Forum

The TPA and world's best practice: proposals for criminal penalties for hard-core collusion

Following is the edited text of a speech given by Commission Chairman, Professor Allan Fels, to the Australian Institute of Criminology on 2 September 2002.

The ACCC has proposed that the Trade Practices Act be amended to introduce criminal sanctions for the most serious contraventions of the competition provisions of Part IV: hard-core cartels. Individual executives and employees found to have been personally involved in hard-core collusion with a competitor would become liable for criminal penalties, including imprisonment.

What is hard-core cartel conduct?

Hard-core collusion is secret price fixing, bid rigging, market sharing and output restrictions. Hard-core cartels are secret, hard to detect and allow participating firms to corrupt the normal competitive process. Without the benefit of competition, consumers will pay higher prices for lower quality. Those engaging in collusion will line their pockets with higher profits.

Cartel agreements are currently illegal. Parliament recognises such agreements as a special category. They are so unlikely to have any pro-competitive benefits that they are generally illegal per se, that is, there is no need to show the purpose or effect of the arrangement is anti-competitive.

Why are criminal sanction warranted?

Six justifications for criminal sanctions for hard-core cartels are discussed below.

1. *A form of theft, like fraud similar to corporate crimes that attract criminal sentences.*

Cartel conduct is akin to fraud and should be treated as such: criminally. It is morally reprehensible. Let me give you two case examples to demonstrate the point.

In the 1994 NSW Haymarket case, the four tenderers for a Commonwealth Government funded project agreed that the successful tenderer would pay each of its three competitors an 'unsuccessful tenderer's fee' of $750 000. The Federal Court found it was likely these fees were passed on and that the Commonwealth paid $2.25 million more than it should have for this project. This is not simply a problem of economic regulation, this conduct was comparable to fraud.

The TNT/Mayne Nickless/Ansett express freight cartel comprised three of Australia's major transport companies and their senior executives who colluded to fix prices and share the Australian express freight market. They did this for about 20 years. Among other things, the participants agreed not to approach each other's customers. Sometimes, when a customer decided to change to a new freight carrier, valuable freight was lost or damaged deliberately to encourage that customer to return to their original carrier. This is surely criminal by any standards. Justice Burchett referred to this conduct as 'particularly pernicious'.

One must ask the question: is it fair that executives engaging in such conduct are not subject to criminal sanctions?

The companies in the freight cartel caused huge losses to society. They controlled and distorted commerce estimated to be worth more than $1 billion annually.

It is a crime for a person who conspires to cheat the social security system of some tens of thousands of dollars but a price-rigging or bid-ridding executive who may cause the community to lose tens of millions of dollars will be liable for a civil penalty only.

Individuals engaging in serious hard-core cartel conduct should only be exempted from criminal liability and potentially being sent to jail on principled grounds.

Criminal law in this country singles out children and the insane as exempt from criminal liability.

It should not, and should not be seen to, make any exemptions for senior executives or others of high standing in the community. The law must be blind to the colour of your collar.

In a recent judgment in the transformers matter, Finkelstein J stated:

> Generally the corporate agent is a top executive, who has an unblemished reputation, and in all other respects is a pillar of the community. These people often do not see antitrust violations as law breaking, and certainly not conduct that involves turpitude, ... There are, however, important matters of which the sentencing judge should not lose sight. The first is the gravity of an antitrust contravention. It is not unusual for anti-trust violations to involve far greater sums than those that may be taken by the thieves and fraudsters, and the violations can have a far greater impact upon the welfare of society... Secondly, there is a great danger of allowing too great an emphasis to be placed on the 'respectability' of the offender and insufficient attention being given to the character of the offence. It is easy to forget that these individuals have a clear option whether or not to engage in unlawful activity, and have made the choice to do so.

Tax cheats may be subject to criminal liability, depending upon the seriousness of their offence. Similarly, those who manipulate stock markets may, upon conviction, be imprisoned. Why should executives who dishonestly collude to the detriment of their customers be treated any differently?

I believe there is no difference in principle. I believe that equity demands that individuals engaging in this conduct at least be liable for a criminal penalty.

Interestingly, the tax and social security examples I have given attract a range of sanctions, from the administrative through to civil and criminal sanctions, depending upon the seriousness of the conduct. The Commission proposes that the more serious and harmful cartels be treated as criminal but that existing civil remedies remain in place. Civil remedies would continue to apply to minor forms of collusion or to those for which the Commission is unable to obtain sufficient evidence for the DPP to prove conduct to the criminal 'beyond reasonable doubt' standard. Criminal sanctions would top up the existing regime and apply to a minority of cases.

2. *Given the existing level of civil penalties, it is anomalous that criminal sanctions do not already apply to cartel conduct.*

Parliament clearly regards cartel conduct seriously. The existing penalty of $500 000 for individuals is more than twice that for other white-collar crimes for which offenders are liable to be imprisoned. For example, insider trading and market manipulation, both criminal offences under the *Corporations Act 2001*, attract jail terms and carry maximum fines of $220 000 and $22 000 respectively.

Similarly, under the Commonwealth Criminal Code the offences of theft, conspiracy to defraud and corruption carry maximum jail terms of 10 years. Yet the maximum fine for each of these is only $66 000.

Objectively assessing the nature and effects of hard-core collusion, and comparing it with other corporate crimes, makes it clear that it is inappropriate for Australia's enforcement regime to be based purely on civil remedies.

3. *Incentives to form cartels are so great that a significant deterrent is essential.*

The OECD, which is comprised of the 30 leading market economies that produce two-thirds of the world's goods and services, has labelled hard-core cartels the most 'egregious violations of competition law' and has called for stronger sanctions against cartel participants to improve deterrence. In 1998 the OECD Ministerial Council Concerning Effective Action Against Hard Core Cartels unanimously recommended that OECD members provide for '... effective sanctions, of a kind and at a level adequate to deter firms and individuals from participating in cartels'.

The OECD has estimated that the total value of commerce affected by a sample of 16 large cartels was more than US$55 billion. For some, prices were as much as 50 per cent above the competitive price.

The OECD estimates the value of commerce affected by cartel conduct worldwide is many billions of dollars each year. Reports from several overseas jurisdictions about cartel investigations confirm that despite heavy penalties national and international cartels continue to flourish. This is largely because cartels are potentially so highly profitable.

The Commission wants Australian penalties that will effectively deter international corporations engaging in cartels here.

In April 2002 the *Financial Times* carried a report suggesting that there is an 'extraordinary' level of illegal price fixing and market sharing behaviour in the UK and that one cartel a month is uncovered by the Office of Fair Trading. Also reported that day was an allegation of price fixing among six UK drug companies supplying penicillin-based antibiotics and the heart drug warfarin. This conduct is estimated unofficially to have cost the National Health Service up to £400 million (A$1118 million).

Australia is not immune to this conduct. The Commission, in the six years to 2001, received 2426 cartel and price fixing complaints and conducted 400 investigations. It is currently investigating 20–25 cases that would be classified as potentially relating to hard-core cartels if they were found to include illegal conduct. From past experience, this is likely to result in four or five court cases.

Cartels have affected the Australian economy in the following ways:

- The participants in the express freight cartel, Mayne Nickless, TNT and Ansett were estimated to hold 90 per cent of a market estimated to be between $1 billion and $2 billion dollars per year. The agreement operated from the 1970s until the early 1990s.
- Between 1989 and 1994 the participants in the Queensland pre-mixed concrete cartel accounted for the sale of $1.1 billion worth of concrete.
- Market sharing and price fixing by the principal manufacturers and suppliers of electricity distribution and power transformers in Australia, a case which is still before the courts for the setting of penalties, is estimated to have affected commerce worth more than $360 million.

Individual managers and executives do benefit from cartels. There are bonuses, promotions and the increased value of share options.

There is little evidence that large pecuniary fines or penalties hurt individuals. It is difficult to ensure that such penalties are not paid by the employer. And companies cannot be prevented from paying bonuses subsequently, in effect indemnifying individuals.

Indeed, there is much anecdotal evidence that the business careers of those participating in cartels flourish even after they have admitted, or a court has found, that they have contravened the law. Several of the most culpable executives in a recent cartel appear to have won significant promotions after they had admitted wrong-doing.

A criminal penalty has personal implications against which the company cannot indemnify an employee. A person will have a criminal record and may lose their liberty.

For companies a pecuniary penalty is just the cost of doing business. Society imposes a penalty, or taxes for anti-social conduct such as late payment of tax, speeding or parking illegally. Companies weigh up the cost of paying a penalty for such offences and may calculate that the benefits are worth the risk. Companies may be tempted to see pecuniary penalties for engaging in cartel conduct as just another tax on a minor misdemeanour. However, cartels should not be in the category of taxable conduct. They are abhorrent and criminal sanctions should underscore this point.

The Commission believes that the pecuniary penalties are not a sufficient deterrent to 'hard-core' collusion by big business. The Commission's experience prosecuting cartels over the past decade bears out my point.

Before 1993 the pecuniary penalties for breaches of the Trade Practices Act were low. The maximum penalty per offence was $250 000 for a corporation and $50 000 for an individual. Moreover, in no case until then had the total penalty exceeded $250 000.

In 1993 the penalty was increased to a maximum of $10 million for a corporation for an offence and to $500 000 for an individual.

Shortly afterwards in early 1995 penalties of around $15 million were imposed on TNT, Ansett Freight Express and Mayne Nickless for conduct which occurred under the previous penalty regime (of $250 000 maximum).

It could be argued that since 1993 penalties have risen enough to deter hard-core collusion.

Fines of $21 million dollars were applied in 1995 under the new penalty regime to Boral, CSR and Pioneer for price fixing for ready mixed concrete in south-eastern Queensland.

It is now clear that the new fines, although having had a significant effect, are still not sufficient. There have been many price fixing cases since then including the following:

- Australian executives participated in the international vitamin price fixing cartel well after 1993. Fines of around $26 million were imposed by the Federal court on the companies and executives.

- There has been extensive price fixing in the power transformers industry. Fines of $20 million have already been collected and the case has not yet concluded. The behaviour persisted until 1999, after the period of high fines.
- The Queensland fire protection cartel of 56 companies and individuals, almost the entire fire alarm and sprinkler installation industry in Brisbane, operated for 10 years until 1997. It only ceased operating when it was detected by the Commission.
- In 1994 the Federal Court imposed a penalty on Simsmetal, the largest scrap metal recycler in Australia, for engaging in price fixing in Victoria. Less than a year later the South Australian arm of the company attempted to bully a small competitor into a market sharing arrangement.
- Perhaps the most vivid demonstration of the inadequacy of the pecuniary penalties on their own, is that of J McPhee and Son. In that case, the company attempted to enter a price fixing arrangement in the freight industry. The company was a subsidiary of TNT, which only months previously had been penalised $4.1 million for collusion in the same industry over many years.

4. *An optimal pecuniary penalty would threaten the viability of a firm.*

There is evidence that cartels are so profitable and difficult to detect it may be impossible to set a pecuniary penalty at a level adequate to deter collusion without threatening the very existence of offending firms.

Let me look first at the purpose of sanctions under the Trade Practices Act. Society imposes pecuniary penalties on individuals and firms found to have participated in cartels mainly to deter the participants and others from engaging in such conduct in the future. The general deterrent effect (the deterrence of others) of enforcement is critical because it is impossible to monitor all businesses and because it is difficult to detect and successfully prosecute violations. This is especially true for clandestine cartel conduct.

Australian case law supports the primacy of deterrence in the Act's penalties but it is being increasingly recognised that penalties may also be punitive.

Eleven years ago, in *TPC v CSR Ltd*, French J found that retribution, rehabilitation and compensation had no part to play in economic regulation of the kind contemplated by Part IV. His Honour considered that the principal and probably the only object of civil pecuniary penalties for violation of Part IV is specific and general deterrence.

This view was also expressed by the Full Court in *NW Frozen Foods v ACCC*, when the majority confirmed that the object of the civil penalty regime under the Act is deterrence. The court stated that 'the penalties imposed by s. 76 are, '... not criminal sanctions, and their purpose, established now by a long line of cases, is not punishment'. However, Carr J disagreed with this proposition and held that the earlier cases 'have not ruled out or excluded punishment as one of the purposes of s. 76'.

Later decisions have reinforced Carr J's comments. Heerey J in the McPhee case found that while deterrence remained a key objective when imposing penalties, the civil penalty regime also imported concepts of moral responsibility well known to the criminal law. Goldberg J in *ACCC v Australian Safeway Stores Pty Ltd*, while following the Full Court in the NW Frozen Foods case also had difficulty with the proposition that imposing a penalty for a contravention of Part IV should not be seen as a form of punishment.

I would like to point out that whatever the truth of the position, the strongest reason for the view that the Act's object is deterrence is that only civil penalties currently apply. There is no reason in principle for this limitation.

In the US, general deterrence and retribution are both relevant goals of sanctions, with general deterrence being by far the most important.

For a pecuniary penalty to be effective, any sanction must be perceived to outweigh the potential gains from participating in a cartel. As I have already described, gains from cartel conduct can be massive. They can be so large that penalties would have to be impossibly high to be effective as deterrents.

Penalties would become so large they would jeopardise the financial viability of offending corporations. For instance in the recent electricity transformer case, AW Tyree Transformers Pty Limited was penalised for price fixing. Even though in setting the penalty the court took into account the business's financial position, the company has since entered voluntary administration; reportedly in part because of the size of the penalty.

Even if a company does survive, penalties will often ultimately end up being passed on to the

consumer in the form of higher prices. In addition, they punish innocent parties such as employees, shareholders and creditors.

Imposing sanctions on individuals involved in a breach, as opposed to companies, will not affect innocent parties.

Let me explain just how high pecuniary penalties would need to be to deter cartel conduct.

A recent article by W. Wils[1] summarises a body of academic work which states that for a penalty to be a deterrent it must exceed the gain anticipated from conduct divided by the risk of detection and seeks to quantify both of these variables, risk of detection and gain:

- The articles estimate the risk of detection at between 13 per cent and 17 per cent. That is, only one in six or seven cartels is detected.
- In relation to gain, the studies estimate that:
  - the average length of a cartel was six years
  - prices of affected commodities increase by at least 10 per cent.

It was calculated that the optimal fine was 187 per cent of the commerce affected by the cartel. This would have bankrupted more than 60 per cent of the firms convicted of cartel conduct in the US in the relevant period.

Let me give one example. It has been estimated that the total value worldwide of the commerce affected by the international vitamin cartel was about $20 billion. Conservative estimates would imply a total gain to the three participants in that cartel of $1–2 billion. Once the risks of detection are factored into the calculation, the optimal penalty is $6–14 billion. Taking into account penalties worldwide and civil damages the participants have paid out about $2 billion. Executives have gone to jail in the US for this cartel, but based on the penalties alone, you would have to ask whether the companies thought their participation was worth it.

It is unrealistic to expect that optimal pecuniary penalties would ever be imposed by courts. In the circumstances there is good reason to introduce criminal sanctions so the Trade Practices Act provides adequate deterrence

5. *The fear of possible jail sentences is a far more effective deterrent.*

There is nothing so effective at focusing the mind of an executive than the possibility that their conduct will land them in jail.

Although criminal sanctions and higher penalties in the US or the EU have not prevented corporations or individuals from engaging in hard-core cartel conduct there is a growing consensus that criminal sanctions are more effective deterrents and appropriate in the case of cartels. For instance:

- the UK Government concluded that introducing criminal sanctions would be a more effective deterrent for those involved in cartel conduct
- in the US, the Director of Criminal Enforcement of the Anti-trust Division of the Department of Justice has stated that:

  > There is no greater deterrent to the commission of cartel activity than the risk of imprisonment for corporate officials. Corporate fines alone are simply not sufficient to deter many would-be offenders. For example, in some cartels, such as the graphite electrode cartel, individuals personally pocketed millions of dollars as a direct result of their criminal activity. The corporate fine alone, no matter how punitive, is unlikely to deter such individuals.

- in a paper delivered in June 2001 Finkelstein J said that criminal sanctions, with the possibility of imprisonment for managers, would have a significant effect in reducing anti-trust violations.
- Sweden has proposed to criminalise cartel conduct.

The need for criminal sanctions is subject to active debate in the EU. I believe it is inevitable that criminal sanctions will be introduced in Australia. I hope it is sooner rather than later. The current review offers an important opportunity to consider the issue.

Let me quote to you what James Griffin, the Deputy Assistant Attorney General of the US Department of Justice Anti-trust Division said on a recent trip to Australia when discussing the deterrent effect of jail sentences. He said that he was unaware of any studies that quantified the general deterrent value of imprisonment in cartel cases but indicated that it was generally accepted in the US that jail terms do deter. He went on to say:

1 Wouter Wils, 'Does the effective enforcement of Articles and 81 and 82 EC require not only fines on undertakings but also individual penalties, in particular imprisonment?' This paper refers to other work by J Bentham, 'An introduction to the principles of morals and legislation', and Werden and Simon, 'Why price fixers should go to prison', *The Anti-trust Bulletin* at 917, 1987.

Of course, it is not possible to quantify the undetected, i.e., cartel behaviour that does not occur because it is deterred by the perceived risk of incarceration. However, it seems clear that when the risk of gaol is introduced into the equation, the conventional businessman's risk/reward analysis breaks down, and it is that breakdown which is critical to the effective deterrent of anti-trust crime.

To illustrate the impact of imprisonment as a deterrent, James Griffin used two anecdotes.

- In 25 years experience prosecuting individuals engaged in cartels he had listened to many accused say they would gladly pay a higher fine to avoid imprisonment but he had never once heard anyone offer to spend a few extra days in jail in exchange for a lower fine recommendation.
- He told of a senior executive, who was committed to complying with anti-trust laws and who explained that: 'so long as you are only talking about money, the company can at the end of the day take care of me—when you talk about taking away my liberty, there is nothing that the company can do for me'.

It is sometimes said that criminal penalties are inappropriate because they will overdeter and cause business to be overcautious or discourage innovative and pro-competitive arrangements. I cannot accept this in the context of hard-core cartel conduct. Secret deals between competitors are understood to be illegal per se.

6. *Australian law must remain in step with our major trading partners.*

Criminal sanctions are international best practice. It is desirable that Australia follows many of our trading partners down the path of criminalising this most harmful and fraudulent of anti-competitive conduct. Australia must not fall behind; it must not be seen as a soft target.

We should join the United States, Canada, Japan, Korea, and now Britain and some other parts of the world, in having criminal sanctions for collusion.

The ACCC proposal in brief

Safeguards

The Commission notes that there would be significant safeguards to ensure individuals were not inappropriately convicted of a criminal offence.

- It would be necessary to prove the elements of the offence beyond reasonable doubt.
- The Director of Public Prosecutions would prosecute criminal cartel conduct.
- Accused persons would be entitled to a trial by jury.
- The jury verdict would need to be unanimous.
- The judge would have discretion as to whether or not a jail sentence, as opposed to other sanctions, such as a fine, be imposed.
- Parties to an innocent agreement could have the agreement authorised.
- Agreements under which all parties are related, or that amount to exclusive dealing under s. 47 or retail price maintenance under s. 48, would be exempt.

Concurrent operation of civil and criminal offence provisions

As I have already noted, the new criminal offences for cartel conduct would operate concurrently with existing civil remedies under the Trade Practices Act.

However, the sections of the Act that prohibit cartel conduct, also prohibit other less reprehensible conduct. Therefore the Commission proposes that new stand-alone criminal sanctions be introduced into the Act that apply only to hard-core collusion.

Cooperation with the DPP

The Commission would need to assess alleged contraventions of the cartel provisions to determine:

- if they satisfy the elements of the criminal offence
- the period of the conduct
- if there is enough evidence to bring a criminal prosecution
- if particular cases should be investigated and prosecuted as criminal offences or as civil offences.

The Commission would need to consult regularly with the DPP and the DPP would have the power to reject a matter referred to it by the Commission, or ask that a matter be referred.

A relationship of this nature between the DPP and enforcement agencies is not uncommon. It currently exists for taxation, customs, social security and corporations law offences.

Conclusion

The possibility of criminal sanctions should not concern most business leaders in Australia. Secret,

unlawful collusion of a major kind is not practiced by most Australian businesses. Most regard price fixing as abhorrent. When it occurs, however, it is harmful, and business is usually the first victim of collusion. I will continue to push strongly for the introduction of criminal sanctions to fight this insidious and highly damaging conduct.

Building a modern Trade Practices Act: a trans-Tasman analysis

Following is the edited text of the first part of a speech given by Commission Chairman, Professor Allan Fels, to the New Zealand Institute of Economic Research on 18 September 2002.

The second part was an outline of the Commission's views on the review of the Trade Practices Act and on relations between the Commission and the media. These can be read in the previous article in this journal and in ones in ACCC Journal *no. 40.*

In examining our competition experience it seems clear that each of our countries has gained from the experience of the other. Our respective law has progressed, if not in perfect harmony, then in the same general direction and with the same general intent.

The key message, I think, is that competition law in both Australia and New Zealand should not be thought immutable.

Competition law in Australia and New Zealand

Economic and commercial ties between our two countries reach back to the days of colonial settlement. Formal relationships, however, and a more integrated approach to market development were given impetus in 1965 with the signing of the New Zealand/Australia Free Trade Agreement and the Australia–New Zealand Closer Economic Relations Free Trade Agreement of 1983.[2]

Since 1983 the legislative paths of competition law in New Zealand and Australia have been similar but not identical. As well, as Maureen Brunt has commented, a distinctive New Zealand–Australia case law has also been evolving.[3]

Before 1970 formal trade practices legislation based on a model imported from the United Kingdom was enacted in both countries. New Zealand led the way with the *Trade Practices Act 1958*, and Australia followed with the *Trade Practices Act 1965*.

Australia then introduced the *Trade Practices Act 1974*, which marked a substantial departure from the existing legislation.

New Zealand followed less radically with the *Commerce Act 1975*, only to introduce its major body of competition law, the Commerce Act, in 1986. Framed on the Trade Practices Act, the *Commerce Act 1986* benefited from 12 years of Australian experience and improved on the original Australian legislation.

It is a general principle that where markets and competition policy lead competition law tends to follow.

New Zealand acted to deregulate and privatise industries and utilities in advance of both the Commonwealth and state governments in Australia. This is the unitary structure of the New Zealand polity. Australia is a federation with the Australian Constitution conferring substantial but not comprehensive powers over economic behaviour on the federal government. This means that federal and state governments must cooperate on national policies such as competition policy.

In moving to implement a comprehensive competition policy in the 1990s, which culminated in the so-called Hilmer reforms, Australian policymakers and legislators addressed issues dealing with:

- the extension of competition law to non-incorporated entities and the professions
- the development, between federal and state governments, of a competition principles agreement by which public monopolies were to be reformed, and access regimes to services were to be established.

In part, we observed and benefited from the competition experience of New Zealand, and the application of court-based remedies that resulted from the s. 36 framework. For example, in 1995, the Australian Parliament introduced a specific and formal legislative regime that provides for access to network industries and natural monopoly infrastructure in Part IIIA.

[2] D. White, 'Cross Tasman trade in competition law: convergence or divergence', in: *Trade Practices Act—A Twenty Five Year Stocktake*, F. Hanks, and P. Williams, (eds), The Federation Press, 2001.

[3] M. Brunt, 'Australia and New Zealand competition Law and policy', in: *International Antitrust Law and Policy*, B. Hawk, (ed.), Annual Proceedings of the Fordham Corporate Law Institute (New York, Transnational Juris Publications, Inc., p. 135, 1993).