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

Consultation document CMA4con – July 2013

Herbert Smith Freehills LLP Response

Introduction

Herbert Smith Freehills LLP welcomes the opportunity to comment on the CMA's draft Statement of Policy (the "Draft Statement") regarding the CMA's powers to impose administrative penalties on a person who fails to comply with "Investigatory Requirements", i.e.

- Notices requiring the attendance of witnesses, production of documents or supply of estimates, forecasts, returns or other information in Phase 1 and Phase 1 mergers and markets investigations ("EA02 Requirements");
- Requirements to provide information or documents or certain other requirements in antitrust investigations ("CA98 Requirements"); and
- Interim measures in mergers cases ("Merger IMs").

We generally welcome the CMA's proposal to apply administrative rather than criminal penalties for failure to comply with Sections 26, 26A, 27, 28 and 28A of the CA98 and Sections 109 and 174 of the EA02. We also agree with the CMA's proposal that penalties for intentional obstruction of certain of the CMA's powers, intentional suppression, destruction and falsification of documents and the provision (knowingly or recklessly) of false or misleading information in connection with a CMA investigation should remain criminal in nature.

Our response to each of the individual Questions for Consultation is set out below.

The comments contaihned in this response are those of Herbert Smith Freehills LLP, and do not represent the views of our clients.

1. **QUESTION 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? **Please give reasons for your views.**

1.1 We note the CMA's statement that its approach to administrative penalties is based on the key policy objectives of:

1.1.1 Ensuring that the CMA obtains the best possible knowledge of relevant facts in order to carry out its functions in compliance with the relevant investigation timetables;

1.1.2 Preventing actions which might prejudice a mergers or markets reference or impede the taking of action following such a reference; and

1.1.3 Deterrence of future non-compliance.

1.2 We agree that these are important policy considerations for the CMA. We also appreciate that ERRA13 amendments to various statutory timetables for merger and markets investigations will require the CMA to work to shorter timescales than was previously the case[1].

1.3 Nevertheless, we consider that it is also important for the CMA to employ a broadly proportionate approach to the imposition of administrative penalties on persons who fail to comply with Investigatory Requirements (referred to as "P"). We note that the CMA refers to the imposition of proportionate penalties in its Draft Statement[2] and proposes to apply the Statement "*flexibly according to the circumstances of the case*"[3]. We consider that this objective should also to be referred to at the outset of the Statement, in conjunction with the key policy objectives set out at 1.1 above. We note in the following paragraphs a number of instances where we consider that proportionality will have a significant role to play in the application of administrative penalties.

1.4 Under ERRA13, the CMA will have extended powers to agree or impose interim measures. These additional powers will be enforced through the imposition of a new administrative financial sanction of up to 5% of the worldwide turnover of enterprises owned and controlled by P. This is a significant and punitive sanction when we recall that the penalty for substantive infringement of the Chapter I and Chapter II prohibitions is capped at 10% of worldwide turnover of the undertaking. We should also recall that the penalty available to the European Commission for failure to notify a relevant concentration is capped at 10% of worldwide turnover of the undertaking. In contrast to cases of substantive infringement or failure to notify, a breach of interim measures may arise as a result of a minor and / or inadvertent infraction. Application of a penalty of up to 5% of worldwide turnover in such circumstances would clearly represent a disproportionate penalty. We therefore suggest it would be appropriate for the CMA to apply the proposed penalty in a restrictive fashion and that the upper threshold of 5% should only be applied in the most egregious of cases[4]. We also consider that, in many cases, civil proceedings under Section 94 EA02 may be a more appropriate and proportionate response than the imposition of a financial penalty.

1.5 We note that under the CMA's recently published Draft Merger Guidance[5] enterprises will be required to provide much more detailed information to the CMA and these requirements will apply at both the Phase 1 and Phase 2 investigation stage. Whereas previously, the

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1 Consultation Document, para. 3.3.
2 See Section 4.10.
3 Consultation Document, para. 1.7.
4 We note that the CMA provides Practical Example 4, Annexe A as an example where a penalty potentially at or close to the maximum penalty of 5% of turnover would be applied due to the flagrant nature of the breach.
5 Mergers: Guidance on the CMA's jurisdiction and procedure, July 2013, CMA2con.

power to impose administrative penalties for failure to comply with such requirements was only available at the Phase 2 stage, it may now be employed at both Phase 1 and Phase 2 stages. In light of the significantly increased administrative burden on enterprises we suggest that the CMA should take great care to apply administrative penalties for failure to comply with these requirements in a proportionate manner.

1.6 We welcome the CMA's statement that "*the financial and administrative resources of P may also form part of the assessment*" of the level of the penalty to be imposed. In light of proposals to increase the upper limit of the fixed penalty to £30,000 and £15,000 respectively[6] we consider that it is particularly important for the CMA to take account of the size of a company to ensure that proportionate penalties are imposed. We note that the Draft Statement does not appear to provide for discussions between enterprises and the CMA regarding ability to pay a fine and consider that further opportunities for dialogue in this regard would be helpful.

2. QUESTION 2

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

Please give reasons for your views.

2.1 We consider that, in general, the level of detail in the Draft Statement is appropriate and we commend the CMA for setting out the factors relevant to determination of whether to impose a penalty and the level and type of such penalties. However, we consider that further detail regarding a number of points would be beneficial to minimise uncertainty.

2.2 We include at Section 3 below (responding to Question 3 of the Consultation) areas where further detail about the factors influencing the imposition and the level and type of penalties would be beneficial.

2.3 We include at Section 4 below (responding to Question 4 of the Consultation) relevant comments regarding the level of detail contained in the Draft Statement about the material influence test.

2.4 We also include at Section 5 below (responding to Question 5 of the Consultation) a few areas where further clarity would be helpful.

Reasonable excuse

2.5 We consider that further detail and guidance on the meaning of "*without reasonable excuse*" would be helpful. This phrase represents a fundamental aspect of the offences for

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[6] Competition Regime: Consultation on CMA Priorities and Draft Secondary Legislation.

which administrative penalties may be imposed and, as noted at Section 4.3 of the Draft Statement, the phrase is not defined in the CA98 or the EA02.

2.6 While we welcome the example at Section 4.3 of the Draft Statement of a scenario that may (depending on the circumstances) amount to a reasonable excuse, we consider that further examples would be helpful to provide companies with a more complete picture of the meaning of the phrase.

Transitional arrangements

2.7 We consider that the transitional arrangements which are currently set out in Annexe E – Transitional Arrangements of CMA2con[7] should be incorporated in the Statement as it will be helpful for companies to have all guidance pertaining to penalties contained in the same document.

3. **QUESTION 3**

Do you agree with the approach in 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.

3.1 We broadly agree with the approach proposed in the Draft Statement but consider that certain of the factors identified may benefit from further clarification as to the precise scope of their application.

Factors influencing the decision to impose a penalty

3.2 We note that many of the factors influencing the decision to impose a penalty were previously reflected in the Competition Commission's Statement of Policy on Penalties[8].

3.3 We suggest that further guidance on the new factor of 'recidivism', would be helpful. The Draft Statement provides that "*persistent and repeated unreasonable behaviour*"[9] which delays the OFT's enforcement action may be considered to merit both an administrative penalty and the application of the aggravating factor under current OFT guidance as to the appropriate amount of a penalty for substantive infringements[10]. The CMA will assess "*where necessary*" and "*on a case-by-case basis*" whether both penalties are merited. We consider that further information on the relevant factors which the CMA is likely to use in this analysis would be useful.

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7 Mergers: Guidance on the CMA's jurisdiction and procedure, Consultation Document, July 2013
8 CC5, June 2003.
9 Draft Statement, Section 4.1, footnote 35.
10 OFT423.

3.4 It would also be helpful to understand whether all instances of 'recidivism' make it more likely that a penalty will be imposed. In this regard, we note that a number of circumstances pertaining to the 'recidivism' (such as the seriousness of a past failure) may affect the level of penalty imposed but that such guidance is absent as regards whether a penalty may be imposed.

Factors affecting the level of penalty imposed

3.5 We welcome the CMA's continued policy of taking into account genuine efforts of companies to ensure compliance with principles of competition law and procedure when assessing the level of the penalty imposed. Nevertheless, further guidance on what is meant by "any *steps taken…to discipline responsible individuals*"[11] in this context would be beneficial. Does the CMA expect that an enterprise should terminate the employment of the individual responsible for the failure or might less drastic disciplinary sanctions suffice?

Specific factors relating to the level of penalty for failure to comply with Merger IMs

3.6 Further detail on the interaction between penalty powers and the power to bring civil proceedings in the context of IMs would be particularly helpful. Section 4.19 of the Draft Statement provides that the CMA would not generally expect to bring civil proceedings as "*it would usually expect parties suffering loss to take such action*". However, the Draft Statement continues to note that the CMA will consider whether to use the power on a "*case-by-case basis having regard to the nature of the failure*". It would be helpful to understand what type of failure could result in the CMA employing both its penalty powers and bringing civil proceedings. It would also be helpful to understand whether it is likely that civil proceedings would be limited in scope to the seeking of injunctive relief by the CMA (as set out at Example 4, Annexe A).

4. **QUESTION 4**

Do you agree with the approach in the Statement to use the material influence test when determining turnover only in cases where the business structure is such that only the material influence test would meaningfully capture P's turnover?
Please give reasons for your views.

4.1 We consider that the proposed material influence test has the potential to result in considerable uncertainty in the application of s94(A)(2) of the EA02 . We consider that a more appropriate approach would be to limit the concept of control to situations where P has either (a) a controlling interest or (b) the ability to directly or indirectly control the policy

[11] Draft Statement, Section 4.10.

of the enterprise (de facto control). This approach would result in greater certainty for companies and would minimise constraints on the CMA's limited time and resources.

4.2 In the first instance, the Interim Measures Order does not appear to give the CMA any discretion regarding the application of the material influence test. By contrast, the CMA Guidance suggests that the CMA may decide to only use the test in cases where it would "*meaningfully capture P's turnover*". This difference in approach is unsatisfactory and introduces uncertainty into this area of the law.

4.3 Secondly, we note the CMA's statement that assessing material influence may not always be a straightforward exercise and, therefore, it may take more time and resources to assess whether P has a material influence over an enterprise than to assess whether P enjoys a controlling interest or de facto control. It is likely that an assessment of material influence would be quite a time-consuming exercise and result in a significant administrative burden for both the CMA and for the companies involved. In contrast, the CMA will have considerable experience in the assessment of whether P has a controlling interest or de facto control in an enterprise. Likewise, companies would find this a much clearer test for the provision of information to the CMA.

4.4 Thirdly, the proposal to use the material influence test "*only in cases where the business structure is such that only the material influence test would meaningfully capture P's turnover*" demonstrates the difficulties in its application. The proposed approach, in the absence of further guidance, is circular and indicates a lack of clarity about the circumstances in which the test could be usefully applied. Moreover, if a further preparatory step were required in each case to determine whether the case was one where "*the business structure is such that only the material influence test would meaningfully capture P's turnover*", this would impose additional constraints on the CMA's time and resources and result in further uncertainty for companies.

4.5 Fourthly, as noted above, we consider that the potential sanction of up to 5% of the worldwide turnover of enterprises owned and controlled by P represents a significant sanction which should be applied in a restrictive fashion. We consider that to ensure a restrictive approach in the interests of proportionality, the concept of control should be limited to those cases where P has either (a) a controlling interest or (b) the ability to directly or indirectly control the policy of the enterprise (de facto control).

5. **QUESTION 5**

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?

Please describe any areas that are not sufficiently clear, the reasons for this and any recommendations you may have.

5.1 We consider that, in general, the Draft Statement is quite clear as to how administrative penalties for failure to comply with the relevant Investigatory Requirements will be applied. However, in addition to the points raised above, there are some areas where further clarity would be beneficial.

Practical Examples

5.2 We welcome the provision by the CMA of the "non-exhaustive" Practical Examples at Annexe A with a view to illustrating how the CMA's powers might apply in practice. However, we consider that these examples may themselves benefit from further clarification by the CMA.

5.3 In the first instance, we consider that greater clarity on the interaction between Section 4.4 of the Draft Statement on the concept of reasonable excuse and Example 1 would be helpful. The Draft Statement provides that the CMA is unlikely "*save in exceptional circumstances*" to accept as a reasonable excuse the fact that P has missed a deadline because it was forgotten. However, Example 1 provides an illustration of a scenario where the CMA may decide not to impose a penalty in precisely those circumstances – in Example 1 the information request was accidentally misfiled and forgotten about. It would therefore be helpful to clarify whether the circumstances outlined in Example 1 (i.e. quick rectification of the failure, lack of benefit from the failure, lack of material adverse effect on the CMA's investigation) are in fact, considered by the CMA to be sufficient to amount to instances of such "*exceptional circumstances*". As noted at 2.5 above, further guidance on the meaning of reasonable excuse more generally would also be beneficial.

5.4 Example 1 also notes the impeccable compliance record of Company A. The relevance of this factor to the decision not to impose a penalty is not explained. It is also unclear whether the compliance record pertains to substantive competition law compliance or relates only to compliance with Investigatory Requirements. It would be helpful if this point was clarified.

5.5 Example 2 also raises a number of questions regarding the application of the CMA's fining powers. We submit that the classification in that Example of the failure by the company as "*serious*" and "*certainly warrant[ing] a penalty*" appears unduly punitive when one considers the difficulties often faced by companies in determining the relevant market and their market share. In the first instance, the market share percentage provided by the company does not appear so removed from the responses received by competitor firms as to be taken, without more, as evidence that D has deliberately provided misleading information. Secondly, a presentation provided to a company's board may have significant empirical weaknesses, or may not have come to the attention of the team responsible for compiling

the response to the CMA's information request. In such circumstances, it appears to be unduly severe to conclude that the information at issue was provided "*in all likelihood in order to prejudice the CMA's investigation to D's benefit*"

Procedural Requirements

5.6 The Draft Statement should provide more detail on the steps leading to the imposition of a fining decision and on the procedure to safeguard P's rights of defence.

5.7 Section 5.6 of the Draft Statement provides that, before making a final decision to impose a penalty, the CMA will "*generally*" write to P describing the apparent failure and inviting P to specify the reasons for that failure. It is unclear whether "*final decision*" refers to the making final of a provisional CMA decision. If so, this would imply that there are some circumstances where the CMA could proceed to adopt a final decision against P without notifying P in advance or providing P with an opportunity to be heard. This would be a very severe approach for the CMA to take and would appear to be contradicted by Section 5.7 which states that, before the CMA decides to make a provisional decision final, "*P will be given a reasonable opportunity to make representations on the provisional decision to the CMA*" (emphasis added). An alternative interpretation is that "final decision to impose a penalty" refers to the adoption of a provisional decision by the CMA. However this interpretation would also result in considerable uncertainty (as discussed at 5.8 below). Further clarity on this point would therefore be welcome.

5.8 Section 5.6 of the Draft Statement is also unclear regarding the circumstances in which a provisional decision may be adopted without consultation with P. Section 5.6 implies that, if after consultation with P the CMA is not satisfied that P had a reasonable excuse for its failure (and imposition of a penalty is appropriate) it will issue a provisional decision setting out the reasons for its proposed action and the approach it plans to take in imposing a penalty. However, the sentence immediately following provides that where the CMA "*considers that P does not have any reasonable excuse*" for its failure "*the CMA may issue its provisional decision without first requesting that [P] provides its reasons for the failure*". This suggests that, on a case-by-case basis, the CMA will decide whether P has a reasonable excuse for its failure and based on that assessment may decide to proceed directly to a provisional decision without giving P the opportunity to be heard. In our view the Draft Statement should allow for all persons concerned to have an opportunity to be heard and the CMA should then take into account whether they had a reasonable excuse for a failure to comply before a provisional decision is adopted. It is also unclear how this proposed approach would interact with the statement that the CMA will "*generally*" ask P to provide reasons for its failure to comply (as discussed at 5.7 above)

5.9 Further clarity in general regarding the extent to which P can engage with the CMA prior the adoption of a provisional decision and a final decision would be welcome. For

example, will P's representations be limited in scope to the issue of reasonable excuse or will P have an opportunity to make representations on the nature and level of the proposed penalty? Will P be permitted to make representations in writing only or will P also have the opportunity to meet in person with the CMA? We consider that P should be permitted to address the CMA both on the issue of reasonable excuse and regarding the level and nature of the penalty to be imposed.

Nature of investigatory power

5.10 Section 1.6 of the Statement provides that "*different considerations may be relevant to the assessment of the appropriate administrative penalty, depending on which statutory power the CMA is using*".

It would be helpful if the CMA set out explicitly the circumstances where it considers that the nature of the statutory power could influence materially whether a penalty is imposed or the nature or level of that penalty.

Herbert Smith Freehills LLP
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