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Understanding prohibited cartel behaviour in order to minimise the risk of prosecution

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Introduction

The Australian Competition and Consumer Commission ("ACCC") currently has identified more than 40 suspected cartels, with 14 cases before the courts.

Some of these involve very small scale local price-fixing arrangements such as local businesses ringing each other to agree on prices; others are nationwide; a few are operating globally.

Regardless of their size, the ACCC regards cartels as a silent extortion, capable of doing far more damage to our economy and to consumers than many of the worst consumer scams.

So what is a cartel?

In a legal sense this is defined by subsection 45(2) of the *Trade Practices Act* ("TPA") which prohibits contracts, arrangements or understandings which:

- have the purpose, effect or likely effect of substantially lessening competition; or
- contain an exclusionary provision.

An exclusionary provision is defined in section 4D of the TPA as a provision that has the purpose of preventing, restricting or limiting dealings with particular persons (whether absolutely or on particular conditions) by all or any of the parties to the arrangement, where the parties to the arrangement are actual or potential competitors.

In plain language this mean an illegal agreement between two or more competitors to undermine competition through price fixing, bid rigging, collusive tendering or market sharing.

Before going further, I must confess some ambivalence about part of the topic proposed for today *"minimising the risk of prosecution"*. I do not propose to give you tips on helping your clients avoid *detection* and *prosecution*. The ACCC has something rather like a zero tolerance approach to cartels – except where leniency applicants are involved. However, by understanding what a cartel is and the potential consequences of involvement in cartels – you can help your clients avoid a breach of the TPA.

They say that a picture tells a thousand words. So with that in mind I propose to show you some of the video footage obtained by the Department of Justice in the course of its investigation into the Lycine Cartel. The sequences I've selected show market sharing, price fixing and an ironic contempt for law enforcement authorities. However, I don't want you to take from this the idea that all cartels are so well organised or so overt about what's agreed.

Role of the ACCC

Enforcement of Australia's cartel law falls to the ACCC.

Unlike some other jurisdictions, the ACCC has no power to issue on the spot fines or penalty notices if it believes a breach of the law has occurred. Rather, we become the applicant in civil proceedings in the Federal Court of Australia.

Like any other litigant, we must prove our case to the Court. Because of the seriousness of the allegations, the standard of proof required is a higher than the traditional civil "balance of probabilities" standard – but lower than the usual criminal "beyond reasonable doubt" standard.

In enforcement proceedings, the ACCC can seek a range of remedies for breach including:

- declarations that the conduct was unlawful;
- penalties (in the case of cartel conduct, a maximum of $10 million per breach for corporations and $500,000 per breach for individuals);
- injunctions – banning repeat conduct and /or requiring the person involved to undertaking compliance training or put in place compliance systems;
- damages for those who have suffered loss by reason of unlawful conduct; and
- a range of other orders, such as community service and adverse publicity orders.

A similar range of remedies (notably, excluding penalties) is available to private litigants who bring proceedings alleging a breach.

The penalty imposed for breach in any particular case is a matter for the Federal Court to determine. While there is nothing akin to "sentencing guidelines" in Australia, a body of jurisprudence has developed such that in determining penalty, the Court will have regard to:

- the nature and extent of the contravening conduct;
- the amount of loss or damage caused;
- the circumstances in which the conduct took place;
- the size of the contravening company;
- the degree of power the corporation has, evidenced by its market share and ease of entry into the market;
- the deliberateness of the contravention and the period over which it extended;
- whether the contravention arose out of the conduct of senior management or at a lower level;

- whether the company has a corporate culture conducive to compliance with the TPA as evidenced by educational programs and disciplinary or other corrective measures in response to an acknowledged contravention;
- whether the company has shown disposition to cooperate with the authorities responsible for the enforcement of the TPA and / or has saved the community the burden of a lengthy expensive case;
- the need for the penalty to act as both a specific and general deterrent; and
- the total penalty for related offences ought not to exceed what is proper for the entire contravening conduct involved.

Where a breach is admitted, it is common for the ACCC and the cartel participant to agree on the appropriate penalty range and to jointly put to the Court an agreed statement of facts and submissions on penalty. However, the Court is not bound to accept any joint position and retains ultimate discretion to determine the penalty in each case.

Some recent examples of cartels against which the ACCC has successfully taken action include the following.

- George Weston Foods – where a former divisional chief executive telephoned a competitor seeking to fix the wholesale price of flour. Even though the competitor did not agree to the price fixing proposal, the company was penalised $1.5 million. This matter originally came to the ACCC's attention via an anonymous tip-off.

- the power transformer cartel - in which, for several years, companies fixed the tender price of power transformers through secret meetings that took place in hotel rooms, airport lounges and private homes across Australia. Ultimately, record penalties totalling $35 million were awarded against the companies and senior officers involved. Again, in this case the conduct was exposed through an anonymous email tip-off.

- Metro Bricks, which agreed in phone calls and meetings with its rival Midland Bricks simultaneously to lift the price of bricks by three per cent, and set a floor price for tender pricing for major builders (in Western Australia). Metro bricks was penalised $1 million.

Leniency Policy

The brick fix was actually exposed when Boral, the parent company of Midland, voluntarily came to the ACCC to take advantage of our approach to leniency. In so doing Midland escaped a financial penalty while its co-conspirator copped $1 million.

The history of our leniency policy goes back to 1998 when the ACCC published a guideline dealing with cooperation.

The cooperation policy is expressed in general terms and applies to all potential civil contraventions of the TPA. Put simply, it indicates that co-operation and assistance can be recognised through partial or complete immunity from ACCC action, administrative resolutions and so on.

It sets out the sorts of matters to which the ACCC is likely to have regard in determining its approach to co-operating party. For example

- whether full and frank disclosure been made;
- whether valuable information (not previously known to the ACCC) has been made available;
- whether steps have been taken to rectify the contravention; and
- whether the co-operating company has a history of past contraventions.

Significantly, the type of leniency offered to reward co-operating conduct is a matter for negotiation between the contravener and the ACCC.

By way of contrast, in 2003, the ACCC released a formal leniency policy *for cartel conduct only.*

Under this policy, the ACCC offers corporations:

- immunity from ACCC initiated proceedings, where the leniency applicant is the first to disclose the existence of a cartel of which the ACCC was previously unaware; or
- immunity from pecuniary penalty, where the leniency applicant is the first to make an application for leniency in relation to a cartel of which the ACCC was aware, but in relation to which the ACCC had insufficient evidence to commence court proceedings.

In addition, the policy only applies under the following conditions:

- the corporation must give full and frank disclosure, co-operating fully, expeditiously and continuously;
- its admission must be a truly corporate act;
- it must cease involvement in the cartel;
- it must not have coerced others to participate or have been the clear cartel leader; and
- where possible, it must make restitution to injured third parties.

If a corporation qualifies for leniency, all directors, officers and employees of the corporation who admit their involvement will also receive leniency. However, I should note that there are specific provisions and conditions dealing with individual leniency applicants.

So, the policy makes cartel lawbreakers and their executives an offer to cease the unlawful conduct and report it to the Commission. In return they receive a clear and certain offer of leniency. Their evidence then exposes others involved who will be investigated and, if the evidence permits, brought before the courts for their just deserts.

While those companies that are penalised may regard this as "unfair", any plea for parity of treatment is unlikely to be persuasive. In the December 2003 *Tyco* case[1], Justice Wilcox noted:

> *"Through its solicitors, Tyco alerted ACCC to the fact of the contravening conduct. Tyco, and its relevant executives, agreed to provide evidence to ACCC in return for a leniency agreement under which ACCC agreed not to seek the imposition of a penalty upon any of them. No doubt it was appropriate for ACCC to offer leniency; without such an offer, ACCC may not have been able to prove the collusive conduct…It is sufficient to say that, because of the existence of the leniency agreement, there can be no valid argument for parity in outcome as between Tyco and FFE. If this approach leads to a perception amongst colluders that it may be wise to engage in a race to ACCC's confessional, that may not be a bad thing."*

Criminal Penalties

It could be that within the foreseeable future, the value of the leniency carrot increases.

Currently, Australia's cartel enforcement regime is a civil one. In Australia, no-one goes to jail for participating in a cartel. However, the Dawson committee recommended that (subject to further work on the detail) criminal penalties be introduced for hard core cartels.

The ACCC has been a strong supporter of this approach. We regard hard-core cartel conduct as one of the most damaging forms of anti-competitive behaviour, harming both business customers and end consumers. The gains to cartel participants can be large and the risk of detection is low. Cartel behaviour is, in reality, a form of theft and little different from classes of corporate crime that already attract criminal sentences. However, it not always perceived this way.

In his judgment in the *Transformers* matter[2], Justice Finkelstein articulated this point well, saying:

> *"Generally the corporate agent is a top executive, who has an unblemished reputation, and in all other respects is a pillar of the community. These people often do not see antitrust violations as law breaking…There are, however, important matters of which the sentencing judge should not lose sight.*
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> *The first is the gravity of an antitrust contravention. It is not unusual for anti-trust violations to involve far greater sums than those that may be taken by the*

1 *Australian Competition and Consumer Commission v FFE Building Services Limited* [2003] FCA 1542, at para 29-30

2 *ACCC v ABB Transmission and Distribution Limited (No. 2)* [2002] FCA 559, at para.28.

> *thieves and fraudsters, and the violations can have a far greater impact upon the welfare of society...*
>
> *Secondly, there is a great danger of allowing too great an emphasis to be placed on the "respectability" of the offender and insufficient attention being given to the character of the offence. It is easy to forget that these individuals have a clear option whether or not to engage in unlawful activity, and have made the choice to do so."*

Why has the ACCC argued so strongly for criminal sanctions? In part, the answer lies in the ACCC's objective of securing compliance with the TPA. Although there are many moral businesses and business people, some businesses and business people need an external incentive to comply with the law – a risk benefit analysis that weighs heavily against involvement in unlawful cartels.

It is clear that the existing pecuniary penalties for breaching the TPA are not insubstantial. However, for a pecuniary penalty to be effective, it must exceed the potential gains from unlawful conduct. Cartel activity will not be deterred if the potential penalties are perceived by firms and their executives to be outweighed by the potential rewards.

To calculate the optimum penalty, the anticipated gain from conduct is divided by the risk of detection. A paper by Wouter Wills[3] noted a body of academic work that has sought to quantify both gain and risk of detection in an attempt to calculate the optimal level of a pecuniary penalty for price fixing cartel. In relation to risk of detection, this was estimated at between 13% and 17% (in jurisdictions where the regulatory authorities have strong investigatory powers). This means that only one in six or seven cartels is detected. In relation to gain, the studies estimate that:

- the average length of a cartel is six years[4]; and
- prices of affected commodities increased by 10% taking into account price elasticities, taxation and other costs of inefficiency.

Using these estimates, Wills calculates that a penalty would not deter price fixing unless it was at least 150% of the annual turnover in the products concerned in the violation.

In an empirical study of almost 400 firms convicted of price fixing in the US between 1955 and 1993, Cray Craft and Gallo[5] estimated that optimal penalties would have bankrupted at least 58% of those firms. Even if a company does survive, penalties will often ultimately end up being passed on to the consumer in the form of higher

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[3] *Does the effective enforcement of articles 81 and 82EC require not only fines on undertakings but also individual penalties, in particular imprisonment*? (2001) EU Competition Law and Policy Workshop Proceedings.

[4] Bryant and Eckard, *Price Fixing: The probability of getting caught.* The Review of Economics and Statistics 1991 at 531.

[5] Cray Craft and Gallo *Anti trust sanctions and a firm's ability to pay* (1997) 12 Review of Industrial Organisation 171.

prices. In addition, they punish innocent parties such as employees, shareholders and creditors. In the circumstances, it may be unrealistic to expect that optimal pecuniary penalties will be imposed by a Court.

Let me give one example. It has been estimated that the total value worldwide of the commerce affected by the international vitamin cartel was in the order of $20 billion. Conservative estimates would imply a total gain to the three participants in that cartel of $1 billion - $2 billion. Once the risks of detection are factored into the calculation, the optimal penalty is between $6 billion and $14 billion. Taking into account record penalties imposed worldwide and civil damages the participants have actually paid an amount in the order of $2 billion.

The *Dawson Review* did recommend an increase in the maximum pecuniary penalty for a breach of Part IV to be the greater if $10 million or three times the gain from the contravention. Where the gain cannot readily be ascertained, 10% of the turnover of the body corporate and all of its inter-connected bodies corporate has been recommended as an appropriate alternative. The Review also recommended that:

- corporations be prohibited from indemnifying officers against the imposition of pecuniary penalties; and
- courts be given the power to disqualify individuals implicated in a contravention from being a director or a corporation or involved in its management.

A bill making changes to this effect was before parliament when the election was called. If implemented, such changes should reduce the risk of pecuniary penalties being seen as merely a cost of doing business; as just another tax on a minor misdemeanour.

However, a criminal penalty has clear personal implications against which a company cannot protect an employee. A person will have a criminal record and may lose their liberty. The cost-benefit balance is shifted.

Overseas Experience

Of course, the introduction of criminal sanctions for hard-core cartel behaviour would not be a revolutionary move by world standards. In the United States, individuals who breach section 1 of the *Sherman Act*, which prohibits cartel behaviour, already face the prospect of jail sentences of up to three years. And that’s real jail, as the Sentencing Guidelines make clear that community or home detention is not to be used to avoid imprisoning offenders. Indeed an industry has been spawned “advising” foreign domiciled cartel participants who have decided to “do time” in the USA on their prison choices.

The United States Sentencing Commission takes the view that *“short prison sentences coupled with large fines”* are the most effective means of deterring individuals from participating in cartels. And we are talking about very large fines here.

While the *Sherman Act* originally provided for fines of up to US$350,000 for an

individual and US$10 million for each violation (not dissimilar to Australia's penalty regime), the *Criminal Fines Improvement Act* of 1997 substantially raised the permissible maximum. Now fines on companies can be levied up to either twice the financial gain from the crime, or twice the loss to the victim (a formulation known colloquially as "twice the pain or twice the gain"). Where it is impossible or inconvenient to calculate the pain or gain, a further alternative fine of 20% of the volume of affected commerce exists. Fines for individuals are set at between 1-5% of the volume of affected commerce – but must be not less than US$20,000.

As a result, fines assessed by the US Antitrust Division have dramatically increased over the past decade. Whereas in 1995 the record fine charged was just US$10 million, by 1999 it had risen to US$500 million.

International Co-operation

As I mentioned earlier, some of the cartels that we are looking at operate across borders. So too do many of the consumers scams we deal with. This is an inevitable consequence of the globalised market place and, in particular, the increasing presence of the internet as an important means of communication between business and consumers.

Of course, it can be difficult to enforce Australian court orders in respect of breaches of the TPA if those responsible for cartels or consumer scams are overseas residents. This is why the Commission is putting a lot of store at the moment in enhancing our relationships with overseas regulators in a range of enforcement areas.

The ACCC will continue to be closely involved with organisations such as the International Competition Network and International Consumer Protection Enforcement network. It is probably worth noting that at the ICN's most recent meeting in Korea, a Cartels Working Group was established with the ACCC elected co-chair of the enforcement subgroup together with Canada. And on November 24 this year, the world's leading enforcement regulators will come together in Sydney to take part in ICN Cartel and Leniency workshops, hosted by the ACCC.

Conclusion

Perhaps all this is rather a long way of saying that, for the ACCC, cartels are on the horizon and on the agenda. For practitioners, it may be that there has never been a better time to understand what a cartel is and how the ACCC's leniency policy works.

And remember, if you and your client find that the leniency carrot has been eaten, do not despair. An interesting (if unexplained) phenomenon known to regulators around the world is that a company involved in one cartel can very often be involved in another. We are not quite at the stage the US authorities are at – formally offering "amnesty plus" and "penalty plus" (differential treatment if you do / don't report your involvement in a second cartel when making a plea in a first cartel) but there is a reason why these formal approaches exist.