Proposed Approach to Fines & Settlements

17th June 2014

A. Introduction

1. This document sets out important principles for the determination of administrative penalties (fines) and remedies by the Competition Authority of Kenya (CAK).

2. At the outset, it is important to be clear that administrative penalties (fines) are only relevant where the CAK has the power to impose a penalty and not where the provision means the penalty is determined by the courts. The penalty that could be determined by the courts may inform the penalty that the CAK would recommend when prosecuting a matter.

3. However, in principle the CAK can in some cases impose a higher penalty on firms than the courts can impose on persons (including individuals and firms). In administrative matters, CAK can recommend a penalty to the CAK Board, and an appeal is then preferred to the Tribunal or final appeal to the High Court.

4. It is also important to appreciate that there are different tests for establishing a contravention under the Competition Act, No. 12 of 2010 (the Act) consistent with international best practices. Specifically, clear cartel conduct, relating to agreements on pricing, market division, and bid-rigging are *per se* contraventions. If there is an agreement or concerted practice between two firms that are competitors then it follows directly that this removes the *independence* of their decisions and undermines competition between them.

5. This still appears to be poorly understood, including by the Practitioners. By comparison, if firms are in a vertical relationship then they are not competitors and an agreement between them needs to be understood also in terms of its effect.

6. The Act, under section 21(1), clearly states that arrangements between undertakings are assessed in terms of whether they 'have as their object or effect the prevention, distortion or lessening of competition in trade in any goods or services in Kenya, or a part of Kenya' (emphasis added, it is clearly not 'object and effect'). These arrangements are prohibited, unless they are exempt under Part III (D) of the Act. This is in line with almost all competition laws around the world and allows for an evaluation based on whether the firms are competitors or in a vertical relationship.[1]

7. In this paper, we consider the determination of penalties in settlements, with specific reference to horizontal restrictive practices where the conduct is a *per se* contravention. It is natural in settlements that there should be some consideration of what a penalty would be if imposed in a contested matter, however, settlements are also an opportunity for the CAK to take cognizance of cooperation on the part of respondents and to resolve matters more speedily. The remedy in such matters is generally simply that the conduct should cease, unless there are very particular considerations to be taken into account.

8. Therefore, we consider settlements, including remedies and penalties, for other restrictive practices and abuse of dominance cases. This is a diverse set of conduct which is typically evaluated on a case by case basis taking into account **the effect** of the arrangements. Settlements in such cases will likely pay greater attention to changing the conduct in question such that materially more competitive outcomes are obtained at an earlier stage than would be the case if a full investigation were concluded and the matter finalized through prosecution.

9. As the finding of a contravention also depends on weighing up the effects (unlike in horizontal arrangements where the effect is presumed) then it also suggests that

[1] Note, firms can be in both a vertical and horizontal relationship where one or more firms is vertically integrated.

settlements are less likely to include an admission of a contravention. The emphasis is rather on changing the conduct in question to ensure materially more competitive outcomes going forwards.

10. A particular settlement process for the resolution of contraventions by industry associations is outlined. By their nature, industry associations are groupings of firms that are in the same line of business and are actual or potential competitors (and are in a horizontal relationship). It is possible that the associations have practices or rules which influence the behavior of their members in ways which contravene the prohibition on horizontal restrictive practices but which the industry associations are not aware constitute contraventions. The proposed approach seeks to incentivize associations to review their practices and alter the conduct to comply with the law, without having to go through possible lengthy litigation[2].

11. This paper is presented given that the Act does not specify the basis on which penalties should be determined in terms of the criteria that should be taken into account. We therefore consider the principles with reference to the approaches taken in other jurisdictions to arrive at a proposed framework.

B. Provisions in the Act

12. The main components of a penalty regime are: fines, personal penalties and criminalization, private actions, leniency, and settlement.[3] However, for purposes of assessing penalties the penalty regimes can be divided into: fines, criminal sanctions and settlement.

13. For ease of reference the different sections where penalties are provided for are noted in Table I. The two sections where it is indicated that the CAK may determine a penalty are highlighted. The other provisions are criminal offences where the

[2] This is further detailed in a separate document.

[3] OFT, an assessment of discretionary penalties regimes (October 2009) Final Report, 15

penalty is imposed by the courts on undertakings and persons that have contravened the Act.

Table I

Area	Provision
Restrictive practices, agreements and decisions	s21(9) contravention means liable to conviction: imprisonment not exceeding 5 years or fine not exceeding KSh10 million or both
Restrictive practices: trade associations	s22(6) contravention means liable to conviction: imprisonment not exceeding 5 years or fine not exceeding KSh10 million or both
Restrictive practices: Abuse of dominance	s24(3) contravention means liable to conviction: imprisonment not exceeding 5 years or fine not exceeding KSh10 million or both
Restrictive practices: Investigation into restrictive practices	s36 after consideration of any written representations raised at conference the Authority may take various measures, including: (d) impose a financial penalty
Mergers	s42(5) contravention means liable to conviction: imprisonment not exceeding 5 years or fine not exceeding Kshs10 million or both s42(6) in addition to (5),the Authority may impose a financial penalty not exceeding 10% of previous years turnover in Kenya.
Consumer Welfare	s.70 contravention of any section under the consumer welfare part (i.e. s. 55- 65) the undertaking shall be liable on conviction to a term not exceeding 5 years or to a fine not exceeding ten million shillings or both.
General	s.91 where no penalty has been specified, fine not exceeding Kshs. 500, 000 or imprisonment not exceeding 3 years or both.

C. *Criminalization and fines*

14. It can readily be seen that the CAK is able to impose a financial penalty on firm(s) for both restrictive practices (including abuse of dominance) and for breach of merger provisions. In each of these there are legal considerations which include:

    (i) For ***restrictive practices*** there is no maximum amount stipulated where the CAK imposes an administrative penalty under s36. CAK can also reach a settlement under s38. It may also be argued that this should be read with reference to the provisions covering criminal sanctions (s21(9),

s22(6), s24(3)) or at least that the administrative penalties should not exceed the criminal sanctions.

(a) s21(9) the matter is referred for prosecution at the Office of the Director of Public Prosecutions (ODPP) and the section provides for a maximum term of 5 years or a fine not exceeding 10 million shillings, or both. This would mean that the directors and/or management of the company would be subjected to criminal prosecution with the possibility of prison terms.

(b) s22(6) the matter is referred for prosecution at the Office of the Director of Public Prosecutions (ODPP) and the section provides for a maximum term of 5 years or a fine not exceeding 10 million shillings, or both. This would mean that the directors and/or management of the company would be subjected to criminal prosecution with the possibility of prison terms

(c) s24(3) the matter is referred for prosecution at the Office of the Director of Public Prosecutions (ODPP) and the section provides for a maximum term of 5 years or a fine not exceeding 10 million shillings, or both. This would mean that the directors and/or management of the company would be subjected to criminal prosecution with the possibility of prison terms.

(d) In addition, s36 contemplates a process in which there is an initial finding, and possibly an oral hearing and written submissions. Only after following this due process may the CAK impose a financial penalty. Under s.36 the CAK can impose the following under (d) and (e): impose a financial penalty or any other appropriate relief. This provides scope for the Authority to resolve matters timeously, however, it must not be viewed as acting arbitrarily which suggests the need to provide guidance as to how such matters will be

approached as well as the way in which they will be explained such that the Authority can be held accountable.

(ii) For ***mergers*** s42(6) stipulates that this is 'in addition' to the criminal penalties under s42(5), the CAK can impose a financial penalty which has been interpreted (by the AG) might mean that the criminal penalty must be decided already in order for the Authority to proceed to penalize the undertaking(s). Therefore, this section contemplates that the CAK can opt for both a criminal and administrative penalty.[4]

(iii) For consumer welfare under s70, the Act provides for a criminal penalty which can be an imprisonment term and/or a fine.

D. ***Settlements***

15. Under the provisions dealing with restrictive practices, it is provided in s38 that the CAK may at any time during or after an investigation into an alleged infringement enter into an agreement of settlement with the undertaking concerned. This may include an award of damages to the complainant and/or an amount as a pecuniary penalty.

16. Presumably such a settlement would deal with both the possible criminal and administrative penalties. This is on the presumption that the matter has not been referred for prosecution to the ODPP to commence the criminal proceedings. While the criminal sanctions appear low, the extensive legal process, reputational harm and threat of imprisonment are likely to be an incentive to rather settle the matter. It is also possible that more than one individual from a single firm could face sanctions, while the firm would be settling effectively on behalf of all. For example, if three people in the firm had been involved in a cartel then each person could face a potential total penalty of KSh10million and a settlement at for example KSh15million could appear attractive.

[4] Under s66(2) of the Interpretation and General Provisions Act, Cap 2 Laws of Kenya Revised Edition 2012 (2010), it means that the criminal and administrative penalties may be inflicted alternatively or cumulatively.

17. It is thus important that the fining guidelines address settlements, taking particular account of the relevant features of such a process.

Under s.36 we propose that the following is taken into account:

a) Making parties aware of a possible finding and on what basis it is contemplated

i. Under s. 34 of the Competition Act, it is provided that upon conclusion of an investigation and where the CAK proposes to make a decision of an infringement under Section A (restrictive agreements, practices and decisions) or section B (restrictive trade practices applicable to trade associations), the CAK must issue a written notice of its proposed decision to each undertaking which may be affected by that decision.[5]

ii. The Notice must contain: the reasons for the Authority's proposed decision, details of any relief that the Authority may consider to impose, inform the undertaking(s) of the options to submit written submissions to the Authority and indicate whether they may require an opportunity to make oral representations to the Authority.

b) Setting out how CAK will do this

The Authority can set out the considerations/options available to the undertaking(s) including a possible settlement in either stage (namely before conclusion of the investigation, or upon conclusion of an investigation when the Authority proposes to make a decision), as follows:

i. This can be at the period that investigations have not yet been completed and a notice issued but there is sufficient *prima facie* evidence supporting the likely finding of an infringement. The Authority can invite the parties for a preparatory conference or a 'without prejudice meeting' and generally state the position the Authority is inclined to take (the 'preliminary view') due to the investigations carried out and generally

[5] There is no such stipulation for infringements under Section C dealing with Abuse of dominance. Section 36 also only refers to sections A and B and not abuse of dominance.

provide an overview of the various available options for the undertaking(s) to resolve the matter.

ii. The second option would be after issuing the notice as prescribed under s.34 when the Authority proposes to make a decision and sets out details of relief it is considering. A pre-trial conference can be convened if the undertaking requests it in order to make formal oral representations, as stipulated in the Act. However, if the undertaking does not require to make formal submissions but wishes to settle the matter the undertaking can engage the Authority for this purpose. The Authority may highlight that if there is no settlement before the matter is forwarded to the Board, then the provision for settlement will no longer be available and it will lead to the imposition of penalty under s36 by the Authority and/or by the courts when making a final appeal or when a matter is referred to judicial review under the other provisions.

E. Key principles and framework for the determination of penalties and remedies

18. It is helpful to distinguish between contraventions where the remedy is simply to cease the conduct, and those where further steps are required. This distinction is perhaps clearest in the case of cartel conduct where the undertakings simply have to stop the conduct and not re-engage in the same or similar type of arrangement. The most important consideration is thus the administrative penalty which is imposed to take into account deterrence and proportionality. However, even with some cartel conduct a remedy maybe required if there was an organisation of the conduct or ancillary practice such as through an industry association which may mean amendments are required to the rules of the association.

19. By comparison, remedies for vertical restrictive practices or abuse of dominance may require undertakings to ensure access to an essential facility, to supply a key input to downstream rivals or to price on fair and non-discriminatory terms. The terms of such a remedy may be more important than any financial penalty which is imposed,

although the threat of a penalty may be an important consideration in a firm agreeing to a remedy in the form of a settlement.[6]

20. Civil remedies which can be considered as administrative fines and penalties are another kind of one-off intervention that have attractive features. Civil penalties avoid much, although not all, of the costs of designing and administering a remedy specifically they are significantly less costly to implement as compared to a behavioral or structural remedy.

Horizontal restrictive practices (cartels)

21. We focus on the principles for determining administrative penalties as the key issue with regard to cartels is deterrence. The penalties thus need to take into account the gains to the firms from the conduct and the harm inflicted. While excessive penalties may chill efficient conduct *ex ante*[7] this is less of a concern with horizontal restrictive practices which are presumed to cause harm through removing the beneficial effects of competition.

22. We do motivate for relatively low penalties where the conduct was inadvertent, not a secret arrangement, and a first offence. As such, a low penalty in these circumstances does not undermine deterrence of future conduct where it is clearly communicated that there will be higher fines in future.

In terms of settlement, it must also be noted that settlements are attractive relative to expectations of decisions in contested cases. While s.36 does not have an explicit cap, the maximum penalties provided for under other sections at Ksh10million may be argued to provide a benchmark even although this amount is much too low to be a deterrent given the gains from cartel conduct to the firms engaged in the conduct.

23. In terms of the economic importance of the conduct (the principle of proportionality), the combination of the value of sales to which the infringement relates and of the

[6] Note that s36 does not provide for a penalty for abuse of dominance as it only refers to sections A and B which relate to restrictive practices.

[7] ICN Merger Working Group Teleseminar on Merger Remedies 10 February 2010

duration of the infringement is thought to provide an appropriate proxy to reflect the economic importance of the infringement.

It is noted that; when developing a framework for imposing penalties several considerations are relevant, as indicated in table II.

Table II

CONSIDERATION	EFFECT ON PROPOSED PENALTY
Duration	If the anticompetitive conduct has been taking place for a long time, a more severe fine should reflect this to capture the detriment on a time continuum.
Recidivism	The frequency of the offence should be indicative of the intent to consciously behave anti-competitively, thus the number of repeat offences should increase the fine levied
Refusal to cooperate / obstruction	Firms that reveal anticompetitive conduct should be shown leniency while firms that actively obstruct the Authority should have this refusal to cooperate reflected in their fine.
The degree of premeditation	A distinction should be made between those firms that exhibit the intent to contravene the competition act and those firms that reveal a lack of understanding of the requirements of the law.
If the offence involved vulnerable victims	If the conduct of firms leads to the detriment of vulnerable groups, then this should aggravate the extent of the fine.
The continuation of infringing conduct	If the anticompetitive conduct continues then this not only suggests the intent of firms to act anti-competitively but also a conscious contravention of the law. This should be reflected in the fine.

24. In several jurisdictions fines, penalties and other pecuniary remedies related directly to the value of sales on the relevant market concerned by the infringement. In addition, corresponding concepts such as relevant turnover, value of affected sales and/or value of affected commerce can be considered in this instance. Generally the **value of sales of the goods or services in the geographic area concerned to which the infringement relates, for the period of the conduct, should be considered**. Specifically, the combination of the value of sales to which the infringement relates and the duration of

the infringement is an appropriate proxy to reflect the economic importance of the infringement[8].

25. However, there is general consensus that the quantification of fines does not merely result from a mathematical approach based on the volume of affected sales, since the Authority retains a margin of discretion in certain instances as provided in S.36. Below are the specific considerations of a proposed penalty.

26. We review the approaches taken in different jurisdictions including the United Kingdom, the European Union and South Africa before setting out a proposed approach for penalties and the considerations in settlement.

27. Internationally, several considerations applying to cartel conduct are now widely recognised.[9]

    (i) There are good grounds for a presumption that the conduct is harmful.

    (ii) The primary importance of penalties is for deterrence and hence they ought to be self-evidently greater than the expected gain to a firm considering a cartel.

    (iii) It is impossible to determine the size of the anti-competitive harm to consumers, and to the economy, without very extensive data analysis and generally after a substantial time has passed following the end of the cartel. Even then such estimates are likely to be within a wide range, depending on the assumptions made.

    (iv) The harm includes non-price factors such as collusion undermining the beneficial effects of competition in spurring better service and quality.

---

[8] ICN working groups on cartels , 2005, Defining Hardcore Cartel Conduct Building blocks of effective Anti-cartel regimes.

[9] Massimo Motta 'On cartel deterrence and fines in the European Union' (2008) 29 (4) *European Competition Law Review* 209; John M. Connor 'Global price fixing: Our customers are the Enemy' 2001 *Kluwer Academic Publishers* Norwell, Massachusetts at 36 - 39; WouterWils 'Optimal antitrust fines: theory and practice' (2006) 29 (2) *World Competition* 183; Scott D. Hammond 'Optimal Sanctions, Optimal Deterrence' (Unpublished Manuscript, Presented at the ICN Annual Conference, Bonn, Germany, June 6-8, 2005); Gregory J. Werden 'Sanctioning cartel activity: Let the punishment fit the crime' (2009) 5 (1) *European Competition Journal* at 19 - 36.

(v) The deterrence effect must take into account that the probability of the cartel being uncovered is much less than one, so a higher penalty is justified.

United Kingdom

28. The Office of Fair Trading (new competition and markets authority) adopted a method of calculating the penalty to be imposed.

A financial penalty imposed is calculated following a six-step approach:[10]

(i) calculation of the starting point having regard to the seriousness of the infringement and the relevant turnover of the undertaking;

(ii) adjustment for duration;

(iii) adjustment for aggravating or mitigating factors;

(iv) adjustment for specific deterrence and proportionality;

(v) adjustment if the maximum penalty of 10 per cent of the worldwide turnover of the undertaking is exceeded and to avoid double jeopardy;

(vi) adjustment for leniency and/or settlement discounts.

European Commission

29. The EC's most recent update of guidelines in 2006[11] sets out a two-step approach:

(i) First, a percentage (typically 30%) is calculated of the firm's relevant market turnover, being that which was the subject of the cartel. This is multiplied by the number of years of the conduct. A fixed component is then added (of 15%-25% of the turnover)

(ii) Second, aggravating and mitigating circumstances are taken into account. Aggravating factors include being a repeat offender or being the cartel ring-leader. Mitigating factors include ending the arrangement as soon as the Commission intervened, having a limited role in the cartel, or the conduct having been authorised or encouraged by public authorities or legislation.

[10] OFT under section 36 of the CA98 OFT, 'OFT's Guidance as to the appropriate amount of penalty' (September 2012).

[11] European Commission (2006) 'Guidelines on the Method of Setting Fines Pursuant to Article 23(2)(a) of Regulation No 1/2003' [2003] OJ C210/02, at 6.

A cap of 10% of world-wide turnover is applied. The fine may also be reduced if the firm proves inability to pay.

South Africa

30. The South African approach has evolved from the first penalties which were imposed for resale price maintenance (*Federal Mogul*) and abuse of dominance (*SAA*) to fines for collusion and an increasing recognition of the larger penalties that are required for deterrence of cartel. In the past two years rulings of cases appealed to the Competition Appeal Court have provided greater certainty.

31. Section 59(3) of the Competition Act provides a set of factors that must be taken into account in determining an administrative penalty. These include:

    a. nature, duration, gravity and extent of conduct;

    b. loss or damage suffered; behaviour of respondent;

    c. market circumstances;

    d. level of profit derived;

    e. degree of respondent cooperation; and,

    f. whether the respondent had previously contravened the Act (repeat offender).

32. This has led to some confusion as it had been argued that even where it was not required to demonstrate effect (in cartel cases) for a finding, nevertheless the penalty determination required this. It has now been clarified that these criteria must be applied with due cognizance to the nature of the conduct being assessed.

33. The key principles above regarding horizontal coordination have now been accepted in South Africa. In particular, the Competition Tribunal acknowledged the importance of deterrence in its determination of the penalties in the *SPC* cartel case regarding cast concrete pipes and culverts which had run for more than 30 years.[12] The Tribunal set out an approach which followed international practice including that of the European

[12] *Competition Commission v Southern Pipeline Contractors and Conrite Walls (Pty) Ltd* case no. 23/CR/Feb09.

Commission ("EC"), which takes deterrence as the starting point. In *Aveng & others*[13] the Tribunal further set out its approach in six steps, as follows:

a. Step one: determination of the affected turnover (based on the sales of the products or services affected by the conduct which reflects the 'effect of the cartel as a whole') in the relevant year of assessment based on the last financial year of the period for which there is evidence that the cartel existed.
b. Step two: calculation of the 'base amount' for the penalty determination. This percentage of the affected turnover will be between 0 per cent and 30 per cent (following the EC) and will be influenced by several factors under s59(3) of the competition Act, specifically under 59(3)(a), (b) and (d): nature, gravity and extent of the contravention; loss or damage suffered; and, market circumstances.
c. Step three: where the contravention exceeds one year, multiplying the amount obtained in step two by the number of years (duration) of the contravention.
d. Step four: rounding off the figure achieved in step three if it exceeds the s59(2) cap, of 10 per cent of total turnover.
e. Step five: adjustment to the outcome of step four on the basis of mitigating and aggravating factors specific to the firm's conduct (under s59(3)(c), (e), (f) and (g)), including its behaviour, extent of co-operation with the Commission, level of profit derived, and whether the respondent had previously been found guilty of a contravention of the Act.[14]
f. Step six: round off the amount derived in step five if it exceeds the cap provided for in s59(2) of the Act.

34. A proposed approach for the CAK in line with that followed in other jurisdictions is outlined after discussion of the key factors.

E. ***Factors***

[13] *Competition Commission vs. Aveng & others* case no. 84/CR/Dec09.
[14] This is in contrast to step two where the Tribunal considers the effects of the cartel as a whole (which should generally be the same for all respondents) and not the circumstances of an individual firm as in step five.

Scope, duration, extent of conduct

35. As in the EC's Fining Guidelines setting the fines with reference to the value of sales in the relevant market and the duration of the infringement means taking account of the extent and importance of the infringement in the economy. Jurisdictions such as the EU, Switzerland, the Czech Republic, Hungary, Italy and Norway use duration as a multiplier while the US, Germany, Russia and Netherlands account for duration through the turnover or volume of affected commerce considered in the calculation of the basic penalty.[15] The duration of a cartel, while reflecting past harm, is also an indicator of cartel durability (and hence expected future cartel returns, absent detection).

36. The EC Guidelines indicate that the basic fine is taken as a proportion (up to 30 per cent)[16] of the sales in the relevant market reflecting an approximation of the illicit cartel gains and harm to the economy. The number of years of duration is then used as a multiplier.

Harm and deterrence

37. The percentage penalties reflect the insights from economic theory and from studies of cartels over many years. These indicate that typically cartel mark-ups range between 15% to 25%.[17] The percentage can be adjusted to take into account factors specific to the cartel in question (such as its stability, coverage of market participants etc). However, the penalty is <u>not</u> based on an actual measure of the cartel mark-up. This is generally not possible at the time of the penalty determination and the fact of benefit from the conduct is presumed (whether in terms of additional profit or a 'quiet life' from the removal of competition).

38. Proportionality suggests fines should be related to the harm caused. In the case of cartels, the harm is likely to exceed the illegal gains obtained by the infringers as it

[15] International Competition Network, 2008.
[16] 20 per cent for the US.
[17] See Conner and Bolotova (2006), Oxera (2010). There are good reasons to believe that mark-ups are higher in developing countries (see Khumalo et al. 2014).

distorts prices in the economy, reduces output and undermines the dynamic gains in service and quality that comes from competitive rivalry.[18]

Aggravating and mitigating circumstances

As described above for the EC these relate to the particular cartel participant's role in the cartel and its behavior during the investigation.

G. *Proposed framework*

39. We propose adoption of a method which is in line with the international practice. While there is no cap for the penalties imposed by the CAK as administrative fines, further consideration needs to be made of the caps under the provisions for criminal sanctions as it can be argued that this reflects the intention of the legislature to limit the exposure of firms to financial penalties. Note that settlement can follow a similar methodology but at very substantially lower penalties.

The proposed steps for the Authority draw from the approaches reviewed, while aiming also to be as clear and transparent as possible:

a. Determination of the affected turnover (based on the sales of the products or services affected by the conduct which reflects the 'effect of the cartel as a whole') in the relevant year of assessment, based on the last financial year in which there is evidence that the cartel existed. One exception to this would be the use of a discrete turnover in cases of ad hoc bid-rigging.

b. Calculation of the 'base amount' for the penalty determination applying 10% of the affected turnover, adjusted to take account of several factors specifically: nature, gravity and extent of the contravention; loss or damage suffered; and, market circumstances. If the contravention was genuinely inadvertent this would be taken into account here.

c. Multiplying the amount obtained in step two by the number of years (duration) of the contravention.

[18] Posner, R.A., (2001): Antitrust Law: An Economic Perspective. Second Edition, University of Chicago Press, Chicago. OFT, Assessment of Discretionary Penalties Regimes (October 2009) Final Report 26.

d. Adjustment on the basis of mitigating and aggravating factors specific to the firm's conduct, including its behaviour, extent of co-operation with the Authority, level of profit derived, and whether the respondent had previously been found guilty of a contravention of the Act. If the respondent(s) opted for settlement and at what stage this option was pursued would be a substantive consideration here.

e. Rounding off the penalty if it exceeds the cap, of 10 per cent of total turnover under s.36 and s.42(6). Similarly the cap under s.21(9), s.22(6), s.24(3) is 10 million.

H. Key principles and framework where substantive remedies required, with reference to vertical restrictive practices and abuse of dominance

40. In contrast to cartels, where there will be competition in the absence of the agreement, vertical restrictive practices and abuse of dominance are much more complicated. It may not be so obvious that competition has been undermined *by object*, and the effects of the arrangements are typically part of the evaluation of whether they are a contravention. In addition, there may be good efficiency reasons why there are, for example, vertical agreements that link the upstream and downstream firms together. Therefore, while the Act does allow for vertical agreements to be evaluated in terms of whether their object is anti-competitive, it is more likely that a vertical agreement will be assessed terms of its effects.

41. As the set of practices are diverse it is not possible to have a detailed discussion here of all the possible arrangements that fall within restrictive practices and abuse of dominance. As such, these are simply high level observations. The discussion is further complicated by the fact that s36 empowering the Authority to impose a financial penalty only refers to prohibitions under Sections A and B of the part namely for restrictive trade practices, and not for Abuse of Dominant Position which falls under Section C. As it is very likely that conduct constituting a vertical restrictive practice can also be assessed as exclusionary conduct under abuse of dominance our discussion covers them together.

The most important point to emphasise is, however, the difference with horizontal restrictive practices.

Vertical restrictive practices and exclusionary conduct

42. In some cases it may be obvious from a vertical agreement that its object is to undermine competition, however, we repeat the earlier observation that the parties are not competitors if they are only in a vertical relationship and often have efficiency reasons for reaching agreements to synchronize their activities. If we then consider where vertical restrictive practices may have anti-competitive effects which are not trivial then this is likely to be where a substantial proportion of the upstream or downstream market is covered by the agreement. In turn, this implies that one or other party to the agreement has a large market share (and may be dominant) such that the arrangement entered into has the effect of undermining or excluding competitors at one or both levels.

43. Vertical restrictive practices and exclusionary arrangements cover a wide set of possible forms of conduct, albeit with common elements. Identifying the common elements is important if the particular remedy is not simply to be by-passed through the company changing the conduct to a different form and achieving the same outcome. For example, a company with exclusive dealing arrangements could end these arrangements and shift to a loyalty rebate structure which would achieve exactly the same effect in the form of quasi-exclusivity. The remedy thus needs to address the historical conduct as well as consider possible undertakings regarding future conduct of a similar nature.

44. The critical issue is thus identifying and enforcing changes to the conduct of the dominant firm to achieve substantively different outcomes in the market, to the benefit of those competitors being excluded (actual and in the future) and to consumers. Given the contestation about the standards for proving a contravention in such cases and the potential for lengthy litigation and appeals to delay any meaningful changes, there is a case for offering favorable settlement terms in exchange for substantive undertakings regarding altered conduct. This could mean not imposing a fine or requiring an

admission of a contravention of the Act if the firm agrees to timeously make the important changes to its conduct necessary to realize more competitive outcomes.[19] The incentive for the firm to agree to such a settlement relatively early (that is, before a conclusive finding is made by CAK) includes the realistic prospect that if they do continue to fight the case then a substantial fine would ultimately be imposed, even if several years in the future after they have exhausted the possible appeals. Conversely, requiring a fine as part of the settlement, however, means there is little attraction to settling as opposed to defending the case.

45. In terms of implementation, as the remedies in these cases are meant to make substantive changes to the market, it is valuable to discuss the broad parameters of possible remedies with market participants to test whether they are likely to be effective. This means being able to discuss under terms of confidentiality and in terms of the main principles rather than all the detail. It is also possible to engage participants on the types of remedies without revealing the one which has been proposed and/or is most likely to be adopted.

Exploitative abuses

46. These abuses include excessive pricing and price discrimination where prices are unfair in that they have been charged at supra-competitive levels to some or all parties by a firm with substantial market power. If there were good competing alternatives then the higher prices charged by the respondent would not have a material effect as customers could simply switch to the rival.

The remedy in the case of discrimination is relatively straight forward in principle in that it can be ordered that supply and pricing should be on fair reasonable and non-discriminatory (or 'FRAND') terms. The devil is in the detail with such a remedy as there are good grounds on which prices and terms can differ such as if there are large volume purchases or long term commitments. However, these issues can be engaged

[19] The best example of this type of settlement in South Africa is that reached between the Competition Commission and Sasol Chemical Industries regarding various arrangements in fertilizer. The settlement was of two cases (the Nutriflo and Profert complaints, cases 45/CR/May06 and 31/CR/May05) and involved structural remedies in the form of divestiture by SCI of five blending plants and behavioural undertakings to price on certain non-discriminatory terms on an ex-works basis. There was no penalty or admission. See the order of the Tribunal on 20 July 2010 confirming the settlement.

with on a case-by-case basis, considering the nature of the product or good in question, and drawing on extensive international experience in this area.

47. A ruling on excessive pricing means identifying a pricing benchmark which approximates reasonable, effectively competitive, and non-excessive pricing. This is typically described as a quasi-regulatory remedy and could be based on comparators (prices in a comparable and competitive market) or on costs (including a rate of return). The latter is demanding in terms of data. A further possibility is that there is a lower price charged to a group of customers that have alternatives, while another group does not and is paying a higher, excessive price. The pricing to the more competitive group can be used. This could take the form of geographic segmentation of customers in which case ordering that pricing should be on an ex-factory or ex-works basis, without distinguishing on certain customer characteristics, will undermine the ability to exert market power over one group. (In effect, this is also a non-discrimination form of remedy.)

    It is possible that there will be remedies which go to the market power enabling the pricing and which may be more appropriate. For example, an excessive price could be possible because of regulations which protect the incumbent, or trade barriers which undermine regional competition. In these cases the better remedy may be to tackle these issues, probably through advocacy.

I. Settlements

48. Settlements can generally be seen as the awarding of benefits to a firm (such as a lower penalty or less burdensome remedy) in exchange for its admission to the conduct, acceptance of penalties and/or remedies, and co-operation regarding prosecution of remaining parties.[20] Settlements facilitate enforcement and reduce its costs and therefore

[20] Wouter Wils 'The use of settlements in public antitrust enforcement: objectives and principles' in Claus-Dieter Ehlermann & Mel Marquis (ed) *European Competition Law Annual 2008: Antitrust Settlements under EC Competition Law*(2008) at 42.

improves the efficiency of the Authority by increasing detection and/or prosecution rates.[21]

49. Firms have greater incentives to settle when they face a high probability of an adverse finding in court resulting in a penalty larger than that on offer in settlement. Firms may also consider the saving in terms of litigation costs. On the other hand, competition authorities have greater incentives to settle when they face litigation costs, resource constraints and continued consumer harm (due to continued anti-competitive conduct).

50. Counter-balancing the benefits of early settlements is the diminished deterrence associated with lower penalties.[22] If due to a settlements procedure the amount of the penalty is likely to be significantly reduced, then the cartel profits are more likely to outweigh a possible penalty. Relatively low expected penalties under settlements also reduce the attractiveness of leniency. Under-deterrence in settlements can be avoided by having harsher overall sentencing, enabling discounts while still having meaningful penalties.[23]

    The South African Competition Commission has used settlements extensively in cartel cases. In the earlier years there were a number of practices which were not secret but where the parties did not know that they constituted a contravention.

    The large number of 'hard core' (secret) cartel cases uncovered following the introduction of the corporate leniency policy also led to a large number of settlements.

51. As indicated earlier, most of these settlements were reached before the Tribunal adopted an approach in line with the European Commission the SA Commission adopted a simple method in settlements. This involved working off 10% of turnover of the entity/product grouping involved in the conduct, depending on the view taken of the gravity of the conduct. There was no multiplication by the years of the conduct, but a shorter duration was taken into account in penalties being towards the lower end of

[21] OFT, Assessment of Discretionary Penalties Regimes (October 2009) Final Report 26

[22] Thomas Miceli 'Plea bargaining and deterrence: an institutional approach' (1996) 3 *European Journal of Law and Economics* at 249.

[23] Chantale La Casse & Abigail Payne 'Federal sentencing guidelines and mandatory minimum sentences: do defendants bargain in the shadow of the Judge?' (1999) 42 *Journal of Law and Economics* at 245.

the range from 0-10%. On the other hand, the turnover used in the calculation was wider than just the affected turnover of the cartel conduct.

Emphasis was placed on firms changing their behavior and adopting a constructive and cooperative approach to engaging with the Commission. This included firms resolving competition issues early and co-operate fully, including appointing outside legal teams to review their conduct and come forward to seek 'all-in' settlements addressing all the identified collusive arrangements.

52. We propose a settlement criteria that is determining the penalty under consistent with those when a penalty is being imposed by the CAK under s36 (as set out above under the proposed framework in G). However, the percentages used under settlements should be very substantially lower, **especially in the earlier years of the competition regime when the emphasis is rather on firms understanding and complying with the law.**

J. *Process for settlement*

53. We set out broad general steps for settlement and then consider specific steps for industry associations in reviewing and addressing conduct amounting to horizontal restrictive practices and the basis on which CAK may adopt a lenient approach. We further propose the steps to be undertaken including the process of raising awareness on the part of industry associations and the way they can address the conduct timeously.

General settlement process

I. Investigation stage

The relevant parties may express their interest in a settlement. Under s. 38 the proposal can come any time before or after investigations but not after a final decision made. The Authority can also during 'a preparatory meeting or pretrial conference' indicate to the parties the options available.

II. Exploratory steps regarding settlement

The Authority upon receipt of such a proposal for settlement will write a letter to all companies informing of them of the decision to initiate proceedings in view of settlement (s. 36) and requiring them to express their interest in settlement. There may, however, be good reasons for pursuing settlement with just a single company *inter alia* because the conduct substantially involves that firm and others played a more minor role, and/or because the firm in question is assisting the investigation, and the settlement process is part of its proactive cooperation with the Authority. There should be a window period during which parties can propose or opt for a settlement to avoid unreasonable delay. It is proposed that this should be 14 days from the date of receipt of the notice under section 34 from the Authority (with possibility for extension on request).

A proposed approach to settlement setting out broad parameters and considerations may also be prepared for the CAK Board for consultation purposes. This would be the case in complex matters which raise particular issues requiring consideration. For avoidance of doubt, any settlement only becomes final when agreed by the Board and guidance from the Board at an earlier stage does not replace or limit the Board in the final decision taken.

II. Bilateral rounds of settlement discussions

This will vary depending on the nature of the case and contravention being settled. In general, the Authority will expect parties to obtain external legal advice and will require the parties to:

a. State all possible violations that the parties may have committed (the Authority may be investigating one agreement but there could be several similar restrictive practices agreements, which it would be better to include in one settlement).

b. Disclose and exchange submissions on potential objections, liability, fines range.

c. Disclose evidence used to establish potential objections, liability, fines.

d. Disclose other non-confidential versions of documents in the file, when justified/pertinent to the investigations.

e. Any information shared during the stages towards a settlement will remain confidential.

III. 'Settled' statement of objections

The Authority will finalise the statement of the conduct and arrangements which are the subject of the settlement, reflecting their relationship to relevant sections of the Act and making explicit where there are admissions.

For avoidance of doubt, the Authority may discontinue settlement proceedings at any point on grounds, inter alia, of failure to disclose all infringements related to the matter at hand, and disclosure of confidential information (e.g. to the press) by the party settling relating to the settlement discussions.

IV. Inclusion of sector regulators input and/recommendation

Based on several agreements currently being negotiated by the Authority, certain remedies should be discussed with the inclusion of the views/expertise of sector regulators. The information shared will remain confidential and in tandem with the Memorandum of Understanding between the Authority and the relevant sector regulator.

V. 'Settlement' decision in line with the relevant s. 36 , s. 42(6) and the other relevant sections

The Board is the only body which takes the decision on settlement on the part of the Authority. This decision process will normally involve:

a. Technical Board Committee consideration of a draft streamlined final decision.

b. Adoption by the Board of the final decision.

We propose this process to be adopted by the Authority, because the Authority will maintain flexibility in the process. Secondly, the Authority can bind the parties seeking for a settlement to maintain all discussions and documents exchanged pursuant and during the settlement process as confidential unless express authorization is given by the Authority, failing which the whole settlement would be disregarded.

VI. Right to set aside a settlement

Once the Board has accepted the settlement terms and adopted the final decision in respect of an agreement or conduct, the Authority may not continue an investigation, make an infringement decision or give interim measures directions in respect of that agreement or conduct unless it has[24]:

(a) reasonable grounds for believing that there has been a material change of circumstances since the commitments were accepted;

(b) reasonable grounds for suspecting that the undertaking(s) has failed to adhere to one or more of the terms of the binding commitments, or

(c) reasonable grounds for suspecting that information which led it to accept the binding commitments was incomplete, false or misleading in a material particular.

However, the Authority is not prevented from taking action in relation to competition concerns which are not addressed by the settlement it has accepted[25].

A. Proposed approach to industry/business associations

54. From issues that have come to light in recent cases it appears likely that industry associations are engaged in practices which likely contravene sections of the Act but which the associations have come to regard as normal ways of working. By their nature, industry associations are groupings of firms that are in the same line of

[24] OFT, 'Enforcement : Incorporating the Office of Fair Trading's guidance as to the circumstances in which it may be appropriate to accept commitments' (Competition Law 2004) <http//: www.oft.gov.uk> accessed 12th May 2014
[25] ibid

business and are actual or potential competitors (and are in a horizontal relationship).

55. It is in the interests of the Authority to make the associations aware of the Act, to incentivize them to proactively review their practices and arrangements, and to make the necessary changes. For the associations to address the risk to which they are exposed in terms of prosecution they cannot only change their practices as a complaint could still be lodged relating to past conduct (for example, conduct pertaining in 2013). This implies a form of compliance and settlement process under which the associations declare the conduct which amounted to possible contraventions, make the specific changes necessary and, in effect, settle with the Authority in that complaints lodged regarding that historic conduct no longer need to be pursued. The proposed approach thus seeks to incentivize associations to review their practices and alter the conduct to comply with the law, without having to go through possible lengthy litigation.

56. It is worth noting that other countries have undertaken something similar. For example, Chile recently went through such a process and was recognized internationally for the success in promoting competition principles. However, the Chile Competition Authority only realized the extent of the competition issues after investigating and prosecuting a number of cartels. The CAK is in the position of being able to deal with this at an early stage, when there is further justification for favourable terms. As time passes, lack of awareness of the law becomes a poorer reason for not having reformed objectionable conduct.

Conclusions and Recommendations

57. After briefly reviewing the relevant provisions of the Competition Act, we first addressed key principles for the CAK's determination of penalties and remedies and then considered how these can be encompassed in an approach to settlements. In this we have drawn on the growing international consensus on the appropriate approach to be taken.

58. We conclude by once again highlighting some of the critical issues and proposed approach, as follows:

(i) The importance of distinguishing contraventions which can be determined by object from those that are largely determined by also assessing effects. The first are principally horizontal restrictive practices where the agreements are by their very nature between competitors and replace their independent action as competitors with a coordinated approach.

(ii) The proposal for an approach to financial penalties in cases of horizontal restrictive practices which bases the penalty on the affected turnover, the duration of the conduct, and mitigating and aggravating factors.

(iii) A similar approach can be followed to settlements, however, with substantially lower penalties due to the advantages of incentivizing acceptance by firms of the new competition regime and settlement with the Authority rather than lengthy litigation. A 'Special Compliance Process' for trade associations can be adopted as part of incentivizing compliance.

(iv) A somewhat different approach is merited for vertical restrictive practices and abuse of dominance. The focus on the effects of the conduct implies remedies oriented to substantively changing market outcomes. The threat of significant penalties, including imposed by courts under the criminal sanctions, is a necessary part of ensuring that firms seriously consider changing their conduct, however, the CAK focus should be on working for more competitive outcomes.