ADMINISTRATIVE PENALTIES: STATEMENT OF POLICY ON THE CMA'S APPROACH (CMA4CON, JULY 2013)

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RESPONSE TO THE CMA'S CONSULTATION ON ADMINISTRATIVE PENALTIES: STATEMENT OF POLICY ON THE CMA'S APPROACH (CMA4CON, JULY 2013)

1. INTRODUCTION

1.1 Freshfields Bruckhaus Deringer LLP welcomes the opportunity to comment on the draft for public consultation (the ***Consultation***) of "*Administrative Penalties: Statement of Policy on the CMA's approach*" (the ***Statement***).

1.2 Our comments are based on our experience of representing clients in a wide range of Office of Fair Trading (***OFT***) and Competition Commission proceedings under the Enterprise Act 2002 and the Competition Act 1998, together with a significant number of equivalent proceedings conducted by competition authorities in other jurisdictions. We rely on this breadth of experience to provide these comments on the approach to administrative penalties.

1.3 We have confined our comments to those areas which we feel are most significant in terms of the effective operation of the regime and providing clarity and certainty for companies that might be subject to such proceedings. The comments in this response are those of Freshfields Bruckhaus Deringer LLP and do not necessarily represent the views of any of our clients.

1.4 Overall, we welcome the Statement as a valuable indication of the approach the Competition and Markets Authority (***CMA***) intends to take to administrative penalties. We believe the guidance is particularly important because of the relative paucity of decisional practice in the area. The comments below are intended to help clarify the CMA's approach, and to bring greater transparency, predictability and certainty to the imposition of administrative penalties. We believe incorporating our suggestions will help the CMA better achieve its objectives of effective and timely management of investigatory proceedings.

2. RESPONSE TO QUESTIONS

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?

2.1 We agree that the objectives outlined in the Statement are appropriate, but would in addition emphasise the need for a transparent and predictable approach to the imposition of administrative penalties, which delivers certainty to participants in CMA processes. Transparency and predictability are not only important from the perspective of market participants subject to CMA investigations, but also help to achieve the CMA's stated goal of deterring non-compliance with its investigatory requirements. As we elaborate in more detail below in response to question 2, the Statement as presently drafted provides minimal guidance as to the likely magnitude of penalties in practice.

2.2 We also note that one of the CMA's primary objectives is to ensure that the CMA can expediently gather information to carry out its functions. While we support

that objective in principle, it is important that the CMA's expectations are tempered with a realistic acknowledgement of the difficulty and cost associated with responding to complex or extensive information requests, particularly for undertakings with less sophisticated information gathering and reporting systems. Such an acknowledgement from the CMA is of particular importance in circumstances where it is proposed to fine undertakings at any stage of a proceeding for failing to respond to requests in a manner that the CMA considers adequate.

Question 2

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

2.3 The Statement outlines in general terms the considerations the CMA will take into account when determining whether or not to impose a penalty, and assessing the level of penalty, but gives little or no guidance on the magnitude of penalties that undertakings might expect to face as a consequence of failing to comply with the CMA's investigatory requirements. For example, paragraph 4.10 et seq. of the Statement gives no indication of likely tariffs or penalty levels. Given the relative paucity of decisional practice in the area, it would be helpful to give some indication – whether in the main text or in the annexed examples – of the levels of penalty that the CMA would consider imposing in a range of circumstances, or alternatively a methodology for assessing penalty levels in the same way that it does for breaches of the Chapter I and Chapter II prohibitions.

2.4 It would also be helpful for the CMA to confirm that the statutory maxima would – as logic demands – be reserved for the most serious instances of non-compliance, with lesser failures attracting a significantly reduced penalty. This is particularly important given the proposed increases in the statutory maxima, and thus the risk that significant fines could be imposed for relatively minor failures.

2.5 More detailed guidance in this area would support the CMA's objective of deterrence by making it clear to undertakings the risk associated with non-compliance, and would also provide increased transparency and predictability in the investigative process.

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?

2.6 The guidance the CMA has set out in the Statement is helpful, but in our view certain aspects would benefit from further clarification. Our comments in response to this question address several topics:

(a) the concept of "reasonable excuse";

(b) the appropriateness of fixed versus daily penalties;

(c) the CMA's annexed examples; and

(d) the procedure by which penalties are imposed.

The concept of reasonable excuse

2.7 The CMA's discussion of the concept of reasonable excuse in its guidance suggests that it considers the threshold a strict one. The example given is a significant and demonstrable IT failure that could not have been foreseen or avoided. Such a case must certainly constitute a reasonable excuse; in fact it would represent a situation in which compliance was rendered impossible by factors entirely outside the undertaking's control. Circumstances falling short of that strict standard would, in our view, clearly also meet the standard of reasonable excuse.

2.8 In particular, we consider that an honest error made in good faith whilst trying to comply with an investigative requirement constitutes a reasonable excuse, particularly where the error is drawn to the CMA's attention and promptly corrected. Imposing a fine in such circumstances would not achieve a deterrent effect as the undertaking in question is in fact using its best endeavours to comply. Conversely, recognition in the CMA's Statement that honest errors will not usually attract a fine would encourage undertakings proactively to investigate and correct inadvertent mistakes, thus contributing to the CMA's objective of obtaining accurate and reliable information.

2.9 Furthermore, in our experience it is often the case that the OFT and Competition Commission issue requests for information that are challenging for undertakings to comply with – for example because the information does not currently exist, is not in the required format, will require very intensive data processing to produce or is being produced to deadlines that do not allow reasonable, or indeed any, time to clarify and correct errors. In those circumstances, notwithstanding a genuine desire to be as helpful as possible to the authority, undertakings may struggle to meet information requests in full, or to do so within the often necessarily tight timetables required. In light of that, we welcome the CMA's indication in paragraph 4.4 that it would acknowledge the reasonable effort of an undertaking to comply when determining whether a penalty is appropriate. In our view, it would be inappropriate to impose a penalty on an undertaking that is making efforts to comply with a deadline, particularly where the CMA has the alternative of stopping the clock.

The appropriateness of fixed versus daily penalties

2.10 The CMA has provided a helpful indication at paragraph 4.9 of the Statement regarding the circumstances in which it will consider a fixed or daily penalty – or both – to be appropriate.

2.11 We note that a feature of the revised statutory maxima is that daily penalties have increased significantly in proportion to fixed penalties. The CMA also acknowledges that "*daily penalties may result in a greater overall penalty than the maximum fixed penalty if P fails to comply promptly*". We recognise the value of the daily penalty regime in incentivising compliance with requirements that remain unmet as of the date of formal notice. However, we believe it is important to ensure that the imposition of daily penalties does not result in an overall penalty that is disproportionate under the circumstances looked at in the round. The CMA need only

impose two days' worth of daily penalties at the maximum rate to achieve an overall penalty equal to the total amount it could impose in relation to failures that predated its formal notice of penalty. Accordingly, we believe it is important that the CMA, when considering the combination of fixed and daily penalties, has regard to the overall gravity of the failure to comply when imposing a daily penalty rate.

2.12 The CMA should also have regard to the need to afford undertakings a reasonable period of time in which to bring into compliance a situation of which they may not previously have been aware. The CMA would not achieve its objective of incentivising compliance by imposing a daily rate during a period of time in which an undertaking – making all efforts – could not reasonably be expected to remedy the situation. The legislation appears to leave open to the CMA the possibility of applying a daily penalty the imposition of which post-dates its formal notice. Accordingly, where the CMA has determined that it is appropriate to impose a daily penalty, the CMA should also consider whether it is appropriate under the circumstances to provide that the daily penalty will only enter into force if the undertaking does not achieve compliance within a specified number of days.

The CMA's annexed examples

2.13 We support the inclusion with the Statement of practical examples of circumstances in which the CMA would or would not be inclined to impose a fine. However, we think the examples could be clarified in order to provide better guidance.

2.14 We make below some specific comments on certain of the examples offered by the CMA, but as a general point we think examples are helpful only insofar as they give a clear indication of the manner in which the CMA would exercise its discretion under the circumstances. A practical example is of little use if it sets out a 'borderline' case and then merely indicates that the CMA might or might not impose a penalty. In our view, the CMA should aim to use the examples to provide clear indications of how its Statement of Policy would apply in these cases.

2.15 We also note that, with the exception of example 1, all of the examples are positioned towards the top end of the penalty range. The CMA might consider providing additional examples of compliance failures that it would consider fall closer to the lower end of the penalty range in order to give some sense of the CMA's view of the penalty tariff.

2.16 ***Example 1:*** in our view this is clearly a case in which the imposition of a penalty would be counterproductive and would not serve the CMA's stated objectives. The failure to comply is inadvertent, the delay is not material and there is no suggestion that the CMA's work would be prejudiced under these circumstances. Moreover, it is apparent that A has a constructive attitude towards compliance. We suggest amending the final sentence of this example to read: "In cases of this nature the CMA would typically not seek to impose an administrative penalty."

2.17 ***Example 2:*** this scenario cannot be considered a "serious failure" without first considering (i) whether there was a reasonable excuse for the inadequate nature of D's response; and (ii) any explanation for the difference in the reported market share

figures. Facts addressing both of those points would need to be included in the "Scenario" section of this example in order to warrant the conclusion in the "Analysis" that this was a serious failure and a deliberate attempt to prejudice the CMA's investigation. As presently drafted, this example suggests that the CMA would conclude merely from the fact of a brief response and a difference in reported market shares that D has deliberately attempted to undermine the CMA's investigation, a conclusion that is not warranted on the information provided in the Scenario.

The procedure by which penalties are imposed

2.18 Administrative penalties imposed by the CMA are 'final' decisions, appealable only to the Competition Appeal Tribunal (***CAT***). With the increase in the statutory maxima, the magnitude of those penalties is also very significant. Accordingly, we consider the following procedural safeguards are necessary:

(a) the decision should be taken by a decision-maker of appropriate seniority, who should be demonstrably independent from the day-to-day management of the particular case, and can therefore exercise – and be seen to exercise – impartiality in relation to the perceived failure to comply; and

(b) undertakings subject to penalties should be given a reasonable opportunity to be heard at all relevant stages of the process for imposing penalties.

Appropriate decision-maker

2.19 Paragraph 5.10 of the Statement outlines the proposed decision-makers in relation to penalties at different phases of an investigation. We note that the CMA proposes to delegate the power of decision in 'phase I' proceedings to the senior official with responsibility for the proceeding, rather than to the inquiry group, market reference group or case decision group, as the case would be in phase II.

2.20 In our view, the decision-maker in relation to administrative penalties should not be someone directly responsible for the management of the proceeding. Instead, the power to impose a penalty should be reserved to a senior and independent decision-making person or body, in the same manner as other 'final' decisions of the CMA. If the power to impose penalties is delegated to personnel with direct responsibility for the proceeding, there is a risk of an actual or perceived conflict of interest in relation to the decision. Moreover, the scope and parameters of investigatory requirements, as well as what constitutes adequate compliance, are frequently a matter of legitimate debate between undertakings and case teams. It does not seem to us appropriate therefore that the personnel imposing the investigatory requirements should also have the responsibility for determining the extent to which undertakings have complied with those requirements and, if not, the consequences of non-compliance in terms of appropriate administrative penalties.

2.21 Administrative penalties carry serious consequences for undertakings, both in terms of the financial burden imposed and the reputational harm suffered by the undertaking. Undertakings also have no recourse beyond an appeal to the CAT. Administrative penalties therefore warrant the same procedural treatment as other

final decisions. We note that equivalent decisions under Article 23(1) of Regulation (EC) No. 1/2003 are reserved to the College of Commissioners, rather than delegated to Directors General or Heads of Service.

Opportunity to be heard

2.22 We welcome the CMA's proposal first to issue a provisional decision on which the undertaking in question will be invited to comment before issuing a final decision. We would further suggest that the CMA make it clear in the Statement that a provisional decision will include all the relevant information on which any final decision would be based, including all the information outlined in paragraph 5.1 of the Statement, in order that the right to be heard can be effectively exercised.

2.23 We also note that paragraph 5.6 indicates that the CMA anticipates in some cases issuing provisional decisions without first inviting the undertaking to specify the reasons for its failure where "*the CMA considers that P does not have any reasonable excuse*". While we appreciate that there may be circumstances in which the CMA considers it is unlikely that the undertaking will be able to adequately explain its non-compliance, we nonetheless do not think the CMA can reasonably reach this view without first giving the undertaking an opportunity to explain. We would not anticipate that this procedural safeguard would impose an undue burden on the CMA, and indeed would improve the quality of the process by ensuring that the provisional decision is made in full possession of the relevant facts.

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?

2.24 In our view "material influence" is not an appropriate test for assessing the turnover of an undertaking for the purposes of imposing penalties. We are separately responding to the BIS consultation on the Draft Order introducing the material influence test, but we explain our views here for convenience and to inform the further points we make in relation to the CMA's proposed approach to this test.

Material influence is not an appropriate test

2.25 The purpose of the turnover test is to allow penalties to scale with the financial strength of the particular undertaking, thereby ensuring that the CMA can impose an adequately deterrent penalty and also so that excessive and disproportionate fines are avoided. The material influence test was conceived for an entirely different purpose – to serve as a jurisdictional threshold for merger control. Accordingly, in our view the use of the material influence test is at odds with the role of the turnover test in the assessment of penalties. The approach is also inconsistent with the methodology for calculating penalties in other contexts.

2.26 The material influence test represents the "lowest level of control" that may give rise to a relevant merger situation. It serves as a jurisdictional threshold

identifying the circumstances in which one undertaking exercises sufficiently material influence over another undertaking (which is otherwise independent) to influence policy relevant to that undertaking in the marketplace, and therefore, to warrant merger control review. Material influence may, according to the CMA, arise at shareholdings of as little as 15%, through Board representation (which may well be minority Board representation) or through contracts or arrangements which allow one undertaking to exercise influence over the other.

2.27 In the penalty context the turnover test is typically limited to the turnover of the "undertaking" in order to give a measure of the financial strength of the undertaking, in order to allow for an appropriately scaled maximum penalty. Material influence, by contrast, is not intended to measure the financial strength of an undertaking on the market. The turnover of undertakings subject to material influence will often not be consolidated into the accounts of the influencing undertaking. In many cases, the influencing undertaking's stake in the materially influenced undertaking will be a financial investment only, where the value of that investment to the influencing undertaking is measured only in terms of the earnings and capital gains or losses that accrue directly to the influencing undertaking. In other circumstances beyond the scope of pure financial investments, material influence may be acquired without deriving any financial benefit through share ownership, such as through Board representation. Applying the material influence test in the context of determining relevant turnover for penalties therefore risks inadvertently capturing the turnover of undertakings that should not properly be considered as part of the undertaking subject to the penalty: for example companies in which pension or private equity funds have minority financial investments.

2.28 Accordingly, there is a real risk that the application of the material influence test would give rise to disproportionate and unreasonable penalties by overstating the financial strength of the undertaking in the market.

2.29 We note also that calculating turnover with reference to the material influence test is at odds with the approach taken in relation to fines for breaches of competition law more generally. For example, the material influence test is not referred to in the OFT's 2012 guidance on penalties, which focuses instead on the turnover of the undertaking itself. Applying the material influence test would also conflict with the European Commission's approach to assessing relevant turnover for penalties and could potentially lead to fines greater than those imposed for substantive infringements of competition law under the UK Competition Act 1998. This appears to contradict the Government's approach in its response to consultation on *A competition regime for growth*. In that response, in explaining its decision to legislate for a maximum penalty of 5% of turnover rather than the 10% it had originally proposed, the Government referred to concerns that a 10% maximum penalty would be the same as for antitrust offences, which respondents considered to be a "*much more serious matter*".[1]

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[1] See paragraph 4.16 of *A competition regime for growth*, and paragraph 5.6 of the Government's response to consultation.

2.30 Finally, the material influence test imports unwarranted uncertainty into the penalty regime for interim measures. The application of the material influence test is frequently contested in merger control proceedings, and the OFT has traditionally recognised that there is a certain amount of discretion involved in its assessment in any given case. In practice, if the material influence test is applied, it will be impossible for undertakings to identify their exposure to penalties. Not only is this lack of legal certainty in conflict with general principles of European Union law, but it also defeats the CMA's deterrent objective; in order for a penalty regime to have a genuinely deterrent effect, undertakings must be able to predict with some certainty the penalties that will apply should they infringe.

The CMA's proposed approach to the material influence test

2.31 The CMA has acknowledged at paragraph 4.18 that applying the material influence test may not be appropriate in all cases. The CMA proposes to apply the material influence test 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".

2.32 Our view is that the material influence test should be removed from the Draft Order entirely. If it transpires that the material influence test is ultimately included in the Order, then we would support an approach under which it is applied in practice only in the most exceptional cases.

2.33 The formulation set out by the CMA in paragraph 4.18 would benefit from clarification. The CMA's formulation ("*capture sufficient turnover…to give rise to a deterrent penalty*") seems to suggest that the CMA might first conclude on what an appropriately deterrent level of penalty would be, and then from that determine whether or not to include turnover subject to material influence. In our view, this reverses the analysis, which should focus first on the business structure of the undertaking and whether its financial strength is accurately reflected in the absence of the material influence test. It may be that this is what the CMA intends in paragraph 4.18, in which case we would simply ask that the point be made expressly.

2.34 We would also suggest that the CMA's guidance should explicitly recognise that the material influence test will only be applied in the most exceptional cases. In general, and as we have explained above, the material influence test will not be necessary in order to accurately reflect the financial strength of an undertaking, and in most cases it will overstate the strength of the undertaking. Indeed, we cannot conceive of any circumstances in which it would be appropriate to apply the material influence test, and would therefore suggest that, should this discretion be retained in the final Order, the CMA's guidance states that it would be used only in the most exceptional circumstances.

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?

2.35 We refer to our comments above.