

IV. BUSINESS AND NON-PROFIT ORGANIZATIONS – GLOBAL AND REGIONAL ASPECTS

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## **DETERMINING THE AMOUNT OF FINES FOR CARTEL PARTICIPANTS IN THE EU**

### **Abstract**

*Price-fixing, quota agreements, division of markets, the general cartel agreements, for years absorbed attention of economists and politicians who have been trying to work out effective policies to deal with this type of behavior. Despite these efforts, limiting the competition in the market through the creation of illegal agreements is still a common phenomenon in today's economy. To make sure that each participant of an illegal agreement will be justly punished multistage EC has developed a mechanism for calculating fines and systematically improves detection and level of penalties imposed to deter companies from violations of competition law.*

*Key words: illegal agreements, cartel, competition, calculation of fines, leniency procedure.*

### **1. Introduction**

Companies from various sectors in the European Union more and more often are coming into conflict with the competition law. Certain agreements are strictly prohibited, including: pricing and other terms of trade, setting the volume of production and the distribution and supply markets. The European Commission is trying to get rid of these agreements and to punish their participants.

After the discovery of a cartel the trial starts and the judgment is delivered and the fines imposed. Taking into account the case law of the European Commission one can conclude that the role of fines imposed on cartel participants is not only a punishment for past offenses, but it also deters companies from engaging in future, in an agreement that violates the law of competition.

The purpose of this article is a theoretical perspective on different types of anti-competitive agreements and to show the mechanism of calculating the fines applied by the European Commission.

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## 2. Types of anti-competitive agreements

Agreements may be concluded by a company at different levels of turnover. If the contract is concluded by companies operating at the same level for, example: several manufacturers market the same product, then we are talking about a horizontal agreement. The purpose of such an agreement is usually the restriction of competition through joint coordination of marketing activities. Typical horizontal agreements of a price-fixing cartel are quota arrangements and a division of markets or purchase. Horizontal agreements are perceived by antitrust laws as the most harmful to the market and consumers. Therefore, such cases deserve to be prosecuted to the fullest extent of the law in most civilized countries.

Agreements concerning price fixing directly or indirectly, fixing other conditions of business transactions, determining production volumes in relevant markets, technological development, the size and structure of investment participants in agreements or the division of markets or stores are all prohibited. Prohibited also are agreements leading to discrimination against trading partners outside an agreement and imposing additional conditions of trade agreements contrary to law and not connected with the transaction [Fornalczyk 2007, pp. 87-88]

Illegal agreements may take the form of arrangements made in any way by individual entrepreneurs or their compounds. It is not uncommon that such an agreement is formulated like a civil contract or resolution by the Association of Entrepreneurs. However, if companies are aware that such an agreement is illegal, most arrangements are not usually put in written form, but are made orally in order not to leave any traces behind.

Among the most important types of anti-competitive agreements are:

- a) Price-fixing - directly and indirectly fixing prices and other conditions of purchase and sale of goods. The direct determination of the price level means for example introducing a minimum price for the product, while the indirect fixing of prices could mean for example setting margins, discounts, payment terms, dates, and the calculation of increases in prices [Connor 2001, s.91].
- b) Quota agreements - to reduce the production or development. In this type of agreement often the main idea is to reduce overproduction and to halt the decline in market prices. The mechanism of reaction rates on the volume of production can be traced by analyzing the decisions of any cartel. Participants in such an agreement start limiting their production and try to keep prices stable at a high level. The calculation of production, production limits and reduction capacity jointly by the parties to the agreement is strictly prohibited.

- c) Division of a market or purchase - assigning each participant a specific area of an illegal agreement and establishing the market for each participant's percentage share of the market. Market allocation can be done by allocating customers and suppliers and limits on supply and sales in certain markets. Market allocation can be either territorial or subjective assortment. Cartels concluded by firms from different countries typically allow companies to maintain dominance in their home markets. Thus limiting competition, the company stabilize its profits, usually setting a price above the market rate.
- d) Restricting access to the market - characterized by unequal treatment by members of the agreement other market participants. In the most extreme form of such discrimination this may result in the elimination of companies which do not take part in a cartel from taking part further in the market. Restricting access to the market and the unequal treatment of partners may also be the objective of agreements and the use of other restrictive practices such as allocation of markets or collusion.
- e) Unrelated binding agreements - making the signing of a contract subject to acceptance by the other partner, the additional benefits that are not related to the subject matter of the contract. Such agreements occur frequently in large retail chains, which demand from smaller partners, the adoption of additional conditions in return for the opportunity to sell their goods in the chain.
- f) Bid-rigging - involving the joint establishment of companies concerning the detailed terms and conditions of its tender offer, the most common wage and price range. Bid-rigging may also be practiced between the organizer of an auction and one of the companies seeking the contract. In this case, collusion is the common setting of such tender conditions that favored one, the chosen company.

It must be added now that it is very important to remember that according to laws governing the right to fair competition, an operator is a person who conducts business. The method of financing and legal form of a project do not matter. However, according to antitrust laws it concerns business by trade industry organizations such as chambers, associations, corporations or associations governed by a broader context.

### **3. Calculation of fines**

The perpetrators and participants of a detected cartel must be justly punished. Therefore, the Commission has developed a complicated procedure that allows the imposition of penalties on any company that brakes laws of competition. Penalties are monetary, but later in the article will be referred to also as fines.

The method of setting fines for companies participating in a cartel consists of many steps. The Commission takes two basic elements into account when calculating amounts: deterring companies from violating these competition laws and the promoting of cooperation with the European Commission. According to guidelines on the prosecution of companies from 2006 [Reports on Competition Policy 2007, s.21-32] EC is obliged to calculate each fine for each individual participant in a cartel separately.

Initially the base amount is calculated. It consists of two basic elements. First, the level of significance is assessed a cartel and is awarded a value equal to the max. 30% of sales in the relevant year (usually takes into account the latest full year by the end of the cartel). Then this value is multiplied by the number of years of the cartel. The next step in calculating the base amount is the addition of another component called an additional amount, representing 15-25% of annual sales company, in order to further deter companies from entering into illegal horizontal agreements. For the significance level and an additional amount was fixed at an appropriate level, the EC takes into account several factors such as market shares of the companies involved, the geographic scope of the cartel's structure and harm to society. First to be assessed is the level of significance of the cartel and its value is set equal to 30% of the max. sales figures in the relevant year (the last full year before the end of the cartel is usually taken into account). This value is then multiplied by the number of years the cartel exists. The next step in calculating the base amount is by adding in another component called the "additional sum", representing 15-25% of the annual sales of the company, with the aim of further deterring companies from entering into unlawful horizontal agreements. In order that the level of significance and additional amount are set at the right level, the EC takes into account several factors, such as market share of enterprises involved, the geographic scope of the cartel's structure and harm to society.

The base amount can then be increased or decreased depending on several elements. Mitigating circumstances may exist such as: cooperation with the European Commission, limited participation in the cartel, immediately exiting the cartel after its discovery by the EC. On the other hand, aggravating circumstances may also exist such as: the refusal to cooperate with the European Commission, leadership in the cartel, forcing other companies to participate in an illegal agreement, and especially repeat offences. Each previous violation of the laws of competition, for example, through participation in other cartels in the past, may increase the base amount by up to 100%.

Some cartels are very profitable and operate for many years, meaning that it may be more profitable for the company to invest money to participate in such

an agreement and then afterwards simply pay the additional fine. Therefore, in the end the EC may decide to increase the fine if high profits of cartel members involved are so large and the penalty so low as to have no detrimental effect on them.

Other rules affecting the amount of the fine are: limiting it up to a max. 10% of the global trade figures of the accused company in the year preceding the termination of the cartel and the possibility of mitigating the punishment that weakens the company and carries with it the only negative economic and social consequences in the region.

The greatest potential for reducing fines is participation in the leniency program. The commission may grant so called immunity from penalties (100% reduction or cancellation of all fines), assessed from participation in an agreement if:

- a) the company is the first to provide the Commission with sufficient evidence to begin proceedings. The immunity referred to in this section may be granted only if at the time the evidence is delivered, the EC did not already have enough evidence to start proceedings.
- b) the company is the first to provide the Commission with sufficient evidence to conclude that the law had been violated under article 81 of the Treaty of the European Communities (TEC). The immunity referred to in this section may be imposed only if at the time the evidence is delivered, the EC did not already have sufficient evidence proving violation of the law according to art. 81 of the Treaty of the European Communities (TEC) in the cartel's case or if so far none of the other companies have received immunity under the conditions previously from the point 1a., in the same case.

In addition to meeting the conditions of 1a or 1b, a company that is trying for immunity must respect the following principles:

- a) co-operation must be complete and continuous throughout the procedure conducted by the EC. The company must provide all the evidence relating to the matter pursued, which are in its possession.
- b) the company must terminate participation in the illegal cartel agreement before presenting evidence relating to the 1a or 1b.
- c) has not forced other companies to participate in the cartel.

A company that wishing to commence efforts to apply for immunity should contact the Directorate General for Competition, European Commission. If the company does not meet the conditions described in points 1. and 2., it will be immediately informed of the fact that immunity cannot be granted. In this case, the company may withdraw from the European Commission previously submitted evidence, or apply for a partial reduction of the penalty [see Hovenkamp, 1994, p.67-69].

Until the process concerning application for immunity has been completed, the EC will not consider any other requests for immunity relating to the matter under consideration.

Companies applying for immunity, but did not meet all the requirements, usually have a second opportunity to reduce the penalty. In order for a reduction to be granted, several important conditions must be met. The company applying for a reduction in EC penalty must provide evidence that it would represent a significant value compared to the material already held by the European Commission. Moreover, such a company must terminate its participation in all agreements before delivery of the previously mentioned evidence.

The level of reduction in penalty is determined in % and amounts to:

- a) 30-50% for the first company that meets the conditions described above
- b) 20-30% for the other company which fulfills the conditions
- c) up to 20% for any other company which fulfills the conditions.

In a) and b) we may observe a large range of interest. The exact level of the reduction is decided by the European Commission taking into account the time taken to provide evidence and its importance to the ongoing investigation. Before considering applications by companies to reduce the penalty, the European Commission is required to deal with applications for granting immunity in the case.

After determining the level of fines, the company can appeal the judgment to the appropriate court and request a reduction in penalty. Referencing is a common and often effective practice among companies fined.

#### **4. The number of detected cartels and fines**

Competition policies implemented by various countries are not identical to each other. However, typically legal systems prohibit firms in certain activities and agreements between undertakings that violate the rules of market competition. In the European Union rules concerning agreements are governed by the Treaty of the European Communities.

According to this treaty horizontal agreements are considered to be harmful to both the economy and for individual consumers. All this makes the fight against cartels one of the main elements of competition policy pursued by the European Commission (EC).

As shown in Chart 1, for the period 2003-2010 the European Commission issued 51 decisions on cartels and fined a total of 344 companies.

**Table 1.** Commission decisions issued in the years 2003-2010

year	No. of Commission Decisions Issued in the years 2003-2010	The number of companies fined by the EC
2003	5	26
2004	6	29
2005	5	41
2006	7	47
2007	8	45
2008	7	37
2009	6	43
2010	7	76
total	51	344

Source: own study based on: <http://europa.eu.int> (25.04.2012).

Penalties to companies by the EC are a heavy burden for companies. Chart 2 indicates the sum of total fines imposed on cartels in a given year. The data in this table include the level of fines taking into account fine reductions associated with the leniency procedure, but before the appeal court.

**Table 2.** Fines imposed on cartels by the Commission members for the period 2003-2010

year	The amount of fines imposed on cartels (thousands of Euro)
2003	400,791
2004	368,753
2005	683,029
2006	1,846,385
2007	3,334,003
2008	2,270,310
2009	1,622,986
2010	3,101,218

Source: own study based on: <http://europa.eu.int> (25.04.2012).

The commission assumes that some of the companies participating in the illegal agreements may be willing to end its participation in the cartel and provide comprehensive information on its operation, but do not opt to do so for fear of high penalties that are likely to be imposed on them. The EC

said that in the interest of the Community milder treatment would be shown to companies which, although involved in the cartel, ceased operations and agreed to cooperate with the EC. In other words, the benefits of assisting in detecting cartel are so great that it warrants establishing a law preventing or mitigating penalties for companies involved in the illegal agreement, if they make a significant contribution to inhibiting cartel operations.

In order to encourage companies to cooperate in the described situation in the preceding paragraph, the EC in 1996 introduced a provision on immunity (called leniency), and reduction of fines in cartel cases [Barlingen 2003, p.54-59]. After five years of applying this procedure, the EC decided to modify it. The procedure confirmed its effectiveness, but the Commission concluded that it could be improved by introducing more transparency, so that firms were more confident of being granted immunity, or even partial reduction of the sentence for cooperation. Thus there was a closer relationship between the degree to which a penalty is reduced and the degree of co-operation with the European Commission [Report on Competition Policy 2007, p.11].

During the first 10 months of the operation of the revised procedures for leniency, there were 10 European cartels detected, which shows clearly the high effectiveness of this type of regulation. The introduction of the leniency procedure complicated the process of calculating the fine, but significantly contributed to destabilization of the cartels, introducing an additional element of uncertainty and fear, due to the fact that each of the participants in an unlawful agreement could choose to cooperate with the Commission.

## **5. Conclusion**

Price-fixing, quota agreements, division of markets and cartel agreements in general have been key issues for many years for economists and politicians, who have been trying to work out effective methods of dealing with this type of phenomena. Despite their efforts, reducing competition in the market through the creation of illegal agreements are still prevalent in today's economy.

The European Commission is trying to keep up with the regulations, making it easier to combat cartels. To ensure that each participant in an illegal agreement is punished justly, the European Commission has developed a mechanism for calculating fines and systematically improving detection rates and the level of penalties imposed to deter companies from breaking competition laws. The introduction of a fine leniency procedure for the reduction of fines in return for cooperation complicated the procedure. However, there has been a significant impact on the destabilization of the cartels, by introducing an additional element of uncertainty and fear, resulting from the fact that any participant in an unlawful agreement now has the option of cooperating with the Commission.



Current legal solutions allow the Commission to impose a penalty equal to 10% of the company's revenue for the year preceding the decision. Statistics show that the Commission increasingly uses the law and imposes the maximum sentence, arguing that the high and the inevitable punishment for participating in a cartel is the only way to discourage companies from entering into unlawful agreements.

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