circumstances the CMA could possibly know that "*P does not have any reasonable excuse for its failure to comply with the Investigatory Requirement*" without having allowed P an opportunity to explain such excuse.

Other than as identified above, we think the Draft Statement is sufficiently clear.

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14 *Ibid.*

15 Paragraph 5.7, Draft Statement.