



International Class Action Conference 2007

*The relationship between private and public
enforcement in deterring cartels*

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Introduction

Imagine if you will, it's 1997 and a typically humid summer's day in Brisbane.

Sitting around a table is a group of old friends, businessmen who got to know each other through working in the fire alarm and sprinkler installation industry.

It's 10 years since the businessmen first met at what has affectionately become known as the 'coffee club' – their regular meeting. Business has been good to the members of the club. Between them, they account for virtually the entire fire alarm industry in Brisbane. The coffee club has become a very effective way of dividing up the market to ensure everyone is able to wring the maximum benefit out of the economic growth going on around them.

As they talk about the latest products on the market and what they intend to charge customers to install them, they laugh about the 'bad old days' and the paltry prices they'd be forced to sell and install the equipment for if they were still busy trying to undercut each other.

Meanwhile, on the other side of the city, a struggling takeaway owner opens his mail to find the maintenance bill on his ageing fire alarm system has gone up yet again. Frustrated at another increase, he starts ringing around other fire alarm service providers, only to find their prices are even higher than what he is already paying. In order to comply with the state's fire alarm regulations, he sees no option other than to raise prices to cover the extra cost, despite the complaints that are bound to come from his customers.

This may sound like a trivial case, but it is a simple example of the insidious trickle-down damage that a cartel can cause to the economy. Over the decade it operated, the fire protection devices cartel affected contracts worth an estimated half-a-billion dollars. It is also by no means one of the larger cartels that have been unearthed. In Australia cartels in the express freight, premixed concrete, vitamins sectors and corrugated fibre packaging have been exposed affecting commerce worth billions. Internationally, the numbers are even bigger than that and cover a wide range of industries.

Research conducted at Purdue University in the US looked at 800 overcharges in the last 125 years and concluded that the median overcharge created by a cartel was around 19 per cent. Other research based on a review

of over 500 cartel episodes estimates that on average cartels increase prices by more like 20-30 per cent.¹

Do a quick back-of-an-envelope calculation and it's easy to see the scale of damage cartels cause. Ultimately, we all pay. They are parasites on our economy, stifling the competition that has led to the prosperity we currently enjoy, which is why deterring, detecting and destroying them is a priority of national significance.

Australia's system for eradicating cartels has several planks. The Australian Competition and Consumer Commission sits perhaps at the top of the tree in terms of detecting and stopping the conduct, but private litigation including class action has an important complementary role to play in seeking financial compensation for victims and providing an additional disincentive.

This system generally works well but there do arise competing demands between the regulator's investigations and the needs of private litigants that can cause tension. While not wanting to hinder private action against cartels, demands for information do present conflicts that can threaten ACCC investigations and dissuade informants from coming to us in the first place. The interdependent nature of cartel enforcement means that if those conflicts lead to difficulties in prosecuting cartels, private litigants also suffer. Everyone loses.

While we do try to help third party actions where we can, our first priority must be to get a satisfactory outcome in court.

While penalties have strengthened in recent legislative changes, we need to ensure the incentives to confess remain so strongly tipped in our favour that the risk/benefit equation becomes a no-brainer for cartel members facing potentially significant punishment. Some view the current incentives for coming in to the ACCC and confessing involvement in a cartel may be compromised by the threat of class action suits against immunity applicants.

Criminal sanctions turn the minds of executives away from the company's financial losses to their own personal futures. The threat of being sent to jail remains by far the biggest weapon in this fight – yet it is a weapon we still do not have access to.

Importantly, greater incentives to confess can also go some way to addressing some of the frustrations class action litigants face when trying to follow up ACCC enforcement of cartels. It's these issues I would like to discuss with you today.

The ACCC's role in prosecuting cartels

While there is no firm definition of cartels contained in the Trade Practices Act, there are four broad categories of conduct that are characteristic of anti-competitive cartel agreements between competitors.

They include:

¹ JM Conner, *Price Fixing Overcharges: Legal and Economic Evidence* (2005), cited in OECD, *Hard-Core Cartels – Third Report on the Implementation of the 1998 Recommendation*, 2005, pp 25, 42-43.

- Sharing markets;
- fixing prices;
- restricting output and;
- bid rigging for tenders

The ACCC sees it as one of its primary duties to protect the public by deterring, detecting and shutting down cartel conduct. It does this under section 45 of the Trade Practices Act which imposes civil penalties for anti-competitive conduct. The ACCC uses a range of tools such as compulsory acquisition of information powers to deal with cartel conduct at many levels. Our investigators are highly trained experts with deep understanding of the industries they are looking into.

At the same time we conduct extensive education campaigns as to both the obligations of business in relation to anti-competitive conduct and providing advice to governments and business as to how they might detect cartel conduct, particularly in the context of procurement.

But one of the greatest difficulties we face in deterring cartels in the first place is overcoming not just the secrecy such arrangements involve, but the huge financial benefits that cartels can deliver to businesses.

With potentially massive gains, some companies simply choose to run the risk of being caught and price it into their operations in the knowledge that if the cartel is detected, the regulator faces a difficult task of proving the matter in court. Disincentives need to be significant if they are to have any effect against such potential benefits from breaking the law.

Which is why one of the ACCC's greatest assets to date in this fight has been its policy of granting immunity from prosecution to cartel members that confess their involvement in illegal agreements.

The immunity policy

As most of you will be aware, we offer immunity from ACCC prosecution to the first eligible cartel member who alerts the regulator to their involvement in a cartel. Most of the ACCC's current cartel litigation and investigation matters have originated from an immunity application.

The immunity policy injects the element of fear into cartel arrangements. As the saying goes, there is no honour among thieves. The constant fear that the other side may be about to rat to the authorities has proved to be a powerful motivator for cartel members to confess, not just here but in a number of countries which have similar policies to ours.

But the incentives contained in the immunity policy, while highly effective, can risk being undermined. The fear of class action dove-tailing on to ACCC enforcement action is a powerful disincentive for those who would otherwise be eager to come forward and seek protection from prosecution.

Why is there no requirement for an immunity applicant to provide restitution under the immunity policy?

One of the uncertainties identified in the ACCC's previous leniency policy was the requirement imposed on applicants to provide restitution, where it was possible, to injured parties. It was seen as a disincentive because it was unclear as to whether the ACCC would insist on restitution being provided, and if so, the class of persons who should be compensated. Further, a cartel participant who seeks immunity may be concerned they could face exposure to more than their share of any damages claims.

There were a number of outstanding issues in relation to the restitution requirement.

- How would the process work in practice?
- Was restitution required for only the customers of the applicant or all customers in the market where the cartel existed?
- Why should a company self report and expose itself to potential third party restitution when it can say to itself, "why should we self report and expose ourselves to that risk if we can keep quiet, defend any ACCC action if it arises and if need be, pay a pecuniary penalty that amounts to a lower dollar figure than providing redress to our customers?"

There were also many uncertain issues internally as to how the ACCC would administer such a process. It was difficult to ensure that best endeavours were being exerted to deliver restitution or to determine the merits or otherwise of any claims made for restitution.

It is useful to look to how other jurisdictions approach this issue.

In the United States, there are restitution requirements in the Department of Justice's amnesty policy that are to be applied, where possible, but this requirement is enforced generally by the private bar through class actions.

The Canadian Competition Bureau recently reviewed its immunity program and implemented many changes adopted by the ACCC in 2005, one of which was the removal of the requirement for restitution. The Competition Bureau identified three issues as the basis of making this change.

- Firstly, their legislation provided a mechanism whereby injured parties may recover damages
- Secondly, there is an increasingly assertive plaintiffs' bar, and
- Thirdly, the change was consistent with their existing practice and allowed the Bureau to make the most efficient use of its resources.

The role of class action litigation

Which brings me to the role private class action plays against cartels in Australia.

Such class action usually relies heavily on the ground-work of the ACCC in bringing the case to light and information arising from its investigation.

In the past two years we have seen the Vitamins class action being settled and class actions being initiated against airlines² and a fibre board box manufacturer³, both alleging cartels. Both involved businesses which made a decision to cooperate with the ACCC and make a disclosure of that fact.

Cartel enforcement works somewhat differently in Australia than in other countries. In the main it is the ACCC that brings cartel cases to the attention of the courts.

Australian pecuniary penalties for cartels are no small beer – there have been several cases where penalties have amounted to tens of millions of dollars, such as the transformers cartel where combined penalties across both the power and distribution transformer cartels totalled around \$35 million⁴. The financial consequences for a cartel extend beyond pecuniary penalties sought by the regulator and may extend to compensation for those who have suffered loss or damage. The extent of damages payable in these instances can be many times the size of those imposed by the courts in relation to the regulator's initial case (for example there are reports that individual and class actions that have been launched in the Amcor/Visy matter, are seeking in excess of \$800 million in damages and restitution).

Many private actions filed under the TPA are also settled between the parties. Victims can also use the benefit of ACCC action against cartel members to negotiate a better deal in future supply arrangements.

Tension between private and public action against cartels

Where parties do decide to take matters further and seek redress through the courts, one of the first places they often turn to for information is the ACCC. This makes sense, as transcripts of interviews, details of cartel arrangements and other information are enormously useful to third party plaintiffs wanting to put together a strong case.

However, this can cause significant problems for the ACCC, especially where private parties start asking for information before the ACCC has concluded its own investigations.

Let me restate, the ACCC understands the important role that private litigation plays in dealing with cartels. Therefore, the ACCC does everything it reasonably can to assist private parties without threatening its own investigations.

There are four main problems we face when dealing with requests to hand over information such as witness statements:

² Auskay v Qantas & Others

³ Jarra Creek Central Packing Shed v Amcor

⁴ See Australian Competition and Consumer Commission v ABB Transmission and Distribution Limited [2001] FCA 383 (5 April 2001) (re power transformers) and Australian Competition and Consumer Commission v ABB Transmission and Distribution Limited (No. 2) [2002] FCA 559 (re distribution transformers) and related cases.

- Compromising current or on-going investigations;
- Compromising any future investigations;
- Obligations of confidentiality;
- The threat of undermining the incentives of the immunity policy.

The first two points are reasonably self-explanatory. It is impossible to overstate how important it is or how detrimental it can be if sensitive information held by the ACCC, that formed part of a cartel investigation or enforcement proceedings, is disclosed prematurely. Premature disclosure of sensitive information has the capacity to close avenues of inquiry, impacting on the ACCC's ability to gather sufficient evidence and ultimately prove a case.

Premature disclosure of information may also have an adverse impact on any settlement negotiations underway between the ACCC and potential or actual respondents.

Where the ACCC agrees to accept information on a confidential basis, it will go as far as it legally can to respect that agreement, unless it is ordered by a higher authority, such as a court, to hand over information.

As I mentioned before, the immunity policy works on fear. Cartel members race to our door to seek immunity under fear that other members of the cartel will beat them to it and expose them to the brunt of prosecution.

But if those seeking protection are virtually assured of still being hit with massive class action damages claims as a result of confessing, they are significantly less likely to come to us in the first place.

These are key concerns that would-be immunity applicants often raise with us. They are reluctant to divulge too much information if the ACCC is likely to be required to hand over that information which they fear may then be used against them.

Frustrations also arise for lawyers running class action cases that follow the ACCC's prosecution of a cartel. There are times when the regulator may be able to get the fastest, most cost-effective result by coming to an agreement with the accused, rather than fighting out a prolonged battle all the way to the High Court.

Such outcomes can be a good result for the ACCC as its goals of stopping the conduct and achieving an outcome in the public benefit are satisfied. But it is not always satisfactory for private litigants who become frustrated as witnesses are no longer called to give evidence, and much of the case against the cartel accused never sees the light of day.

That frustration is understandable. They say to us, "by settling this matter you have denied us the evidence of dozens of witnesses, information that is crucial to our case".

However, ACCC settlements typically involve parties coming to an agreed set of facts which are submitted to the court for the purposes of the proceedings. These are also made publicly available. Such statements can provide a solid

platform on which third party litigants can build their case. It may be difficult for cartel participants to resile from facts they have already agreed to in ACCC litigation.

It is important to remember that the ACCC and class action litigants have slightly different goals in pursuing action, that do not always work in perfect harmony.

What I would say to you is that we try to do all we can to assist third party action where appropriate. But it is often not appropriate – indeed we are often not legally able to hand over all the information those third parties seek, and our first commitment is to the ACCC’s own cases, be they current or future.

Increased penalties

Recent amendments to the existing civil regime for punishing cartels that came into effect on January 1 this year have led to a significant stiffening of the penalties available. For each breach of the Act corporations now face up to:

- \$10 million
- Three times the value of the illegal benefit gained or;
- Where the gain cannot be ascertained, 10 percent of the corporate group’s turnover in the preceding 12 months;

whichever is the greater of the three.

Individuals can face up to \$500,000 for a breach of the Act, community service orders and disqualification from managing a company. The new amendments also mean that a company can’t indemnify an employee against legal bills and liability for pecuniary penalties – the individual has to pay.

These penalties are likely to force companies and individuals to seriously question the value of forming or staying in a cartel.

What we are likely to see on a corporate penalty level is a default to the penalty equalling 10 per cent of annual turnover.

The reason for this is the ‘three times the contravention’ rule is unlikely to come into play. Calculating the actual gain of a cartel is notoriously difficult, and no cartel member is likely to assist in this task. Doing so simply identifies the actual loss that third parties may then seek to go after.

The case for criminal sanctions

There are however, ways around some of the frustrations and conflicts between private and public cartel enforcement. At the heart of these solutions is the need for Australia to implement criminal sanctions for hardcore cartel behaviour.

In 2003 a review into the competition provisions of the Trade Practices Act headed by former High Court judge Sir Daryl Dawson recommended the Government investigate introducing criminal sanctions for hardcore cartel behaviour. In response to the Dawson Review an expert working party was

established to examine the issue and came back with a recommendation to introduce criminal sanctions, which the Government accepted.

This view was backed in 2005 by the OECD's third hardcore cartel report which recommended governments consider introducing criminal sanctions against individuals to enhance deterrence and incentives to cooperate.

Despite the Australian Government's initial support, and the success of similar sanctions in other OECD countries, such sanctions have yet to be introduced.

The ACCC believes, and has stated publicly before, that there is a compelling case for doing so.

Most importantly, such sanctions would provide a hefty boost to our immunity policy through the threat of jail sentences.

There is also a case for doing it sooner rather than later. Often we hear about cartel activity several years after the conduct has occurred. Cartel members can only be punished under the laws of the day that existed at the time of the breach. That means that even if criminal sanctions were introduced tomorrow, in five years time we may still find ourselves unable to send accused cartel ringleaders to jail because the conduct predated the legislative changes.

As I've discussed, there are financial incentives that work against cartel members who may be thinking of putting their hand up. The fear of ending up in jail however, would eclipse any financial considerations.

We are not just assuming this, there is already strong international evidence that shows us jail sentences are a far greater motivator for cartel members to confess than the threat of losing large amounts of money.

In 2006 the US Department of Justice's deputy assistant Attorney General responsible for cartel enforcement Scott Hammond delivered some telling insights from interviews with international cartel participants.

The international cartels involved sophisticated operations in Europe, Asia and a number of other regions, but not the United States. The cartel members had businesses that already sold into the US market, but their cartel arrangements stopped at the US border, despite flourishing elsewhere.

When asked why they had not extended their cartel arrangements to the potentially lucrative US markets their businesses were already operating in, the cartel members told investigators it was because they were fearful of going to jail under the US's antitrust laws. In some cases cartel members have even offered to pay larger fines in order to escape jail sentences.

As one senior executive put it, "As long as you are talking about money, the company at the end of the day can take care of me ... but once you begin talking about taking away my liberty, there is nothing the company can do for me".

Our more recent experience dealing with international cartels is that participants give priority in their immunity applications and the extent of their cooperation to enforcement agencies in those jurisdictions where criminal penalties exist. The reason is obvious. The consequences of failure to obtain immunity or of inadequate cooperation can be a jail sentence. Where such

failure can only lead to a financial penalty, dealings with the relevant enforcement agency are very much a second order priority.

Finally, another advantage is cartel conduct could be the subject of criminal proceedings, no matter how old the conduct. Currently under the civil regime, pecuniary penalties are only available within a six year timeframe.

I could cite numerous other examples, but the case has already been well made – criminal sanctions work in both deterring cartel conduct and in encouraging members to come forward and confess their involvement.

How would criminal sanctions assist third party action?

As the focus shifts from losing money to going to jail for cartel members, the concerns of third party action become a much lesser consideration. Therefore, factors that may have previously made executives reluctant to confess all suddenly seem less important. They are much more likely to be prepared to deal with the consequences of a class action case than risk being sent to jail. And their best opportunity to avoid going to jail is to be the first in the immunity queue and the first to give details on the illegal arrangements.

Recent legislative amendments increasing the financial penalties are a welcome addition to our fight, and help tip the scales further in our favour for those considering confessing their involvement in cartels.

Criminal sanctions make the incentives to confess so overwhelming there will be only one decision left to make – confess, or risk a term in jail.

If we don't get to hear about a cartel, we can't disrupt the conduct and prosecute the offenders. The flow-on is it's therefore also unlikely that private action will be taken either, simply because the cartel never comes to light. But the introduction of criminal sanctions significantly tilts the risk/return equation in our favour, resulting in more cartels being exposed.

Conclusion

Let's be absolutely clear what we are dealing with. A cartel involves a carefully calculated, premeditated act of fraud with one driving motive – to satisfy an insatiable greed for profit that demonstrates a total disregard for consumers who are defrauded by this arrangement.

If a corporate executive defrauds shareholders in a company, they go to jail. If a corporate executive defrauds consumers, by deliberately implementing a cartel arrangement, he should also go to jail.

It is true that criminal convictions are more difficult to achieve than civil penalties and that taking cartel cases as criminal proceedings has the potential to stretch out the time they take to resolve.

But the benefits of having such sanctions available for use in appropriate cases would far outweigh any difficulties that might result. The time has come for Australia to take this important next step in shutting down this insidious crime that costs the community millions every year.

Not only would criminal sanctions assist the regulator to meet its goals of deterring cartels and provide a greater incentive for offenders to confess, it would solve many of the difficulties faced by third parties in their subsequent private action for redress.

Quite simply, executives would have no choice but to spill the beans if they didn't want to go to jail. And that would be a win not just for customers who have become victims of cartels, but for all Australians.

Thank you.