HERBERT SMITH FREEHILLS

Competition and Markets Authority Consultation

Draft revised CMA guidance on the appropriate amount of a penalty

Response of Herbert Smith Freehills LLP

1. INTRODUCTION

1.1 Herbert Smith Freehills LLP welcomes the opportunity to provide comments in response to the CMA consultation document of 2 August 2017 *Draft revised CMA guidance on the appropriate amount of a penalty (CMA73con)* (**Consultation Document**) and associated draft revised guidance (**Draft Guidance**). The comments set out below are those of Herbert Smith Freehills LLP and do not represent the views of any of our individual clients.

1.2 We support the CMA's initiative to update the current guidance on penalties produced by the OFT and adopted by the CMA's Board (*OFT's guidance as to the appropriate amount of a penalty: OFT423*)(**Current Guidance**) to reflect the CMA's decisional practice to date and its power to approve voluntary redress schemes (as well as to update the guidance to reflect the legislative and institutional changes since the Current Guidance was published) [1]. We also welcome the CMA's stated aim of increasing clarity and transparency as to the penalty setting process, which we agree is important in order to provide some measure of predictability for businesses.

2. QUESTION 1: DO YOU AGREE WITH THE PROPOSED CHANGES SET OUT IN CHAPTER 5? PLEASE GIVE REASONS FOR YOUR VIEWS

2.1 We set out below our comments on the CMA's proposed changes to each of the relevant steps in the penalties calculation process.

Starting point (Step 1)

Seriousness

Type of infringement

2.2 We agree with the CMA that it would be useful to provide increased clarity as to the assessment the CMA makes when deciding on an appropriate starting point. To this end

[1] Given the time which has now passed since the relevant provisions of the Enterprise and Regulatory Reform Act 2013 (and related secondary legislation) came into force, we would urge the CMA to make similar updates to all of its guidance which has yet to be so amended, including producing consolidated guidance where various separate guidance documents exist in relation to the same topic (for example in relation to market studies and investigations *Market studies and investigations - guidance on the CMA's approach: CMA3, Market investigations guidelines: CC3,* and *Market investigation references: OFT511*).

we agree that it is useful to provide some indication of the likely starting point within the 0-30% range for different types of infringement, provided always that these are not fixed starting points and that in each case an assessment of seriousness is an infringement-specific one considered on its own facts (as recognised within paragraphs 5.7-5.8 of the Consultation Document and paragraphs 2.5-2.6 of the Draft Guidance).[2]

2.3 In relation to the "*most serious*" types of infringement, for which the CMA proposes in paragraph 2.6 of the Draft Guidance to generally use a starting point of between 21 and 30% of the relevant turnover, in respect of infringements of Chapter I/Article 101 TFEU we believe that this category should be limited to cartel activities (which, as per the CMA's definition of cartel activities within footnote 25 of the Draft Guidance, incudes vertical price-fixing).[3] We consider that this should not extend to other object restrictions.

2.4 This is because cartel activities are clearly the most serious and inherently harmful infringements of Chapter I/Article 101 TFEU,[4] and it is not clear that other object restrictions generally justify the same treatment (although of course in individual cases a similarly high starting point may be justified). Moreover, it is difficult to identify which non-cartel object restrictions the CMA envisages falling in this category, and which are the "*less serious*" object restrictions for which it envisages a 10 to 20% starting point being more appropriate. Paragraph 2.6 of the Draft Guidance refers to "*other, non-cartel object restrictions which are inherently likely to cause significant harm to competition*" as being included in the "*most serious*" category. However, given that agreements can only be categorised as restrictions by object where "*by their very nature*" they are harmful to the

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2 It would nevertheless be useful for this point to be made even clearer, and for the guidance to include an explicit statement that which percentage will be applied will depend on the facts of the case in question, and that the CMA may apply a figure outside the sub-ranges highlighted as generally appropriate, depending on the specific circumstances of the case.

3 Separately, we believe that the definition should make it clear that the concept of cartel activities is intended to cover secret cartels and does not extend to price-fixing or output restrictions in the context of legitimate cooperation, for example the agreement of output in the context of production or specialisation agreements covered by *Commission Regulation (EU) No 1218/2010 on the application of Article 101(3) of the Treaty on the Functioning of the European Union to certain categories of specialisation agreements.*

4 This is consistent with the approach of the European Commission, which in its *Guidelines on the method of setting fines imposed pursuant to Article 23(2)(a) of Regulation No 1/2003 (2006/C 210/02)* (**EU Guidance**) highlights (usually secret) horizontal price-fixing, market-sharing and output-limitation agreements as the most serious infringements for which the proportion of the value of sales taken into account will generally be set at the higher end of the scale. Non-cartel object restrictions are not treated in the same way in the EU Guidance.

proper functioning of normal competition[5], it is unclear how the proposed different categories of object restriction are to be delineated.

2.5 If the CMA, contrary to the position outlined above, nevertheless decides to include certain non-cartel object restrictions in the category for which a 21 to 30% sub-range is generally suitable, we believe it should provide illustrative examples of which type of object restriction it would generally consider falls into this category.

2.6 Separately, we are unpersuaded that 21% is the appropriate starting point for this "*most serious*" sub-range (in particular if it is to include non-cartel object infringements). We consider that somewhere between 15 and 20% would be a more appropriate starting point. This is reflective of CMA decisions in a number of recent resale price maintenance cases for example[6], and with the approach of the European Commission in horizontal cartel cases, for which its starting point since 2014 has generally fallen in the 15-17% range.[7]

2.7 In relation to Chapter II/Article 102 TFEU, we query whether it is appropriate to include excessive pricing in the "*most serious*" category (as proposed within paragraph 2.6 of the Draft Guidance). Given the uncertainties in determining when a dominant firm's pricing is abusively excessive, it is unclear that this can be considered as inherently harmful (although of course this may be the case on particular facts). It would also be useful if the CMA could specify whether there are any other categories of abusive conduct which it considers are "*inherently likely*" to have a serious exploitative or exclusionary effect, including whether it would place exclusivity and exclusivity rebates in this category, in particular in light of the recent decision of the Court of Justice in the *Intel* case.[8]

2.8 Finally, we consider that whether the type of infringement in question was novel (in the sense of having not previously been found to constitute an infringement by the CMA (or a concurrent regulator) or the European Commission) should be taken into account when assessing seriousness. General uncertainty should therefore be taken into account at Step 1 in addition to taking into account specific uncertainty on the part of the undertaking in question as to whether the agreement or conduct in question constituted an infringement at Step 3.

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5 See for example the judgment of the Court of Justice in Case C-67/13 *Groupement des cartes bancaires v European Commission*.

6 For example in its decisions in *Light Fittings*, *Commercial Refrigeration*, and *Bathroom Fittings* (and also in a number of horizontal cases, for example *Property Advertising*).

7 Generally, we note that the CMA should not lose view of the fact that competition fines are already very much higher than the level of fines for very serious corporate behaviour such as corporate manslaughter.

8 Case C-413/14 P *Intel Corporation Inc. v European Commission*.

Circumstances of the case

2.9 We are not clear how the nature of the product is relevant to the seriousness of the infringement (as proposed in paragraph 2.8 of the Draft Guidance). If the CMA considers that this is relevant then it would be useful to include examples of how the CMA will take this into account, for example what factors in relation to the nature of the product will lead to an upwards adjustment and what will lead to an adjustment downwards.

Infringement involving more than one undertaking

2.10 We welcome the CMA's clarification in paragraph 2.10 of the Draft Guidance that the seriousness assessment will be consistent for each undertaking involved, provided that any distinctions between undertakings (for example in terms of their respective level of involvement in the infringement) are appropriately reflected at other steps (for example Step 3 in relation to aggravating and mitigating circumstances).

Adjustment for aggravating and mitigating factors (Step 3)

Failure to comply with competition law following receipt of a warning letter or advisory letter in respect of the same or similar conduct

2.11 Whilst we acknowledge that the CMA has treated this as an aggravating factor in previous cases (and that its guidance *Warning and advisory letters: essential information for businesses* indicates that it may do so), we are unpersuaded that this is appropriate. At the time of receipt of the warning letter/advisory letter there has been no formal investigation opened into the relevant undertaking, no opportunity for it to exercise its rights of defence, no finding of infringement, and no opportunity to appeal. An undertaking is being treated as akin to a recidivist without having had the benefit of the procedural protections afforded to those formally accused of infringing competition law.

2.12 If an undertaking ignores a warning/advisory letter and chooses to continue its activities prior to the commencement of any formal investigation, the duration of the infringement will be longer and the penalty higher than would be the case if it had self-assessed following receipt and chosen to cease or amend its activities (if had concluded these were problematic). This should itself be sufficient incentive for recipients of such letters to conduct such an assessment and adjust their behaviour if necessary.

2.13 If the CMA nonetheless continues to believe that failure to comply following receipt of a warning/advisory letter should constitute a potential aggravating factor, we agree that this should be reflected in the guidance.

2.14 We note the CMA's statement in footnote 33 of the Draft Guidance that it is "*likely*" that it will only uplift a penalty where the letter is issued in relation to the "*same or similar*" conduct as that under investigation. This should be the *only* circumstances in which this

can be relevant, and the Draft Guidance should be amended to reflect this accordingly. Moreover, if "*same or similar*" is intended to have the same meaning as in footnote 31 of the Draft Guidance in relation to recidivism, i.e. that it falls under the same head of infringement (Chapter I/Article 101 TFEU rather than Chapter II/Article 102 TFEU and vice versa), we consider this is misplaced. Any uplift should only apply in relation to continuation of the specific conduct that the undertaking was warned or advised about (or equivalent conduct), and this should be made clear in the guidance.

Compliance activities

2.15 We agree with the CMA's proposed changes within footnote 34 of the Draft Guidance to reflect its decisional practice, namely that a clear and unambiguous commitment to compliance should include a public statement on an undertaking's website regarding its commitment to comply with competition law (subject to the relevant undertaking having a public website), and a periodic review of its compliance activities.

2.16 We query, however, whether the latter requirement needs to extend to reporting to the CMA in each and every case – we suggest that internal record-keeping and a commitment to provide an update to the CMA if requested should be sufficient. If the CMA does require such reporting, it should make clear in what format/level of detail, with what regularity, and for what period (which should not be indefinite). If the CMA decides to retain the general requirement for reporting, we consider that the guidance should make it clearer that such reporting is only required where the CMA has carried out an investigation and an undertaking has made a commitment to compliance going forward in the context of that investigation, rather than constituting a more general reporting requirement for all undertakings (which we assume is the intention).

Cooperation

2.17 We agree with the CMA's proposal to amend the Current Guidance to include the provision of voluntary witness interviews and/or the provision of witness statements as an example of when it may make a reduction for cooperation at Step 3. If the CMA has treated any other conduct as constituting sufficient cooperation for a reduction in its decisional practice then it would be useful to also include these examples.

Adjustment for specific deterrence and proportionality (Step 4)

2.18 We agree with the CMA's proposal to include in the Draft Guidance (at paragraph 2.20) further detail on what indicators of the undertaking's size and financial position it considers appropriate to take into account, i.e. by including references to profits after tax, net assets and dividends and liquidity, as well as turnover and industry margins.

2.19 We note that within paragraph 5.25 of the Consultation Document the CMA refers to considering such indicators over a period of time, which is stated to usually be three years.

The three year period is not mentioned in paragraph 2.20 or footnote 37 of the Draft Guidance; if this is the period which CMA generally considers, this should be referred to in the guidance.

Application of reductions under the CMA's leniency programme, settlement and approval of voluntary redress schemes (Step 6)

Voluntary redress schemes

2.20 We agree that the Current Guidance should be updated to reflect the possibility of a discount at Step 6 for undertakings which have implemented an approved voluntary redress scheme (reflecting *Approval of voluntary redress schemes for infringements of competition law: CMA40*), as per paragraph 2.31 of the Draft Guidance.

2.21 We consider that it would be useful for the CMA to specify in this guidance the maximum reduction possible, and summarise the factors it will take into account when considering a reduction, as well as highlighting that the reduction can be reversed in certain circumstances (reflecting paragraphs 3.29-3.3. of *Approval of voluntary redress schemes for infringements of competition law: CMA40*), so that this guidance provides a complete picture on this point.

Application of discounts

2.22 We welcome the CMA's clarification (in paragraph 2.32 and footnote 46 of the Draft Guidance) of how the CMA will apply discounts where two or more discounts are available.

3. QUESTION 2: ARE THERE ANY OTHER AREAS OF THE CURRENT GUIDANCE WHICH YOU CONSIDER COULD BE USEFULLY CLARIFIED? PLEASE EXPLAIN WHICH AREAS AND WHY

Attribution of liability

3.1 Given the importance of this issue in practice, and the fact that the CMA has considered this in detail in a number of recent cases, we consider it would be useful if the CMA could include within the guidance an outline of its approach to the attribution of liability (covering both parental liability and successor liability).

Determination of relevant turnover at Step 1

3.2 It would be useful if the CMA could provide further detail as to its approach to the calculation of relevant turnover at Step 1, in particular how it would treat certain issues which have been addressed in recent decisional practice on the calculation of the value of sales at EU level (which may arise more frequently for the CMA following the UK's exit from the EU). This could include, for example, the treatment of vertically integrated companies, internal sales and transformed products, and the treatment of market-sharing arrangements which extend beyond the UK.

Adjustment for mitigating factors at Step 3

3.3 We consider that the establishment of a compensation or redress scheme which was not notified to or approved by the CMA under the statutory procedure for approval of voluntary redress schemes should potentially be taken into account as a mitigating factor in appropriate cases.

3.4 This would provide a further incentive for defendants to establish such 'private' schemes in circumstances where they may well choose not to follow the statutory procedure given its prescriptive and expensive nature as currently constituted.[9]

Financial hardship

3.5 We consider that the CMA should provide further guidance on the circumstances in which it will and will not be prepared to reduce a penalty on the grounds of an undertaking's financial position, what factors it will take into account when considering a request for reduction on this ground, and what evidence undertakings will be expected to provide.[10]

Examples from decisional practice

3.6 Generally, it would be useful for the CMA to include in the guidance examples from its decisional practice, in particular in relation to actions which are relatively rare (for example reductions on the ground of financial hardship or uplifts for specific deterrence), or where it has rejected arguments as to particular mitigating circumstances.

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[9] In relation to the disadvantages of the statutory procedure we refer to our response of 15 April 2015 to the CMA's previous consultation on *Draft guidance on the CMA's approval of voluntary redress schemes (CMA40con)*.

[10] As the European Commission has done in relation to reductions for inability to pay under paragraph 35 of the EU Guidance (within the *Information note by Mr Joaquín Almunia Vice-President of the Commission and by Mr Janusz Lewandowski Member of the Commission of 12 June 2010 (SEC(2010) 737/2, OJ 1922*) and the *Standard questionnaire for inability to pay* of October 2015).