

The dichotomy between the penalty regime in competition law and the firm's ability to pay: South Africa's experience.

Londiwe Senona¹

Introduction

The latest global economic downturn and its concomitant financial crisis and economic recession were perhaps the worst economic crisis since the Great Depression of the 1930s. An interesting yet peculiar characteristic about such far-reaching phenomenon is that they more often than not act as change agents and catalyst for new approaches; precisely because of their ability to expose small and sometimes big gaps and shortcomings in economic policy orientation of a nation. No doubt the South African competition policy arena was also tested. And while it proved itself to be intact and relevant to thwart any disturbances to the fair competition atmosphere, it has exposed some gaps. As the title of the article alludes, a long standing hitherto dormant dichotomy between the penalty regime in competition law and the firms' ability to pay such fines; was placed in sharp focus as firms felt the brunt of the recession.

High administrative penalties imposed against firms found to be on the wrong side of competition law are part of a regiment geared towards ensuring fair, transparent, and efficient markets. Yet in certain border line cases, such penalties may arguably be a threat to a firm's ability to compete or continue conducting its business. No doubt the recent financial crises, followed by global economic recession produced a number of casualties; among others squeezing many firms' expected profit margins, and consequently, affecting some firms' ability to pay their administrative penalties.

The recession brought to the fore an interesting concern; having to do with a broader lacunae in South African competition law relating to how the authorities deal with a situation in which, subsequent to signing a consent order, a firm suddenly faces an unforeseen event that leads it to being unable to pay the administrative penalty, such that short of a reprieve, the firm would be forced out of business. This article will explore and analyze this seemingly scant area of competition law in South Africa by firstly, assessing South Africa's policy of imposing high fines, secondly critically evaluating the status quo in relation to the consideration of the firms' inability to pay when imposing fines, and thirdly setting out the policy positions of jurisdictions such as the United States and the European Union where claims of inability to pay fines have become more prevalent in the light of higher fines being imposed, including in context of the ongoing economic crisis.

The article ultimately concludes by calling for the South African competition authorities to adopt guidelines which strike a proper balance between the continued and necessary trend of imposing high fines for cartel activity, and the particular firms' ultimate ability to pay the penalty;

¹ The author is a Case Manager at the Competition Tribunal of South Africa writing her in personal capacity. Views expressed in the article are those of the author and do not reflect or represent those of the Tribunal.

particularly where such enforced punitive payments may or will demonstrably result in the firm being driven out of business or rendered less competitive. After all, it must be recognized that the legislature's objective for meting out maximum fines, was to ensure that anticompetitive conduct is rooted out for the sole purpose of promoting a conducive competition environment necessary for firms to succeed and for economic development and growth to be spurred. Consequently, fines imposed such that they threaten the economic viability of firms would run contrary to the aim of the Competition Act. As a matter of course therefore, the Competition Commission's and Tribunal's strive for a harsh policy against contravening behavior, should equally ensure firms' continued contribution to market efficiency.

South Africa's policy of harsh fines

The Competition Tribunal has in *Commission v Federal Mogul [2003] ZACT 43 (CT)* emphasized that the upper threshold of 10% of the firm's turnover should be unreservedly imposed against firms involved in the most egregious contraventions of the Act; where no mitigating factors exist. No doubt, deterrence by imposition of heavy fines is a fundamental element to any competition law regime if it is to successfully achieve efficiency in markets and promote fair competition. In fact, by far and large praxis, posits that under-deterrence, which specifically occurs when fines are not heavy enough, is likely to create an incentive for firms to engage in anti-competitive conduct, in particular cartel conduct.

Seemingly following this ideological and practical orientation, the South African competition authorities have thus far strived for the adoption of a rigorous fining policy, which is focused on effectively prosecuting cartel conduct. Accordingly, firms found to be on the wrong side of competition law are not only visited by huge fines, but are made to feel the present and future pinch of paying such fines. This is to ensure that the firms which have profited from the anti-competitive activity should be held accountable not only for the prevailing contraventions of the Act that have been discovered, but also for preventing or deterring future contraventions of the Act. No doubt such a policy approach is consonant with international standards aimed at achieving effective deterrence.

The recent case between the *Commission and Pioneer Foods (15/CR/Feb07)* saw the Commission recommending the imposition of what may be said to be an unsympathetic fine amounting to the maximum 10% of the total turnover of Pioneer, despite that in practice the Tribunal has calculated penalties on the basis of affected turnover, being the threshold on the turnover in the infringing line of business only. It goes without saying that a fine which is based on overall turnover would be substantially higher than that which is only based on affected turnover. For example in the Pioneer case the fine imposed by the Tribunal against Pioneer for its participation in the bread cartel was 10% of the turnover of the affected business (i.e. Pioneer's bread baking division), which amounted to approximately R196 million, and the Commission's appeal which seeks the fine to be based on total turnover will effectively mean that Pioneer ends up coughing up more than R1.5 billion fine. The Commission's approach in this case is that a turnover based on the firm's affected turnover, particularly in the circumstance of this case, results in under deterrence of cartel conduct. Such an approach is logical, in particular if contextualized within the Commission's enforcement strategy which seeks to prioritize, among others, the food sector which impacts particularly, the poor population in South Africa.

Though the Tribunal has not, in the past awarded a penalty based on a firm's total turnover, the decision in *Federal Mogul* made it clear that there is no bar on the Tribunal to do so. Further, in the *Pioneer* decision, the Tribunal made it clear that the assessment of appropriate turnover will depend on the factual matrix of the case. In light of this the Tribunal noted that it would consider a penalty based on the total annual turnover of a firm [which is not precluded by the Competition Act] in circumstances where a "*firm's monopolisation efforts through anti-competitive conduct in one product market conferred or tended to confer onto it some leverage in another product market which it otherwise would not have had*". The Tribunal also emphasized that hard core cartel activities are considered to be the most egregious offences under the Competition Act, and absent mitigating factors, deserve the maximum penalty provided for in the Act. Hence it does not seem appropriate to generalize about the Tribunal's approach in the *Pioneer* case, as having the effect of under-deterrence.

Juxtaposing the recent developments with the past, it is clear that fines are becoming heavier and heavier particularly as the anti-competitive behavior become ever more egregious; with firms willing to go as far as they can to maintain their competitive edge. It is foreseeable, given the dynamics of competition law, both from the perspective of complex and more egregious anticompetitive behavior and the authorities' need to effectively deter such; that even the Tribunal may in the near future met out fines based on total turnover. As the trend of imposing heavier fines in the name of deterrence increases however, a corollary scenario, and possibly a new area for competition theory in South Africa, to grapple with also begins to emerge: that of heavy fines, being so heavy that they not only deter bad behavior but effectively run the firms out of business or threaten to weaken their operation thereby denying the consumer who is the ultimate beneficiary of an efficient market.

In such instances, what is meant to promote fair competition as a fine now turns out to be the main threat to competitive atmosphere of the overall economy. Already, there has been much reports and debate following the Commission's appeal in the *Pioneer* case about the fine sought by the Commission. The debate centered around the fine as having the potential to break Pioneer's back, and potentially resulting in its exit from the market. No doubt this type of fine is, as seen in the *Pioneer* case, likely to raise public interest concerns. This may particularly be so during financial crisis and recessionary times; in labor intensive sectors where the threat of job losses may fuel public outcry leading to the loss of confidence by the public in the competition authorities.

This begs the question of whether or not South African competition authorities should consider the firms' ability to pay, particularly during financial crisis/recessionary times or any such circumstance, where such large penalties may simply be unaffordable. Indeed, should the competition authorities go beyond the consideration of flexible payment options to consider substantively how the punitive penalty will affect the firm's viability in the long run?

Should SA Competition Authorities consider firms' inability to pay?

In terms of the legislative prescripts, affordability of the penalty is not one of the factors that neither the Commission nor the Tribunal must consider in meting out administrative penalties. Nevertheless, it may be argued or so interpreted that the provisions setting out maximum fine levels at a certain percentage of the turnover are self regulatory in that they indirectly take the ability to pay into consideration. As in most jurisdictions, the 10% turnover maximum was considered by the lawmakers as a guarantee that the set fine would not jeopardize the firm's economic viability.

It would therefore seem incorrect to suggest that the Commission completely disregards the firms' ability to pay as a relevant factor, as this is seemingly indirectly considered. This is perhaps demonstrated in the fact that the Commission has in select cases allowed for a flexible payment plan. More so, in the recent case between the Commission and two close corporations: *Anix and Zedek (07/CR/Mar10)*, which engaged in collusive tendering in the market for the supply and delivery of animal feed to all nine South African provinces in terms of a National Treasury tender. In this case the Commission asked for smaller penalties due to the sizes of the firms and the fact that they are not hugely profitable. In so doing the Commission not only considered objectively the firms' inability to pay, but the impact a higher fine would have on the viability of these firms. Although the Commission has generally followed the sensible approach which ensures that small businesses are not disadvantaged against larger ones, the problem is that the Commission does not have a *de jure* policy which better articulates its thinking and clarifies its position on this issue. Consequently, the fact that the Commission's policy on fining is unspecific makes it unclear and sometimes inconsistent. This is compounded by the fact that there exists no case law in South Africa that has ever pronounced on the supposed interpretation that the provisions setting out maximum fine levels at a certain percentage of the turnover are self regulatory in that they indirectly take the ability to pay into consideration.

In its eleven years of its existence, the Tribunal has not yet made any definite ruling regarding a firm's inability to pay. Notwithstanding that however, evidence of the impact of the financial crisis on firms' ability to pay administrative penalties was recently considered in a peculiar application that came to the Tribunal in April this year. In terms of this application, the applicant sought a revised payment plan in relation to an administrative penalty imposed on it as a result of a consent agreement entered into with the Commission which was subsequently made an order of the Tribunal.

The background of this application is that in May 2008 the Tribunal confirmed a consent order between *New Reclamation Group and the Commission (CT Case No: 37/CR/Apr08)*, in which New Reclam was fined an amount of approximately R146 million for price fixing and market allocation for the supply of ferrous and non-ferrous scrap metal. This fine represented about 6% of New Reclam's annual turnover in the affected markets where the contravening conduct took place. In terms of the consent order such penalty was to be paid in three equal installments over the period of three years as the Applicant could not afford to pay the penalty in one lump sum and immediately, but was determined that it could sustain its operations and fund the administrative penalty over a 3 year period. However due to the global economic downturn which severely impacted New Reclam's business with the resultant pressure on its finances and a significant number of retrenchments, New Reclam struggled to settle its final installment, and subsequently brought an application to the Tribunal for a revised payment plan to pay the final installment over a number of months. New Reclam argued that if it paid the final installment in a lump sum in terms of the Tribunal's order, this would negatively affect on its profitability and would lead to even more severe consequences to its operation.

The Commission challenged this application on the basis that it undermined the very purpose of administrative penalties which is the deterrent effect. The Commission stated that if the administrative penalty is to achieve its deterrent effect, both the complying firms and those firms which have not complied with the law must be convinced that the penalty places an infringing firm in a worse position than those firms which have complied with the law.

Unlike in the *Anix and Zedek* case the Commission in this case clearly expressed that affordability of the penalty is not one of the factors which it must take into account, and that its main concern is to ensure that the fines are large enough to have a significant deterrent effect. The Commission therefore, rightly or wrongly, did not address the question of how to deal with situations where the payment of heavy fines have the potential of forcing a firm out of business, a consequence which would seem to be contrary to the very objective of the Act which is to achieve efficiency.

This type of uncertainty and lack of proper guidelines to deal with such borderline cases should be a worrying factor worthy of further consideration. Unfortunately the Tribunal did not have a chance to rule on this case as it was ultimately withdrawn. However some guidance can be drawn from other jurisdictions which have dealt with issues relating to firms' inability to pay, which could assist the Commission and Tribunal if faced with similar applications in future.

Comparative Analysis: US and EU Approach

Although a firm's inability to pay is taken into consideration in both the US and Europe, the increasing level of fines being imposed in these jurisdictions is not abating. Skeptics of the approach, however still seem to suggest that such an approach would render the deterrence effect nugatory.

The legal rationale for such a consideration is nevertheless based on the principle of proportionality as well as the economic contention that a fine cannot drive a firm out of the market thus resulting in additional harm to competition. In that regard, the effect of successful argument by a firm that it is unable to pay the imposed fine, would either be a reduction in the fine imposed or the fine being deferred and payable in installments.

In both these jurisdictions the firm's ability to pay fines influences the amount of the fine only in exceptional cases. Under US guidelines (United States Sentencing Commission Guidelines (November 2004)), a stringent test is imposed on firms seeking an inability to-pay-discount. Section 8, Part C of the Guidelines provides for the imposition of fines on firms. Section 8C3.3 is entitled "Reduction of a Fine Based on Inability to Pay" and its subsection (a) states that a "court shall reduce the fine below that otherwise required ". . . to the extent that imposition of such fine would impair its ability to make restitution to victims." Subsection (b) allows—but does not require—a court to decrease a fine below the minimum fine, "if the court finds that the organization is not able and, even with the use of a reasonable installment schedule, is not likely to become able to pay the minimum fine - *provided, that the reduction under this subsection shall not be more than necessary to avoid substantially jeopardizing the continued viability of the organization.*"

In terms of the US guideline, a firm is considered unable to pay the minimum fine if, even with an installment schedule, the payment of that fine would substantially jeopardize the continued existence of the firm. Consequently, for an entity to qualify for a reduced fine based on its inability to pay, it must prove that the payment of the fine would put its continued existence in jeopardy or affect its ability to make restitution to the victims of the crime.

Some of the cases interpreting the inability-to-pay discount in the US seems to in fact tighten the requirements further. For instance in *United States v Nathan*, 188 F. 3d 190, 213 (3d Cir. 1999) it was held that in evaluating the inability-to-pay question, "[t]he sentencing court must

take account of the corporate defendant's financial resources, putting the burden on the defendant to produce relevant materials, before setting a fine that *may consume all of the defendant's assets.*"

It is important to highlight that the US guideline on the issue of consideration of a firm's inability to pay, does not prohibit the court from imposing a fine that may jeopardize a firm's continued viability. However, it permits, but does not require a court to exercise its discretion, to reduce the fine, if such fine, without reduction, would impair the firm's ability to make restitution to victims.

The EC may, in exceptional cases, consider such a factor at the request of the offender and in a specific social and economic context. This has had an influence on the set fine, only in exceptional cases. The EU's Fining Guidelines of 2006 makes some provision relating to inability to pay applications (ITPs). It states that such a relief would be granted only on the basis of objective evidence that would prove that imposition of the fine would irretrievably jeopardize the economic viability of the undertaking after taking into account its specific social and economic context. The evidence that is taken into account when assessing ITP applications includes: financial statements of recent years, claims of significant loss of value of the company's assets were it to be liquidated as a result of the fine, provisional current year statements and future projections, financial ratios that measure a company's solidity profitability, solvency and liquidity, as well as relations with banks and shareholders.

The approach in these jurisdictions is thus to ensure on the one hand that a firm's bankruptcy is not provoked by the fine imposed by carefully assessing inability to pay applications, whilst on the other hand also carrying on the legacy of issuing substantial fines as a necessary part of the policy to preserve the deterrence aspect of the fines. This balanced approach has ensured that there is no negative impact as a result of the number of high fines which have been imposed against contravening firms. What is worth noting is that in both jurisdictions, it is not easy for a firm to pass the test and qualify for an inability to pay consideration, and the firms are put to the task of proving that they satisfy the criterion that is required.

Conclusion and Way forward

Having regard to this approach, the lacunae in South Africa's approach becomes more glaring. This lack of uncertainty is not sustainable particularly as notwithstanding the troubled times, the competition in our country continues to evolve due to the increased commercial activity of the South African economy. Legal jurisprudence has long held the view that, the law must be certain, predictable and transparent. Consequently, it is the duty of the competition authorities to ensure that uncertainties are removed.

No doubt, the trend of imposing higher administrative penalties in South Africa should continue against contravening firms as a reminder that cutting corners is not an option, even during recessionary times or during the normal course of doing business where firms struggle to stay afloat, and may be tempted to for example, agree with competitors not to sell their goods below certain prices, or to try to buy out rivals, just to stay in business. In such instances, the firms must know that the risks of being caught far outweigh the benefits that may be sought from the anti-competitive conduct. Furthermore, firms must know that there is no recession defense available for those firms found to be on the wrong side of competition law, and that competition authorities are no less vigilant during recessionary times.

Nevertheless to make the law in relation to administrative penalties more lucid, guidelines on the fining policy adopted by the competition authorities are necessary, and lessons should be drawn from other jurisdictions. In that regard our law must de facto and de jure create space for the consideration of a firm's financial difficulties, hence their ability to pay such fines in advancement of the greater economic and social good. Of course like other jurisdictions such a de jure consideration must be carefully assessed; weighed, balanced, and allowed only in exceptional circumstances. This is important given that a consideration such as this may be susceptible to abuse as well as the risk that badly managed companies may benefit or may engineer corporate structures to play the inability to pay card.

In short, the imposition of higher fines is necessary; however, this must equally be balanced against the firms' ability to pay. Consequently, competition authorities in South Africa have to adopt clear policies in order to remedy the shortcoming and bridge the chasm.