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An Economic Review of Penalties and Settlements for Cartels in South Africa

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Abstract

Recent decisions of the Competition Appeal Court and the Competition Tribunal have discussed the appropriate way to determine penalties for cartel conduct. This paper reflects on the issues raised from the stand point of economic theory and insights from analysis of recent cartel cases, drawing attention to the incentive effects and the critical importance of deterrence. We distinguish between penalties imposed and those reached in settlements. In doing so, we further examine evidence on cartel mark-ups and review the key principles to be embodied in a settlement procedure. We also briefly review the Competition Commission's approach to settlements.

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1. INTRODUCTION

Both the Competition Tribunal (“Tribunal”) and Competition Appeal Court (CAC) have suggested that the Competition Commission (“Commission”) might consider drawing up guidelines for penalties, however, under the South African competition regime the Competition Act No. 89 of 1998 (“the Act”) is interpreted by the Tribunal and higher courts on a case-by-case basis. Commission guidelines would not necessarily have brought any more certainty in the absence of decided cases. In 2011 and 2012 there were a series of decisions where the Tribunal and CAC engaged with the issues and relevant principles for determining penalties for collusion meaning it is now an opportune time to take stock.

The issue of penalties is also important in the context of leniency programmes and settlements. Under the Commission’s corporate leniency programme (CLP) the first firm to admit to a cartel and provide information will not pay a penalty.⁴ Settlement implies a lower penalty in exchange for co-operation and early resolution. The notable success of the CLP in uncovering cartel conduct in South Africa⁵ has highlighted both the importance of high powered incentives for colluding firms to break ranks and come forwards, as well as the on-going extent of collusive activity. The latter suggests that the combined effect of the penalties and probability of getting caught had previously been too low to achieve the necessary deterrence effect.

We seek to make a contribution to the debate by critically reviewing the recent decisions of the Tribunal and CAC through the lens of economic principles and the implications for evolving standards for penalties – both imposed in contested cases and agreed in settlements. After an overview of recent decisions of the Tribunal and CAC, we set out how cartel penalties can be understood in terms of the basic economic theory relating to deterrence and incentives. We then review how the Commission has approached penalties, which have mainly been in the form of settlements, and take into account evidence on the size of cartel mark-ups in South African cases. In the concluding section we map out possible ways forward.

2. OVERVIEW OF DECISIONS OF THE TRIBUNAL AND CAC

⁴ Chantal Lavoie ‘South Africa’s Corporate Leniency Policy: A Five-Year Review’ (2010) 33(1) *World Competition* at 141–162.

⁵ See Gertrude Makhaya, Wendy Mkwanzani & Simon Roberts, ‘How should young institutions approach competition enforcement? Reflections on South Africa’s experience’ (2012) 19(1) *South African Journal of International Affairs* at 43-64.

The first penalty was imposed by the Tribunal for anti-competitive conduct on the part of *Federal Mogul*.⁶ This was then followed by SAA⁷ where the Tribunal set out its approach to applying the factors under s59(3) of the Act for the determination of financial penalties together with the weightings for each of the factors. The 'SAA tests' were thereafter commonly referred to by parties when presenting arguments in the determination of penalties, even although the Tribunal noted the need to draw distinctions between various types of contraventions in terms of the factors under s59(3). In particular, s59(3) indicates that the nature, duration, gravity and extent of conduct is a relevant consideration which implies that different types of conduct can be distinguished for the purpose of penalty.

It seems obvious that prohibited resale price maintenance (as in *Federal Mogul*), failure to notify a merger, cartel conduct and various abuses of dominance (as in SAA) are all different in nature and therefore a single 'ruler' for determining penalties need not apply for all. Reinforcing this observation is the fact that the Act does not provide for financial penalties for some contraventions, even where an effect has to be proven, such as in 4(1)(a) and 8(c). In other words, notwithstanding effects, a form of safe-haven from financial penalties was provided for the catch-all categories of conduct not separately defined but where the conduct *is* found to be harmful. For our purposes, it is relevant that the 4(1)(b) prohibitions on horizontal restrictive practices in the forms of price fixing, market division or collusive tendering are *per se* prohibitions without the requirement to demonstrate harm. In other words, they are presumed harmful.

Internationally several considerations applying to cartel conduct are now widely recognised.⁸ First, there are good grounds for a presumption that the conduct is harmful. Second, 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. These analyses are the realm of damages claims that are brought after cartel findings by competition authorities, and of academic papers. Third, the harm includes non-price factors such as collusion undermining the beneficial effects of competition in spurring better service and quality. Fourth, the primary importance of penalties is for deterrence and hence they ought to be self-evidently greater than the expected gain to

⁶ *Competition Commission v Federal Mogul Aftermarket Southern Africa (Pty) Ltd & others* case no. 08/CR/Mar01.

⁷ *Competition Commission v South African Airways (Pty) Ltd* case no. 18/CR/Mar01.

⁸ 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; Wouter Wils '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.

a firm considering a cartel. Fifth, the deterrence effect must take into account that the probability of the cartel being uncovered is much less than one.

The *Pioneer Foods* decision in the bread cartel case was the first penalty imposed by the Tribunal in a contested cartel case.⁹ In this matter Pioneer contested its participation in a cartel (more specifically cartel arrangements nationally and in the Western Cape) despite being implicated by the other major producers. Premier Foods had been granted conditional leniency, Tiger Brands and Foodcorp reached settlements of R99 million (5.7 per cent of bread turnover) and R45 million (6.7 per cent of bread turnover), respectively. Pioneer also argued that such arrangements as there were had no effect on the bread price. The Tribunal found that there had been collusive conduct in 2006 in the Western Cape and from 1999 to 2006 across the country. Penalties were imposed of R46 million (9.5 per cent of bread turnover in the Western Cape) and R150 million (10 per cent of bread turnover nationally excluding the Western Cape).

The Act stipulates (section 59(2)) that an administrative penalty may not exceed 10% of the firm's turnover in the Republic and its exports from the Republic in the preceding financial year. In determining the Pioneer penalties, the Tribunal found that the 'maximum' penalty percentage of 10 per cent (confusingly termed the 'threshold' by the Tribunal) was appropriate for the national cartel, and a small discount be applied for the Western Cape where the conduct was shorter in duration. However, the Tribunal limited the turnover on which the percentages were applied to the 'infringing line of business'.¹⁰ The Tribunal's reasoning was that the penalty should only go beyond 10 per cent of this turnover if there was some evidence that the anti-competitive conduct in one product market was extended or 'leveraged' into other markets.

In appealing the decision the Commission argued that the Tribunal decision confused the determination of the penalty, which under the Act is not in any way restricted to, or based on, fractions of 10 per cent of the turnover of the infringing line of business (also termed the 'affected turnover', as in the Tribunal's decision in *Aveng & others*), and the precautionary cap on the penalty which is explicitly set at 10 per cent of *total turnover including exports* from the Republic.¹¹ A cartel mark-up (the additional profit margin from the collusive conduct) can easily be more than 10 per cent in a single year meaning it was impossible, with cartels typically existing for many years, for a penalty capped at 10 per cent of the turnover of the particular line of business for a single year to be an adequate deterrent. For meaningful deterrence, the size of the penalties needs to be considered relative to the likely gains being made rather than

⁹ *Competition Commission v Pioneer Foods* case no. 15/CR/Feb07 and 15/CR/May08.

¹⁰ *Ibid*, para 141-142.

¹¹ Notice of Appeal by Competition Commission to Competition Appeal Court of Competition Tribunal decision in cases 15/CR/Feb07 and 50/CR/May08, 24 February 2010.

merely making observations that penalties appear 'large' in Rand terms.¹² The appeal was withdrawn pursuant to the settlement reached between the Commission and Pioneer on the wheat flour and maize meal cartels.

The Tribunal acknowledged the importance of deterrence in its determination of the penalties in the next cartel case (*SPC*), regarding cast concrete pipes and culverts.¹³ This cartel which had run for more than 30 years was uncovered in 2007 following the leniency application of Rocla (a subsidiary of Murray & Roberts). The Tribunal set out an approach which followed international practice including that of the European Commission ("EC"), which takes deterrence as the starting point. This approach uses the turnover of the products cartelised but contemplates a starting percentage higher than 10 per cent and multiplies by the number of years of the conduct, with both mitigating and aggravating factors taken into account. The 10 per cent measure is only applied as the cap on the total penalty arrived at (as per section 59(2)), as a proportion of the *total* turnover of the firm and not only the infringing line of business).

The CAC, while agreeing with the emphasis on deterrence, found in *SPC* that the harm in terms of the mark-up from the cartel conduct needed to be assessed.¹⁴ The CAC reduced the penalty for one party appealing the amount to one half of that determined by the Tribunal and for the other party to just one third. In the penalty computation the CAC only took one year into account, although it is not clear why, as the CAC recognised the cartel had continued over many years. There are very substantial challenges in measuring cartel mark-ups, especially in a case such as this.¹⁵ The cartel was of such long duration that there was no readily available pre-cartel benchmark to use and it is wrong to assume that immediately after the ending of explicit coordination pricing will simply shift to be competitive (meaning the immediate post-cartel period should not be used).¹⁶

The Tribunal's decision in the wire mesh cartel (*Aveng & others*)¹⁷ followed *SPC* and further developed the approach it took. Of the four wire mesh producers against which the Commission referred, BRC had obtained conditional leniency and Aveng (Africa) Limited

¹² The apparently large penalties have led both the CAC and the Supreme Court of Appeal to observe that the administrative penalties bear a close resemblance to criminal penalties. Supreme Court of Appeal, *Woodlands Dairy v Competition Commission* 2010 (6) SA 108 (SCA). The decision related to what standards to hold the Commission to in exercising its powers in conducting an investigation. The CAC in its decision on *SPC* and *Conrite Walls* noted (para 9) that 'a penalty which is of a criminal nature should be proportional in severity to the degree of blameworthiness of the offending party, the nature of the offence and its effect on the South African economy in general and consumers in particular'.

¹³ *Competition Commission v Southern Pipeline Contractors and Conrite Walls (Pty) Ltd* case no. 23/CR/Feb09.

¹⁴ *Southern Pipeline Contractors and Conrite Walls vs. Competition Commission* case no. 105/CAC/Dec10.

¹⁵ Junior Khumalo, Jeffrey Mashiane & Simon Roberts 'Harm and overcharge in the South African precast concrete products cartel' (forthcoming, 2014), *Journal of Competition Law and Economics*.

¹⁶ *Ibid.*

¹⁷ *Competition Commission vs. Aveng & others* case no. 84/CR/Dec09.

trading as 'Steeledale' had admitted the conduct and settled with the Commission. Reinforcing Mesh Solutions (RMS) admitted the conduct but contested its extent and the appropriate penalty while Vulcania Reinforcing denied it was part of the cartel although it admitted to attending several meetings with its competitors in the cartel.

The Tribunal set out its approach in six steps, as follows (paras 133 to 154 of *Aveng & others*):

- 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.
- 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 Act, specifically under 59(3)(a), (b) and (d): nature, gravity and extent of the contravention; loss or damage suffered; and, market circumstances.
- Step three: where the contravention exceeds one year, multiplying the amount obtained in step two by the number of years (duration) of the contravention.
- Step four: rounding off the figure achieved in step three if it exceeds the s59(2) cap, of 10 per cent of total turnover.
- 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.¹⁸
- Step six: round off the amount derived in step five if it exceeds the cap provided for in s59(2) of the Act.

These follow the European approach, cited approvingly by the CAC in *SPC*, while also taking into account the factors in the Act.

The Tribunal applied the steps, deciding on a base penalty in the case of each firm, multiplying by the years, which meant the cap was binding in the case of RMS, and then applying a reduction of 40 per cent in the case of each firm reflecting mitigating factors such as that the

¹⁸ 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.

firms were not instigators and at times disrupted the cartel arrangements. It is not clear why the cap applies at both step four and step six.

Notably, in *Aveng & others* the Tribunal accepted the arguments of both RMS and Vulcania that they had profited little from the cartel, in the absence of evidence from the Commission on this factor. It appears that the Tribunal understands that the Commission should obtain such information in its investigation and should have led it in the hearing. This is a complex task. Determining the competitive counterfactual is very difficult, as we discuss below. In addition, a cartel may shield an inefficient firm from the rigours of competition and thus keep that firm in the market when it would have exited absent the cartel. The latter scenario may be harmful to consumer welfare even while the inefficient firm does not appear to be making excess profits.¹⁹

The Tribunal then applied the six steps again in the determination of penalties in the plastic pipes cartel (*DPI & others*),²⁰ in its decision released two months after *Aveng & others*. For MacNeil, Amitech and Petzetakis the Tribunal had again determined a base amount of 15 per cent, which was multiplied by the number of years of participation in the cartel. After applying the 10 per cent cap of total turnover the Tribunal then discounted the penalty by 20 per cent, 40 per cent and 80 per cent respectively by taking into account mitigating and aggravating factors. In the case of Petzetakis the Tribunal's 80 per cent reduction in the penalty was due to the Managing Director, Michelle Harding, having unilaterally exited the arrangement following attendance at a conference on business ethics. Ms Harding had informed the group chief executive (based in Greece) about her intention which had been endorsed as long as it did not compromise 'the bottom line' (para 219).²¹ Ms Harding was subsequently fired although no link can apparently be drawn with her decision to leave the cartel. Petzetakis had been a ring-leader in the cartel,²² however, the owners of the firm obtained a substantial reduction in the penalty (a benefit not shared with Ms Harding apparently!). Ultimately the penalty of R9.92 million was just 1.6 per cent of one year of Petzetakis' affected turnover, for a cartel in which they had participated for six years (since acquiring the company).

The Tribunal also applied the six step approach in the case involving an alleged cartel between four firms who manufacture mining roof bolts (*RSC & others*).²³ Of these firms, RSC (which was a subsidiary of Murray & Roberts at the time) filed for corporate leniency and *Aveng*

¹⁹ See *MacNeil Agencies and the Competition Commission* ("MacNeil") case no. 121/CACJul12 par 35. In this recent judgment involving MacNeil Agencies (implicated in the plastic pipes cartel), the CAC notes that collusive firms may operate inefficiently and the harm that consumers feel is not related to the collusive firms' profits but to the amount that consumers spend on their products or services.

²⁰ *Competition Commission v DPI Plastics & others* case no. 15/CR/Feb09.

²¹ Petzetakis did not apply for leniency, as Ms Harding claimed not to be aware of the possibility.

²² It had interestingly also been a subsidiary of Murray & Roberts (as Main Industries), which owned a ring-leader in the concrete pipes cartel, Rocla.

²³ *Competition Commission v RSC Ekusasa Mining & others* case no. 65/CR/Sep09.

(Duraset) subsequently agreed a settlement with the Commission where the administrative penalty levied was 5 per cent of Duraset's total turnover. The remaining firms, Dywidag-Systems International ('DSI') and Videx Wire Products ('Videx') admitted many of the contraventions (including collusive tendering), however, they argued that the practices had ceased more than three years before the initiation of the complaint and that, in relation to one of the contraventions that allegedly fell within the three years, the Commission's case was not explicitly brought against them in the referral but rather the two other respondents.

In its ruling, the Tribunal only found one contravention in relation to an Anglo Platinum tender and thus considered this as the affected turnover. In the second and third steps, the Tribunal determined a base amount of 18 per cent of this turnover for one year for what it considered to be the most 'aggravating' form of cartel contravention (bid rigging). The Tribunal considered mitigating factors to be the fact that the primary purpose of the bid rigging was not achieved and the conduct related to only a single tender for a single customer. However, the Tribunal also took into account the fact that senior management was involved in the conduct, and that the firms admitted to several contraventions that were not considered (in the turnover) only due to prescription, and thus increased the base amount by 10 per cent. DSI received a penalty of R1.8 million, and Videx a penalty of R4.7 million.

The preceding discussion shows that the Tribunal's approach to determining penalties in contested cartel cases has evolved over time in a manner that seeks to account more explicitly (and predictably) for the factors under s59(3). It has seen potentially more severe penalties, imposing percentage amounts of up to 30% of affected turnover (reflecting an understanding of collusive mark-ups) and taking into account the duration of cartels. This is an important step in so far as firms will be better able to evaluate the likely penalty if they lose a contested case, and weigh this against the penalty they are likely to be able to agree if they approach the Commission to settle the matter (which we discuss below). These aspects have important implications for the effectiveness of deterrence and the incentives of firms.

3. DETERRENCE AND INCENTIVES IN DETERMINING PENALTIES AND SETTLEMENTS

(a) The principle of deterrence

Penalties play two roles, of punishment and deterrence, with the latter being more important.²⁴ To achieve deterrence, the likelihood of cartel detection and the resulting penalty (which together give the expected penalty) must be sufficiently high when set against the illicit gain

²⁴ See Gunnar Niels, Helen Jenkins, and James Kavanagh 'Economics for Competition Lawyers' (2011) *Oxford University Press Inc.*, New York at 475; OECD 'Determination and application of administrative fines for environmental offences: Guidance for environmental enforcement authorities in EECCA countries' 2009, available at <http://www.oecd.org/dataoecd/32/44/42356640.pdf>, accessed on 01 August 2012.

from the conduct.²⁵ Very high penalties have little deterrent effect if there is no realistic possibility of detection. The size of the expected penalty should also be weighed against the harm to society to take into account the importance of deterring the conduct. However, estimating the probability of detection, societal harm and illicit gains are not easy tasks.

The probability of detection could be estimated as the proportion of cartels that are uncovered relative to the total universe of cartels that exist. However, due to the secret nature of cartels it is difficult to accurately ascertain the extent of this universe and, as such, the probability of detection is difficult to establish. Of course, the probability of detection is always less than one (and likely to be substantially so given that secret cartels are designed to remain hidden) which implies that achieving deterrence requires imposing a significantly higher penalty than the cartel gain. There is effectively a trade-off between the probability of detection and the level of the penalty in that a lower probability of detection implies that higher penalties are required. Estimates of the probability of detection at substantially below 1 have been given as one explanation for the significant increase in penalties in the EU in recent years.²⁶

While harm to society will differ from the cartel gains and may be lower than these gains, in practice optimal deterrence is best achieved if penalties directly reflect the benefits that accrue to firms engaging in cartel conduct.²⁷ This is reflected in the EC's Fining Guidelines²⁸ where fines are set with reference to the value of sales in the relevant market and the duration of the infringement. These two factors (value of affected sales and duration) are considered a proxy for the economic importance of the infringement, where economic importance can be interpreted as the importance to either the economy or to the firms involved in the cartel conduct.²⁹ Accounting for duration of infringement seems to acknowledge that the gains from cartel conduct are earned in each period of involvement in the cartel. 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.³⁰ The duration

²⁵ Ibid. Firms may also consider the negative reputation effect of entering into a cartel which is likely to be uncovered at some point. This depends on the likelihood of detection and, as all substantial firms are normally involved in a cartel, it does not mean any individual firm will necessarily suffer from a poorer reputation than another.

²⁶ Aurora Ascione & Massimo Motta 'Settlements in cartel cases' in Claus-Dieter Ehlermann & Mel Marquis (ed) *European Competition Law Annual 2008: Antitrust Settlements under EC Competition Law* (2008) at 668.

²⁷ Ibid at 476 – 477, see also Wils op cit., Motta op cit. and International Competition Network 'Setting of fines for cartels in ICN jurisdictions' 2008 (ICN Cartels Working Group, Report to the 7th ICN Annual Conference, Kyoto, April 2008) at 9.

²⁸ 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.

²⁹ Ibid; Gunnar Niels *et al* op cit. at 477.

³⁰ International Competition Network op cit. at 21.

of a cartel, while reflecting past harm, is also an indicator of cartel durability (and hence expected future cartel returns, absent detection).

The EC Guidelines indicate that the basic fine is taken as a proportion (up to 30 per cent)³¹ 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.

Some concerns have been raised that large penalties could lead firms into bankruptcy and to increased consumer prices as firms attempt to recoup losses from penalties.³² Most jurisdictions, including South Africa, have caps on penalties and some make provisions for the presentation of objective evidence demonstrating that the penalty would irretrievably jeopardise a firm's economic viability and cause its assets to lose all their value.³³ In other words, a firm should demonstrate that the penalty leads to insolvency which, in general, is likely to occur if the penalty is larger than the market value of the firm/shareholders' equity.³⁴ Note, there may be inefficient firms that are not sustainable at competitive prices, while efficient firms make healthy returns. Firms that are too inefficient to compete outside the shelter of the cartel would be eliminated by the competitive process even in the absence of the penalty.³⁵ It can be argued that competition is lessened if the number of firms declines post-cartel, however, competition is not simply a function of the number of firms but how they behave and it would be perverse to allow a cartel on the grounds that the arrangement sustained a larger number of firms.

In addition, penalties represent a sunk cost which does not affect the pricing and supply decisions of firms. These decisions are essentially about weighing up the increased sales from a discounted price against the cost of supplying the additional volumes demanded. Increased competition post-cartel also means that individual firms cannot profitably raise prices without losing sales to competitors. This is reinforced by leniency programmes and differential settlements which put firms in asymmetric positions.³⁶

(b) Settlements and deterrence

³¹ 20 per cent for the US.

³² Patrick Van Cayseele, Peter D. Camesasca & Kristian Hugmark 'The EC Commission 2006 fine guidelines reviewed from an economic perspective: risking over-deterrence' (2008) 53 (4) *The Antitrust Bulletin*.

³³ European Commission (2006) op cit. at 35. The South African competition authorities have also allowed for extended payment terms.

³⁴ Niels *et al* op cit. at 478.

³⁵ Motta op cit.

³⁶ Paolo Buccirossi & Giancarlo Spagnolo 'Optimal fines in the era of whistle-blowers' (2006) CEPR Discussion Paper no. 5465 *Centre for Economic Policy Research*, available at <http://www.cepr.org/pubs/dps/DP5465.asp>, accessed on 2 August 2012.

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.³⁷ 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) that exceed the cost of settling (lower fines and diminished deterrence).³⁸ In the EU, firms earn automatic discounts of 10 per cent if they elect to settle cases with the EC.³⁹ In France this discount ranges between 10 per cent and 30 per cent.⁴⁰ Firms are, however, unlikely to settle if they believe that the courts will provide larger fine reductions than the authority's settlement procedure, as discussed with relation to the South African context in the following section.

Settlement is separate from a leniency programme in which a firm is granted a reduced or a zero penalty for providing information and evidence of an infringement. Settlements free up resources which are then diverted to screening and other investigations thereby increasing the probability of uncovering more cartels.⁴¹ This is achieved through the early settlement of cases. As such, a successful settlements' procedure reduces the time period between case inception and final decision.⁴² Competition authorities should therefore be open to settle with, and extend larger benefits to, firms that come forward earlier on in the investigation. In the EU there has been some debate on the time limit within which settlement can be explored, with the EC notice limiting this to around the time it issues a Statement of Objections.⁴³

Counter-balancing the benefits of early settlements is the diminished deterrence associated with lower penalties.⁴⁴ 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

³⁷ 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.

³⁸ Ibid at 669.

³⁹ Ibid at 33.

⁴⁰ Bruno Lasserre & Fabien Zivy 'A principled approach to settlements: a few open issues' in Claus-Dieter Ehlermann & Mel Marquis (ed) *European Competition Law Annual 2008: Antitrust Settlements under EC Competition Law* (2008) at 147.

⁴¹ Motta op cit., William Landes 'An economic analysis of the courts' (1971) 14 *Journal of Law and Economics* 61, Richard Adelstein 'The plea bargain in theory: a behavioural model of the negotiated guilty plea' (1978) 44 *Southern Economic Journal* 488 and Lasserre & Zivy op cit. at 143-146.

⁴² Motta op cit and Ascione & Motta op cit at 71.

⁴³ Lasserre & Zivy op cit at 152.

⁴⁴ Thomas Miceli 'Plea bargaining and deterrence: an institutional approach' (1996) 3 *European Journal of Law and Economics* at 249.

leniency. Under-deterrence in settlements can be avoided by having harsher overall sentencing, enabling discounts while still having meaningful penalties.⁴⁵

4. AN ASSESSMENT OF PENALTIES AND SETTLEMENTS

In this section we critically assess the Commission's historic approach to settlements for cartel conduct through the lens of economic principles. We also look at recent South African evidence of the level of cartel mark-ups to assess deterrence and firms' incentives to settle, and we critique the approach to penalty determination suggested by the Tribunal and CAC against this evidence.

(a) Review of the Commission's approach to settlements

Section 59(3) of the Act provides no guidance as to the relative importance of each of the listed factors for the determination of penalties or how they should be considered, whether by the Tribunal in imposing a penalty or in confirming a settlement reached between a respondent and the Commission.

Firms will try to weigh-up the penalty that they think the Commission is likely to agree in settlement against the fine that they expect the Tribunal (or higher courts) to impose. There is thus a critical interrelationship between the process that the Tribunal follows for fine determination and the approach of the Commission in settling matters. If administrative penalties required by the Commission for settlements are high relative to the expected penalties from the Tribunal then firms would look to contest the matter, as in *SPC*. Certainly the evidence of cartel mark-ups, which we discuss below, indicates that penalties in general should be higher. With regard to settlements, we examine whether the Commission should adopt the same approach (applying the factors in the same way) as the Tribunal in determining a penalty in a contested case, or should it maintain its current approach based on a case-by-case treatment of settlement.

In the early years, before the inception of the CLP in 2004, the Commission prosecuted mostly 'non-secret' cartels and typically the penalties for participants were nominal. The arrangements generally did not concern a concealed attempt to coordinate market conduct. We therefore draw a distinction between this early period and after 2004, where the focus shifted to detecting, penalising (and hence deterring) secret cartels. The post-2004 experience also reveals the effect that the CLP had on firms' incentives to come forward and settle with the Commission. There has been a discernible evolution in the way the Commission has approached settlement from 2004 to date, towards achieving greater deterrence.

⁴⁵ Chantale LaCasse & 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.

Following the introduction of the CLP the Commission saw a marked increase in the initiation and prosecution of ‘hard-core’ cartel cases.⁴⁶ In this early period there was naturally a high degree of uncertainty regarding the level of penalties that the Tribunal would impose in a contested hearing. The uncertainty and risk could be addressed through settlement, providing a way out for cartelists. The Commission used settlements as a way to induce firms to ‘clean-up’ while avoiding litigation of a large number of cases.⁴⁷ The settlements thus provide an indication of the firms’ and the Commission’s expectations of penalties in contested cases, that is, penalties imposed by the Tribunal would be significantly higher. An interesting feature of the South African experience is that there have been a large number of settlements before the basis on which cartel penalties should be determined had been clarified by decided cases. This is a result of the large number of cartel cases which were uncovered in 2007 to 2009 (and the incentives to reach settlements) against the time taken for cases to be heard and decided by the Tribunal and CAC with the *SPC* decision of the CAC being finalised only later in 2011.

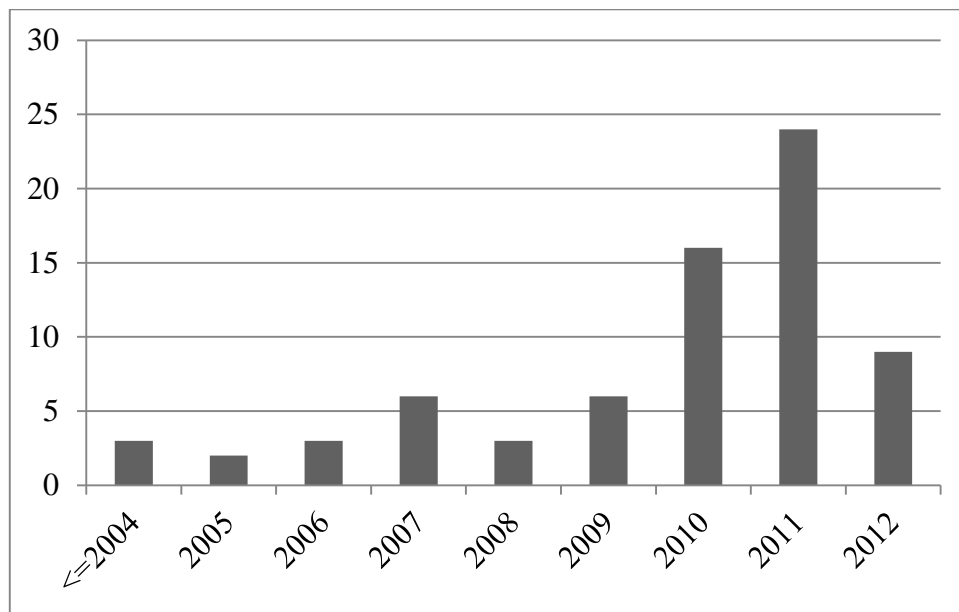
In the years following the introduction of the CLP the Commission’s approach evolved as it gained experience in handling the new leniency process, and faced an increasing number of cases to prosecute together with firms wishing to settle. For example, in the bread cartel case, there was apparently overlapping leniency for two firms as Tiger Brands provided information on more widespread conduct than the initial CLP applicant, Premier Foods. Thus Tiger Brands received leniency for some conduct and only received a penalty of 5.7 per cent of their national bread turnover for the multi-case settlement. These actions by the Commission are consistent with those of an authority getting to grips with a new leniency regime.

As the Commission followed through on leniency applications, there were increased settlements, peaking in terms of number in 2011 (Figure 1).

Figure 1: Number of cartel settlements confirmed by the Tribunal

⁴⁶ Lavoie (supra note 1)

⁴⁷ Makhaya et al. op cit.



Source: Competition Commission and www.comptrib.co.za

In terms of the penalties agreed with firms through 72 individual settlements across 34 cartels since the inception of the Commission, we see in Appendix Table A that penalties can be grouped in four ranges, of less than 3 per cent, 3 per cent to 4.9 per cent, 5 per cent to 6.9 per cent, and 7 per cent and above. The percentages are of a single year's turnover of the entity involved in the conduct. The following broad observations can be made.

Turnover

In settlements the Commission has generally expressed penalties as a percentage of the total annual turnover of the relevant business entity. At times, a narrower turnover has been used, or specific product lines have been excluded from the turnover (noted in Appendix Table A). The Commission has not focused on the affected turnover, on which there may be some dispute and on which evidence led in the Tribunal hearing may have bearing. Instead, the Commission has taken the total turnover of the relevant entity, whether a firm, division, unit or subsidiary 'which controls its decision-making process'.⁴⁸ This allows for the fact that firms may incorporate similar activities differently in their corporate structures, while focusing on the

⁴⁸ Lavoie, op cit., at 144. See *Adcock Ingram* where the operating entity was fined, although it was part of Tiger Brands. The turnover was much wider than the affected turnover of the conduct which was on intravenous drips. In the case of *Aveng Duraset's* settlement of the mining roof bolts cartel, the fine was levied on Duraset's turnover. Duraset had five divisions reporting to the same managing director who was actively involved in cartel meetings (Case No.: 65/CR/Sep09). In settlements of the concrete pipes & culverts cartel, only World Cup 2010 joint venture turnover was excluded in the case of two firms, and the turnover was thus that of all cast concrete products, not only the sales of products subject to the cartel arrangements.

structure within which the conduct fell and over which management should have been aware and exerted decision-making responsibility. The Commission has allowed for the subtraction of lines of business from the turnover of the entity where it could be demonstrated that it was not part of the cartelised products. For example, in the cartel of cast concrete products (of items such as pipes and culverts) turnover from a major unrelated project was excluded. This, in effect, reduces the turnover used to an amount closer to the affected turnover. For more recent settlements, such as those related to silo storage fees in 2011, the affected turnover was used.

The Commission settlements have worked off a base of 10 per cent of the turnover derived in this way, with the majority between 3 per cent and 7 per cent (Appendix Table A). This implies low penalties, especially for those cartels where the conduct related to the main business of the entity and ran for a number of years. However, the settlement penalties appeared high when considered against the Tribunal's decision in *Pioneer*, where the Tribunal only imposed a penalty of 10 per cent of affected turnover on the firm with no multiplier for duration, and this penalty was obviously only imposed after the time taken for the case to be heard. A firm settling would take into account the prevailing interest rate in likely paying the penalty several years earlier than if it would be imposed by the Tribunal following a contested hearing and on probably a wider turnover than the affected turnover that had been used by the Tribunal. The considerable number of settlements reflected the views of respondents that higher penalties were going to be imposed.

Size of penalties

Generally, the firms that have received penalties of less than 3 per cent have either been those involved in non-secret arrangements, including where the contravention arose from provisions of contractual agreements. For example, this group includes the collective arrangements in negotiating private healthcare pricing on the part of the Board of Healthcare Funders, SA Medical Association and Hospital Association of South Africa which were deemed to contravene the Act (settled in 2004/05). It also includes the Safripol settlement at 1 per cent of turnover where the arrangement with Sasol Chemical Industries (SCI) was an outcome of merger proceedings before the old Competition Board.⁴⁹ Almost all of the settlements in this basket were also reached in 2007 or earlier.

Seventeen of the 22 settlements between 3 per cent and 4.9 per cent are those relating to price fixing of grain silo storage fees – arrangements which were prevalent throughout the industry as part of regulatory hangover. This grouping, however, also includes a few notable

⁴⁹ *Competition Commission and Safripol (Pty) Ltd* case no. 48/CR/Aug10.

settlements where there was significant and material co-operation, discussed further below, such as Keystone Milling, Afrisam and Apollo Tyres.

The 33 settlements with penalties of 5 per cent or more are the more traditional hard-core cartels, all but one are after 2007 and 26 are settlements post-referral.⁵⁰ These settlements are largely accounted for by the bread and milling, scrap metal, concrete pipes, plastic pipes and bitumen cartels – the types of products in which cartels are found around the world.⁵¹

A subset can be identified of the highest penalties agreed in settlement, of between 7 per cent and 9 per cent. Of these nine settlements, three are settlements of more than one contravention and if considered on a per contravention basis would fall in a lower category.⁵² The six remaining relate to late settlements, including by cartel ring-leaders. They include those where firms did not co-operate with the Commission. For example, in the case of Aveng (Infraset) representatives of the firm had sought to mislead the Commission in the concrete pipes cartel investigation.⁵³ Nonetheless, firms in this category still received an implied discount of between one and three percentage points for settling.

Co-operation and firm behaviour

The obvious benefit of a clear leniency policy and creating incentives for cartelists to come forward is that the applicant provides the authority with valuable information which helps to reduce the cost of investigation and successful prosecution, while the firm benefits from a zero penalty.⁵⁴ In cases where there is little or no documentary evidence there is much value in a second firm admitting to the conduct and providing useful information when settling. In countries such as South Korea this is recognised through an automatic penalty discount for the second firm to settle.

The Commission has favoured and rewarded early and substantial co-operation from firms and particularly those that have provided new and relevant information for the case, in some instances information exceeding what a CLP applicant can provide, such as in the example of Tiger Brands in the bread and milling cartels.⁵⁵

⁵⁰ The only one in 2007 is Tiger Brands which was in fact settling more than one contravention.

⁵¹ See John M. Connor & C. Gustav Helmers 'Statistics on modern private international cartels: 1990-2005' (November 2006) Department of Agricultural Economics: Purdue University Working Paper No. 06-11.

⁵² These are the SCI Sasol Nitro, Aveng (Steeleale) and Pioneer Foods settlements. On a per contravention basis these would fall in the lower ranges.

⁵³ *Competition Commission and Concrete Units (Pty) Ltd* case no. 23/CR/Feb09 hearing transcript 31 March 2010 at 6.

⁵⁴ Oxa 'Truth or dare: Leniency and the fight against cartels' (2008) *Agenda*.

⁵⁵ *Competition Commission and Tiger Consumer Brands (Pty) Ltd* case no. 15/CR/Feb07 hearing transcript 28 November 2007 at 13. In its submissions the Commission stated that Premier Foods and Tiger Consumer Brands

Firms have also been rewarded for making ‘exceptional’ efforts to conduct internal investigations regarding anti-competitive conduct. The important point is that material co-operation is about actions taken and not simply expressions of co-operation amounting in effect simply to meeting the requirements of the investigation. The penalties for SCI⁵⁶ in fertilizer, Tiger Brands⁵⁷ and later New Reclamation⁵⁸ as a ring-leader in the scrap metal case were mitigated by their efforts to conduct internal investigations to uncover conduct within their businesses. However, the SCI penalty was also increased to reflect the fact that senior management had with-held information. In the cement matter, AfriSam received a lower fine than Lafarge Industries, reflecting early co-operation and the provision of extensive information including witness statements obtained through an internal investigation at the firm.⁵⁹

In instances where respondents failed to co-operate with the Commission or have sought to frustrate the investigation or misled the Commission, the relevant fine was adjusted upwards.⁶⁰

Duration and extent

Throughout the cases reviewed the duration and extent of the conduct has affected the severity of the fine, although to a relatively limited extent and certainly not by setting the penalty proportional to the duration. There are several reasons for this. First, at the settlement phase without all the evidence being led there is likely to be some uncertainty about the duration, especially where the managers involved at an earlier stage of the cartel are no longer employed by the firm settling.

Second, there have been long-running cartels, where coordination was essentially part of the norms of business, and the Commission had an incentive to uncover all of this conduct through the assistance of the firms settling. There are perhaps two main reasons for the extent of collusive conduct. There was extensive regulation of markets, often by or on behalf of producer groups, under apartheid.⁶¹ In areas such as agriculture and cement it is now evident that de-regulation simply led to the producers continuing with secret cartel arrangements in a range

were both granted leniency partly because the CLP was a new policy and the Commission was more inclined to grant leniency for parties that co-operate than to deny this.

⁵⁶ *Competition Commission and Sasol Chemical Industries Ltd* case no. 31/CR/May05.

⁵⁷ Foodcorp was implicated in the same cartel but received a larger penalty at least partly because they waited until the matter was referred to come forward.

⁵⁸ *Competition Commission and The New Reclamation Group Ltd* case no. 37/CR/Apr08.

⁵⁹ *Competition Commission and Lafarge Industries South Africa (Pty) Ltd* case no. 23/CR/Mar12 hearing transcript 28 March 2012 at 11.

⁶⁰ See *Competition Commission & others and American Natural Soda Ash Corporation & others* case no. 49/CR/Apr00; *Competition Commission and Adcock Ingram Critical Care (Pty) Ltd* case no. 20/CR/Apr08; and *Competition Commission and Aveng (Africa) Ltd* case no. 24/CR/Feb09.

⁶¹ Gertrude Makhaya and Simon Roberts ‘Expectations and outcomes – considering competition and corporate power in South Africa under democracy’, (2013) 138, *Review of African Political Economy*, at 556-571

of markets. There are also very tight-knit industries in South Africa with multi-market contacts between firms that facilitate collusion. This appears to have been the case with construction products such as cast concrete pipes, reinforcing steel and wire mesh, in which the same main construction firms have subsidiaries, as well as in construction tenders.⁶² The Commission sought to use settlements to incentivise firms to examine conduct across different markets and make a step-wise change. This is evident first in the baking and milling matters where the initial discovery of a cartel in bread sales in the Western Cape (and leniency granted to Premier Foods) led to extensive collusion being uncovered at a national level in bread, wheat flour milling and maize milling, especially through the co-operation of Tiger Brands as part of its settlement. It is also reflected in the leniency applications and settlements following the cast concrete products cartel where Aveng and Murray & Roberts, in particular, reviewed their operations across different markets.⁶³

Third, at the time, firms in the very long-running cartels (such as the three decade long concrete pipes cartel) may not in any case have been penalised by the Tribunal above a cap of 10 per cent of the turnover of these products (affected turnover). This reflected a probable alternative which the Commission had to consider in setting the penalties in settlements.

In summary, while in terms of duration the Commission's approach has generally been that the longer a firm has been involved in the conduct the larger the penalty, this has not been approached in terms of a multiplier to increase the penalty proportional to the duration. Having addressed a legacy of collusive conduct in many markets in areas such as construction products and agriculture, and with a much wider awareness in business of what constitutes a cartel, it could be argued that it is now appropriate to take a harder line on duration as reflected in the approach of the Tribunal in *Aveng & others*.

Other considerations

As might be expected smaller players in a cartel in terms of influence have been penalised less than the ring-leader(s). Examples of firms that have received larger penalties include New Reclamation which was influential in the scrap metal cartel and Aveng Steeledale⁶⁴, a founding member in the mesh and rebar cartels.

⁶² Reena das Nair, Junior Khumalo & Simon Roberts 'Corporate conduct and competition policy in Intermediate Industrial Products'. *New Agenda*, (2012) First Quarter, at 16-21. Competition Commission 'Construction firms settle collusive tendering cases with R1.5 billion in penalties', press release 24 June 2013, <http://www.compcom.co.za/assets/Uploads/AttachedFiles/MyDocuments/Construction-Fast-Track-Settlement-Process-Media-Release.pdf>, downloaded 7 January 2014.

⁶³ Makhaya et al. (2012) *supra* at 5.

⁶⁴ *Competition Commission and Aveng (Africa) Ltd t/a Steeledale* case no. 84/CR/Dec10.

Other things equal, firms such as Pioneer⁶⁵ and SCI⁶⁶ have received higher penalties for coming forward and settling more than one case at the same time, although the penalties are favourable if one were to consider all the contraventions separately. There has thus been an incentive to settle several cases at the same time, reflecting co-operation on the part of the firm in seeking to identify and settle all the contraventions (including those not yet referred), compared to a piecemeal approach.

Profitability and harm

The Commission has not focused on calculating cartel mark-ups (the increased profit margin from the cartel) but has rather taken it as given that cartel conduct is profitable for cartelists for the purposes of settlement. Indeed, as we discuss below, estimating the level of cartel overcharge at the time of investigation is particularly onerous and tantamount to pursuing a full excessive pricing case in terms of the evidentiary burden, a process which would seem to contradict the recognised resource and time savings associated with settling a matter. Only recently has the CAC implicitly acknowledged the complexity of using profits figures to estimate the effects and profitability of cartel conduct.⁶⁷

Evaluation

As discussed above, if the administrative penalties which the Commission is likely to agree in settlements are believed to be high, then firms are more likely to contest cases at the Tribunal. However, when settlement penalties are considered low there is likely to be under-deterrence. Generally, the Commission has agreed higher penalties with ring-leaders and long-standing cartel members (except in multi-case settlements) and lower penalties in cases where cartel arrangements may have been a legacy of apartheid government policy. Within specific cartels, there are differences in the final settlement amounts which is reflective of the Commission having effectively applied the s59(3) factors to each individual firm. This is consistent with step five of the Tribunal's approach in *Aveng & others* where mitigating and aggravating factors are considered. It is more difficult to compare the Commission's approach across cartels given differences in the nature of the cartel, duration, measurements of turnover, and extent of the conduct.

The Tribunal's approach to penalty determination was initially not in line with the Commission's approach to settlements in that the Tribunal did not impose much higher penalties, as a percentage of affected turnover and accounting for duration, than those agreed in settlements by the Commission. It is only in recent decisions that the Tribunal has adopted a basis for

⁶⁵ *Competition Commission and Pioneer Foods (Pty) Ltd* case no. 10/CR/Mar10 and 15/CR/Mar10.

⁶⁶ *Competition Commission and Sasol Chemical Industries Ltd* case no. 31/CR/May05.

⁶⁷ *MacNeil Agencies and the Competition Commission* case no. 121/CACJul12 par 86.

determining penalties that acknowledges the importance of deterrence, provides greater certainty for firms, and allows the methodology of the Commission to align with that of the Tribunal in terms of the actual penalties determined. Firms are better able to estimate for themselves that the penalty from a contested case is likely be substantially high compared to an administrative penalty in a settlement.

(b) Recent evidence of cartel mark-ups in South Africa

Estimates of cartel mark-ups serve as both an indicator of the extent of profitability of cartel conduct for member firms as well as the potential harm to consumers over the period of the cartel. The overcharge is effectively the difference between the price charged during the cartel period and the prices that would have been charged in a competitive market absent the conduct. In addition, higher prices have the distortionary effect of reducing demand. Of course, the primary difficulty with this exercise is determining the appropriate counterfactual period, and the price and likely volumes sold against which to compare the observed cartel prices. In the case of long-standing cartels, such as in concrete pipes, defining this counterfactual for the analysis is challenging as there is no 'before cartel' competitive period. And, prices will not necessarily adjust to the competitive level for a considerable time after the explicit cartel ends.⁶⁸

International studies have typically found that cartel mark-ups are approximately 15 per cent to 25 per cent of the cartel price.⁶⁹ The Commission's assessments of the impact of its own interventions on cartel conduct in several sectors suggests comparable mark-ups. Given this evidence of high mark-ups for contraventions in South Africa, there is scope to increase both administrative penalties in settlements and those penalties issued by the Tribunal. We summarise these findings below.

Precast concrete products

Members of the concrete pipes cartel agreed market shares in the three main geographic areas, fixed prices, and agreed not to compete in the remaining areas. The findings in this particular study in which different counterfactuals were defined for the main areas of trade were that: overcharge in the Gauteng (Johannesburg) region was in the range of 16.5 per cent to 28 per cent; and overcharge in the KwaZulu-Natal (Durban) region was in the range of 51 per cent to 57 per cent.⁷⁰ The estimated overcharge for the KwaZulu-Natal region was very high when compared to the international studies but it should be noted that demand is very

⁶⁸ Khumalo et al. op cit.

⁶⁹ Ibid, at 4.

⁷⁰ Ibid, at 17.

inelastic and the market was very concentrated, while in Gauteng there were also fringe firms present and not part of the explicit cartel.

Wheat flour

The Commission has made several interventions in the milling industry including uncovering a cartel in wheat milling in late 2006. Members of this long-standing cartel (many of which were vertically integrated into several levels of the 'wheat-to-bread' value chain) attended numerous meetings in which they agreed to: fix the price of milled wheat products; create uniform price lists for wholesale, retail and general trade customers; fix the timing and implementation of price increases; and to allocate customers. One study estimated an average overcharge of approximately 25 per cent on both white and brown flour prices to independent bakeries and an average overcharge on cake flour sold in the wholesale channel of approximately 7 per cent.⁷¹ Another assessment found that in the Western Cape the overcharges on white bread flour and cake flour were 42% and 32%, respectively; while in Gauteng the overcharges were approximately 24% and 33%, respectively.⁷²

(c) Review of recent Tribunal and CAC decisions on the determination of penalties

As part of the debate on appropriate standards for fines and settlement penalties, such as would be embodied in guidelines, we revisit the recent decisions of the Tribunal and CAC in light of the economic framework, incentives and evidence on mark-ups.

An appropriate framework for the determination of penalties creates dis-incentives for engaging in cartel conduct whilst encouraging firms to come forward. This begins with the level of turnover that the firm believes can be affected by either a settlement with the Commission or a penalty determined by the Tribunal. The Commission's approach has been to focus on the turnover of the relevant business unit within which decision-making regarding the cartel conduct lies, which is in contrast to the Tribunal's approach in the mesh case (*Aveng & others*) of assessing the turnover from products affected by the contravention. It is important to note that in either approach the turnover considered and the base percentage are inter-related. The Tribunal in its decisions on concrete pipes, wire mesh, plastic pipes and mining roof bolts has started with a base for the penalty of between 10 per cent and 30 per cent of turnover. This is appropriate given the preference for using the affected turnover. An approach that takes the affected turnover but is restricted to a maximum of 10 per cent of this turnover will clearly not deter given that mark-ups are typically higher than this, and firms earn supra-

⁷¹ Sunel Grimbeek & Bongisa Lekezwa 'The emergence of more vigorous competition and the importance of entry – comparative insights from flour and poultry' paper presented at the *Sixth Annual Conference on Competition Law, Economics and Policy in South Africa*, University of the Witwatersrand, 6-7 September 2012.

⁷² Liberty Mncube 'The South African wheat flour cartel: overcharges at the mill' (December, 2013) *Journal of Industry, Competition and Trade*.

competitive returns in each year of the cartel. On the other hand an approach that takes the affected turnover but where a high base per cent is set (close to 30 per cent), and where this is multiplied by the duration of conduct, can still be deterrent. We would emphasise that for deterrence the penalty has to be substantially higher than the return earned given that: (a) the probability of getting detected is far less than one; and, (b) the penalty is paid sometime in the future while the cartel returns are earned today. The risk of high legal costs and reputational damage can reinforce the effect of a high penalty, although each of these factors is largely subject to commercial considerations and the views of profit-driven shareholders, and thus falls beyond the direct control of the competition authorities.

The incentive to settle, and the gains in terms of co-operation and further information into the conduct that this brings, is also enhanced if the penalty likely from a contested hearing clearly outweighs the returns from cartel conduct rather than simply seeking to balance them. This is so as it provides scope for the Commission to substantially discount the likely penalty without running the risk that it will benefit a firm to collude and then to settle when found out because of the low level of penalties under such settlements.

While ideally firms should know with a reasonable degree of accuracy the discount for settling, in reality there will always be uncertainty given the range of factors to be taken into account and the different views of them taken by the Tribunal and CAC. This implies that, while the Commission can move towards the Tribunal's recent penalties framework in calculating penalties in settlements, there are cases where it may still make sense for the Commission to base the settlement penalty on the (wider) turnover of the entity. Such cases will include where there is a high degree of uncertainty about the affected turnover and duration of the conduct. This is therefore an alternative approach which can be taken depending on such uncertainties.

There are two further considerations which undermine deterrence. First, the 10 per cent total turnover cap applicable under section 59(2) may be too low, especially in the case of single product firms. Second, the practice of the Tribunal in recent decisions of awarding discounts in steps four and six (set out above) may be too expansive. These two steps effectively allow a firm whose conduct may warrant a high penalty to have its penalty discounted at both stages.⁷³ In *RMS & others* (wire mesh cartel) the CAC seems to agree that there are concerns regarding the Tribunal's approach of discounting at both steps four and six.⁷⁴ Furthermore, the practice of discounting after the cap has been applied means that a single product firm can

⁷³ In *RSC & others* the Tribunal took a strong position in terms of a high base percentage applied at step two. The base amount which was applied to DSI and Videx was 18 per cent and this was increased by 10 per cent at step five due to significant aggravating factors. Despite this, because the affected turnover was defined narrowly the penalty amount constituted less than 1 per cent of DSI's annual turnover and less than 2 per cent of Videx's annual turnover.

⁷⁴ *RMS & others* case no. 119/120/CAC/May2013 par 63.

contemplate a penalty substantially below 10 per cent of one year's turnover, a penalty likely to be much lower than the rewards from collusion.

This in turn affects the settlement processes of the Commission. Firms involved in the most egregious of contraventions that would otherwise receive high penalties from the Commission have an incentive to take their chances at arguing for very narrow turnover to be used by the Tribunal and for additional discounting. This undermines the Commission's ability to settle, and obtain useful evidence from settling parties that may assist to prosecute other cartellists.

A further concern that arises from the Tribunal's decision in *Aveng & others* is the suggestion that evidence should have been led on the loss or damage suffered including through examining the change in prices after the cartel was exposed. While this may be a fair requirement in the context of a full hearing, it seems unduly onerous at the level of settlements with the Commission. We already know that such evidence is particularly difficult to compile in the absence of an economically reasonable counterfactual. It also reduces the benefits from settling matters at an early stage of investigation.

The Tribunal may require this evidence to be led for the very reason that the six step approach was developed in the first place, that is, in case the decision is challenged at the CAC. However, the evidentiary burden should be different at the settlement stage and the wider turnover of the entity should be considered particularly where there is uncertainty about the turnover to be considered and the duration of the conduct. In those cases where firms wish to motivate that specific turnover be excluded from the calculation of a penalty, the onus should be on the firm to clearly demonstrate that the specific turnover should be exempt or that the cartel had limited effects.

At the settlement stage the Commission has relied on being able to presume harm and profitability of the conduct. If evidence of this is required at settlement then the firm in question would have an incentive to conceal information on the conduct (where the information would mean an increased penalty) instead of being forthcoming with information that can assist the prosecution of others.

Greater predictability will improve the incentives of firms to settle with the Commission, particularly if there is also an understanding that the penalties likely to be imposed in a contested hearing at the Tribunal are high. In other jurisdictions a stated policy of partial leniency for the second and subsequent informants is used to enhance the incentives to come forward. In South Korea under Article 35(1) (iii) of the Enforcement Decree, a 'second reporter' who reports to the KFTC and co-operates before or after the investigation commences can qualify for a 50 per cent discount on the penalty and partial exemption from corrective orders

as well subject to several other conditions.⁷⁵ The EU leniency process also sets out conditions for granting a discount on penalties for the second and third applicants. In South Africa there may be benefit in exploring such an approach.

As noted above an appropriate framework for the determination of penalties creates disincentives for engaging in cartel conduct. It also provides sufficient incentive for firms to come forward for leniency or to settle cases. Firms should believe that contesting a cartel case at the Tribunal is likely to result in a high penalty, whilst at the same time firms should be aware that settling is not an 'easy way out'. Together these aspects, and the increasing probability of being caught, create deterrence. The threat of high penalties and the concomitant legal and reputational costs also increase the level of deterrence. Our review reveals how the competition authorities have moved towards an appropriate framework on a case-by-case basis. This started from the SAA approach being adopted to *per se* cartel conduct. The much larger number of cartel cases than expected then saw the Commission evolve an approach to settlement, as well as appreciate the importance of deterrence to alter the risk and reward calculus of firms considering colluding with their competitors. This is in line with international experience that has seen a move towards higher penalties. The most recent decisions of the Tribunal and CAC in this regard suggest an increasing recognition that the level of penalties (through settlement and contested cases) is critical to deterring future violations of the Act.

5. CONCLUSIONS

The framework for penalties for cartel conduct ought to be fundamentally premised on deterrence. In this regard, it is important to remember the straightforward gains to firms from colluding which underlies why the conduct is a *per se* contravention requiring no assessment of effects. In addition, the harm to the economy extends beyond simply the collusive price mark-ups and includes the negative effects on quality, service and effort. The low probability of secret collusive arrangements being detected must also be taken into account.

The very large number of cartels uncovered from 2006 naturally led the Commission to appreciate the benefits of settlements. Settlements that reward co-operation reveal more information about the conduct and can greatly assist in the prosecution of the remaining cartel members, especially where there is little documentary evidence of the conduct. Moreover, incentivising settlement also led to other cartels being uncovered as part of the commitments to co-operation made by settling firms. The Commission's approach evolved pragmatically

⁷⁵ K. Jung, H. Park, M. Yu, Kim & Chang 'Leniency Regimes - Jurisdictional Comparisons: South Korea' in *The European Lawyer Reference Series* (Third Edition 2010).

according to these priorities and not along the lines of the tests that had been set down by the Tribunal for penalties in SAA.

The reasons for settlements being made at different penalty levels were explained by the Commission on a case-by-case basis in the Tribunal hearings motivating their confirmation. Discounting of settlement penalties to below six per cent has reflected meaningful co-operation, including proactive early settlement. These cartels had all generally run for several years at least and were of relatively tight-knit groups of firms for whom this had become a norm in the way of doing business. Assessing what the competitive counterfactual would have been was nigh impossible. The pragmatic approach reflected considerable uncertainty about the penalties that would be imposed by the Tribunal and higher courts for this conduct. At the same time there was a need to deal with the far-reaching collusive conduct, apparently almost a norm in many sectors such as construction products.

After the Tribunal and CAC decisions in *Pioneer* and *SPC* the decisions of the Tribunal in the wire mesh, plastic pipes and mining roof bolts cases have set out a coherent approach that, while taking the narrower affected turnover, applies a high base percentage and multiplier for duration to this. The Commission's approach to settlement could provide clear expectations as to the discounts off the expected penalties, with substantial discounts to incentivise early co-operation that assists in the prosecution of the remaining members (along the same lines as leniency). Importantly, there should be a progression towards higher penalties through the settlement process given a move by the Tribunal towards harsher penalties as well. A misalignment in the approached of the Commission and the Tribunal will undermine deterrence.

Lastly, we note also that there are coordinated arrangements which do not fit clearly into the characterisation of secret cartel agreements while nevertheless falling foul of s4(1)(b). Several of these arrangements are a legacy of extensively regulated markets. This warrants a somewhat different approach, which has been reflected in lower percentage penalties.

Appendix Table A: Profile of Competition Commission settlements (1999-2012)

PENALTY	CARTEL	FIRM	FACTORS	SPECIAL TURNOVER	DATE	CLP?
0-2.9%	health	UDIPA	non-secret		2007	no
	health	BHF	non-secret		2005	no
	health	SAMA	non-secret		2004	no
	health	HASA	non-secret		2004	no
	export	USA Citrus Alliance	efficiency benefits, export cartel, effects in the US		2005	no
	property	IEASA	non-secret, cooperation		2004	no
	health	SAOPA	unique circumstances		2007	no
	airlines	SAA & SA Express	conduct ceased after initiation	joint turnover	2006	yes
	airlines	SAA	cooperation, conduct had ceased		2006	no
	airlines	Deutsche Lufthansa	cooperation, conduct had ceased	SA turnover	2006	no
	milk	Lancewood	small player, factual & legal position different, financial position		2009	yes
	boilers	Zip Heaters	distribution agreement terms		2007	no
	fasteners	CBC Fasteners	sale agreement terms		2007	no
	fasteners	Nedschroef	sale agreement terms		2007	no
	polymers	Safripol	agreement from competition board compliance, smaller player		2010	no
	bitumen	SABITA	industry association	annual sponsor/membership fees	2011	yes
	airlines	SAA	early cooperation	inbound & outbound route revenue	2012	no
SUMMARY			non-secret, cooperation, unique circumstances			
3-4.9%	property	Liberty Group	contravention in contractual agreement	property portfolio revenue	2011	yes
	milling	Keystone Milling	small player, short duration, cooperation	total turnover	2010	yes
	polymers	SCI Polymers	contravention arose from merger remedy agreement w/ competition board, cooperation, leader	polymers turnover	2011	no
	grain trading	Rand Merchant Bank	prior-referral, cooperation	grain affected by agreement	2011	no
	grain trading	NWK Limited	prior-referral, cooperation	grain affected by agreement	2011	no
	grain storage	Agri Operations	not wholly secret	grain silo storage turnover	2011	no
	grain storage	Kaap Agri Bedryf	not wholly secret	grain silo storage turnover	2011	no
	grain storage	Tuinroete Agri	not wholly secret	grain silo storage turnover	2011	no
	grain storage	Grain Silo Industry	industry association	membership fees	2011	no
	grain storage	GWK Limited	not wholly secret	grain silo storage turnover	2011	no
	grain storage	MGK Bedryfsmaatskappy	not wholly secret	grain silo storage turnover	2011	no
	grain storage	Moorreeburgse Koringboere	not wholly secret	wheat daily storage tariff silo turnover	2011	no
	grain storage	NTK Limpopo Agric Beperk	not wholly secret	grain silo storage turnover	2011	no
	grain storage	NWK Limited	not wholly secret	grain silo storage turnover	2011	no
	grain storage	Overberg Agri Bedrywe	not wholly secret	wheat daily storage tariff silo turnover	2011	no
	grain storage	OVK Operations Limited	not wholly secret	grain silo storage turnover	2011	no
	grain storage	Sentraal-Suid Co-operative	not wholly secret	wheat daily storage tariff silo turnover	2011	no
	grain storage	Senwes Limited	not wholly secret	grain silo storage turnover	2011	no
	grain storage	Suidwes Agriculture	not wholly secret	grain silo storage turnover	2011	no
	grain storage	Vrystaat Koöperasie Beperk	not wholly secret	grain silo storage turnover	2011	no
	cement	AfriSam SA	prior-referral, cooperation	all cement turnover in SACU	2011	yes
	tyres	Apollo Tyres SA	post-referral, cooperation - change of ownership, financial position	affected turnover	2011	yes
SUMMARY			not wholly secret, cooperation, contravention through contractual arrangement			

PENALTY	CARTEL	FIRM	FACTORS	SPECIAL TURNOVER	DATE	CLP?
5-6.9%	bread,milling	Tiger Consumer Brands	prior-referral, multi case settlement, cooperation, long duration, extent of conduct	national bread turnover	2007	yes
	milling	Carolina Rollermeule	post-referral, small player, cooperation but no new info	total turnover	2011	yes
	medical	Thusanong Healthcare	post-referral, short duration, unique circumstances	all operations	2009	yes
	medical	Dismed Criticare	post-referral, longer duration, smaller player	all operations	2009	yes
	scrap metal	National Scrap Metals	post-referral, consistency with other fines, late cooperation, limited involvement	total turnover	2010	no
	scrap metal	Power Metal Recyclers	post-referral, consistency with other fines	total turnover	2010	no
	scrap metal	New Reclamation Group	prior-referral, ring leader, cooperation	affected market turnover	2008	no
	scrap metal	Universal Recycling	post-referral, consistency with other fines	URC & SteelCo	2010	no
	scrap metal	Abeddack Metals	post-referral, consistency with other fines	total non-ferrous	2010	no
	scrap metal	Amalgamated Metals	post-referral, consistency with other fines	total non-ferrous	2010	no
	plastic pipe	Marley Pipe Systems	post-referral, limited duration	turnover less unaffected products	2010	yes
	plastic pipe	Flotek Pipes Irrigation	post-referral, consistency with other fines, limited duration, poor cooperation	total turnover	2010	yes
	plastic pipe	Swan Plastics CC	post-referral, consistency with other fines, late cooperation	total turnover	2010	yes
	bread	Foodcorp	post-referral, cooperation, multi case, late settlement	baking operations	2009	no
	concrete pipe	Cobro Concrete	post-referral, unique circumstances, cooperation		2010	yes
	bitumen	Masana Petroleum	prior-referral	black fuels	2010	yes
	roof bolts	Aveng (Africa) - Duraset	prior-referral, duration of cartel, withdrew themselves from cartel	only Duraset	2010	yes
	fish	Oceana Group (& Brands)	prior-referral, cooperation	pelagic fish operations in SA	2012	yes
	freight service	Schenker SA	prior-referral, cooperation, conduct mainly by international holding company	turnover from affected routes	2012	yes
	freight service	Kuehne + Nagel	prior-referral, conduct mainly by international holding company	turnover from affected routes	2012	yes
	bitumen	Engen Petroleum	post-referral	bitumen	2012	yes
	bitumen	Shell South Africa Marketing	post-referral, cooperation	bitumen	2012	yes
	cement	Lafarge Industries SA	prior-referral, cooperation (less information than AfriSam)	all cement turnover in SACU	2012	yes
	tyre retail	Maxiprest	post-referral, cooperation	specific product lines in Gauteng	2012	yes
SUMMARY			post-referral, consistency with other fines, duration, unique circumstances			
7-9%	soda ash	ANSAC	post-referral, non-secret, lack of cooperation, very late settlement	soda ash turnover in SA	2008	no
	medical	Adcock Ingram (Tiger Brands)	post-referral, lack of cooperation, extent of conduct	only Adcock operations	2008	yes
	fertilizer	SCI Sasol Nitro	post-referral, multi case settlement, late cooperation	SCI Nitro excl. unaffected products	2009	no
	concrete pipe	Concrete Units	post-referral, late cooperation, smaller player	turnover excl. WC2010 JV project	2010	yes
	concrete pipe	Cape Concrete Works	post-referral, late cooperation, smaller player	turnover excl. WC2010 JV project	2010	yes
	concrete pipe	Aveng (Africa) - Infraset	post-referral, ring leader, lack of cooperation	turnover excl. paving products	2009	yes
	mesh,rebar	Aveng (Africa) - Steeledale	post-referral, repeat contravention by Aveng, ring leader, multi case	only Steeledale not Aveng	2011	yes
	milling	Pioneer Foods	post-referral, multi case settlement	Sasko grain excl. baking & Africa	2010	yes
	airlines	Singapore Airlines	cooperation, duration	passenger turnover booked in SA	2012	yes
SUMMARY			poor cooperation, ring leader, multi case, extent of conduct			

Source: Competition Commission and www.comptrib.co.za