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Settlements in cartel cases

An examination of the European Commission's settlement procedure with a comparative study and a law and economics analysis

Summary and main findings of the doctoral dissertation

Original German title:

Verständigungen – Settlements in Kartellbußgeldverfahren

Eine Untersuchung des Vergleichsverfahrens der Kommission mit einer rechtsvergleichenden und rechtsökonomischen Analyse

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Background and concept of the work

Public enforcement of competition law has undergone fundamental changes in recent years. The leniency program that grants immunity from fines to cartel members in return for genuine, full and continuous cooperation in the investigation has led to an enormous rise in cartel fine proceedings, and thus to an increasing workload for authorities. This is increased further by the more economic approach to competition law initiated and promoted by the European Commission, that aims at a better economic underpinning of enforcement by way of economic case-by-case analyses, but requires significantly higher enforcement costs.

As competition authorities consider themselves to be no longer able to cope with the work- and caseload caused by the aforementioned developments by use of conventional procedures, they move to more „amicable“ (consensual) forms of competition law enforcement in all major jurisdictions. For quite some time already, this regards the control of abusive practices where the Commission now relies heavily on the instrument of commitments. Recently, however, a consensual variant usually referred to as “settlements” has taken root also in cartel fine proceedings, i. e. an enforcement branch that is fundamental for competition policy as well as sensitive under the rule of law.

Such a way of proceeding has since long become general usage particularly in the USA, pointed out by the US antitrust authorities as a superior form of enforcement. In recent years, it is gaining importance worldwide, especially in Europe, as evidenced inter alia by a report by the Cartel Working Group of the European Competition Network and an OECD round table on plea bargaining/ settlements in cartel cases.

Even though competition can authorities sometimes take up earlier, more informal settlement mechanisms, this development represents a fundamental change. While the authorities point to various advantages of settlement procedures, the development towards consensual competition law fine proceedings is highly controversial in terms of law and legal policy.

The dissertation, supported with a scholarship by the *Arbeitskreis Wirtschaft und Recht im Stifterverband für die deutsche Wissenschaft*¹, provides what appears to be the first comprehensive analysis of settlements in cartel cases from a comparative law, law and

¹ A charitable organisation that grants scholarships for research, in particular dissertations, in the field of economic law.

economics and European law perspective. It is presented in three supplementary parts, each building on the last, that provide different research focuses that are brought together in a final fourth part, complemented by legal policy considerations. The main emphasis is on the European Commission's so called settlement procedure (German name: *Vergleichsverfahren*) that has come to use in seven cases so far. The subject is first and foremost the legal and economic problems associated with this kind of procedure, which are vastly unsettled today. This dissertation thereby takes account of the foreseeable high practical significance of the settlement procedure, which has already prompted modifications of corresponding procedures used by national competition law authorities, including by the German *Bundeskartellamt* and the French *Autorité de la Concurrence*.

Part 1: Comparative Law

This first, comparative law part confronts the practice of settling cartel cases by the competition authorities in the USA, France, Germany, the Netherlands and Great Britain in the form of country reports. (p. 54 et seqq.). On this basis, the dissertation proposes a systematisation (p. 103 et seqq., 107 et seqq.) based on the insight that settlements may deal with a range of subject matters („matters for negotiation“) and may fulfil several functions in enforcement that demand specific design principles and mechanisms to coordinate with other investigative and enforcement tools. The main result and core thesis of this section is that the various forms of settlement procedures can be systematised typologically according to three variants with specific key characteristics:

- In integrated systems such as that of the USA, settlement proceedings have a dual purpose, namely to speed up and streamline the investigation as well as the prosecution, and are therefore functionally interconnected with the leniency program;
- In procedural economy systems such as France, settlements are limited to the function of streamlining the prosecution and thus markedly decoupled from investigative tools;
- Rather rare discretionary systems such as that in Great Britain are usually still involved in the phase of gathering experience and therefore emphasise the authority's discretion with respect to the organisation of the procedure and do not commit to a specific structure.

Differences between the integrated model and the model that focusses on procedural economies are explained synoptically.

Building on this systematisation, this dissertation examines potential conflicts in case of parallel settlement procedures of different systems from the perspective of the undertakings as well as the authorities and new approaches to administrative cooperation (p. 114 et seqq.). The dissertation shows that practice of settlement procedures leads to an international convergence of competition law enforcement, aligning in practical terms so called adversarial procedures and continental or inquisitorial procedures (p. 120 et seqq.).

Part 2: Law and Economics analysis

The second, law and economics part of the dissertation discusses three influential approaches to justify the contention that settlement procedures are not “only” a pragmatic instrument to reduce workload, but also provide a superior way to fight cartels. The theories are each examined with respect to the strength of their economic argument as well as with respect to the question of whether difficulties in their practical and/or legal implementation may cause adverse effects. The key finding and core thesis of this part is that (1) none of the approaches are able to justify settlement procedures as being a superior solution, so that a rather

restrictive attitude towards them is appropriate, and that (2) settlement procedures should follow specific design recommendations in order to avoid impending dangers and adverse effects, respectively.

a) The *Shadow-of-Trial-Model*

The law and economics part starts with the so-called *shadow-of-trial*-model. It conceives settlement mechanisms as negotiations on markets, taking place against the background of an imminent trial or sanction which would otherwise arise. The essence of the argument rests on the assumption that parties are generally able to anticipate the outcome of a standard procedure, so that a settlement provides the opportunity to implement that outcome without the cost of legal action. The dissertation critically analyses this view, drawing on, inter alia, insights from the economic theory of regulation and bureaucracy, behavioural economics and empirical economic research, in addition to economic research about plea bargaining.

First, the dissertation argues that *modelling* settlement procedures as negotiations on markets seems doubtful due to the power imbalance inherent in the authority's (regulatory) superiority and its concomitant *ability to exert influence and shape the process* in a regulatory relationship.

Furthermore, the "classical" *shadow-of-trial*-model assumes that the law enforcement authority perfectly represents the public interest, thus disregarding *agency costs*. The arguments for this view are not convincing. This aspect is particularly important when assessing settlement procedures, as they increase the authority's leeway and may thereby compound potential agency-problems. There is however no coherent theory about the motivation of enforcement authorities or their officials within the context of plea bargaining/settlement procedures. This previously neglected aspect is explored drawing on insights from different branches of economic research that yield five specific hypotheses about the crucial characteristic variables of the authority's actors' objective function.² Each of these hypotheses implies that an authority prefers settlements in situations in which, from a law and economics perspective, they have adverse effects. In relating these hypotheses with European competition procedure and confronting them with the available empirical and anecdotal evidence from other jurisdictions, the thesis is not able to arrive at a definite answer, inter alia since the dominant motivation may differ depending on the hierarchy. Notwithstanding, the author does see substantial corroboration for the assumption that competition authorities strive for high numbers of decisions and sanctions.

Moreover, settlement procedures increase *information asymmetries* on both sides. The dissertation identifies several problematic consequences of this effect and looks at peculiarities that arise with respect to multiple party cases.

In addition, settlement procedures between an authority and undertaking/s produce negative external effects for the victims, the legal system and society as a whole. The dissertation discusses the details and importance of these effects, citing as far as possible circumstantial evidence about the extent of practical relevance.

This is followed by an examination of the *new behavioural school of law and economics* with regard to bounded rational human behaviour and the associated *psychological distortions in the settlement process*. The dissertation initially examines the scope for and limitations on the application of insights from behavioural economics research. Inter alia, these insights raise the question whether competition authorities, in particular the European Commission, are subject

² These are adopting as many decisions imposing sanctions as possible, achieving a maximum total penalty amount, minimizing the authority's processing effort, striving for career related objectives and approaches that combine two or more of these goals.

to a *prosecutorial bias* as the combined exercise of the investigative, prosecutorial and adjudicating function may be conducive to a human tendency to interpret complex facts in a confirmatory and self-serving manner. This is relevant for settlement procedures if one assumes that the authority's bargaining power exceeds that of the undertakings to an extent that, without safeguards, the settlement result may be distorted. This issue is discussed using available empirical findings from different jurisdictions, and results in the development of recommendations for the internal structure of competition authorities that can counteract such distortions.

The heading "*innocence problem*" refers to an additional important problem that is due to the fact that settlement procedures, if associated with high sanction reductions, may systematically induce innocent defendants to accept a sanction. The obvious solution to limit available reductions is difficult to implement particularly in competition law: there are a number of practically relevant options beyond formal fine reductions or formal additions to a fine that grant benefits or increase the severity of the sanction. As a result, there is a danger that the authority may threaten excessive objections or fines at the beginning of a settlement procedure in order to prompt the company to accept a settlement instead of pursuing the uncertain outcome of contentious proceedings (*overcharging*). Moreover, the pressure to accept a settlement can be intensified further by way of high, but "hidden" (fine) reductions. This is due to the fact that competition authorities can significantly influence adverse indirect consequences of fine proceedings that occur under civil law (e. g. actions for damages) and in the form of extra-legal effects (e.g. reputational damage), that are as or more severe for companies. Based on the European Commission's guidelines on the method of setting fines and taking into account the practice of German, British and US competition authorities, the dissertation shows that and how such reductions or benefits are put to practice. The author then develops and discusses several recommendations in order to avoid these problematic effects of settlement procedures in cartel cases.

b) Settlements as a contribution to efficient competition law enforcement

As a second law and economics approach to justify settlements, advocated especially by European competition authorities, the dissertation examines the argumentation that settlement procedures improve the *efficiency and thereby ultimately the effectiveness of public competition law enforcement* to the benefit of society. Settlements preserve the authority's resources, enabling prosecution of more cases, thereby preventing restraints of competition to a larger extent than without the use of settlement procedures.

The dissertation first describes the economic standard model of optimal enforcement that is behind this reasoning and its assessment of settlement procedures. In the following, the author shows that the model needs significant *extensions* that take account of theoretic refinements (inter alia the risk preferences of the persons affected, effects of competition law fining procedures on reputation), economic and social costs of fines imposed on undertakings, limitations of law and legal practice as well as recent insights of behavioural economics (overconfidence, sunk cost bias implying that competition law fines may be added to prices, acceptance of enforcement). These restrictions and limitations of the standard model are set forth in light of recent economic insights and examined with respect to their relevance for settlement procedures. The dissertation concludes that, based on the current state of scientific research, a stronger deterrent effect and thereby better enforcement of competition law through settlement procedures cannot be verified. Notwithstanding, the dissertation develops *recommendations for the design* of settlement procedures in order to work towards this result

and avoid possible negative effects. In addition, it discusses how a settlement procedure should be coordinated with a leniency program. Due to the different perspectives of the models, the author considers these recommendations as cumulative to those of the shadow of trial model, insofar as they do not overlap.

c) Responsive Regulation

As a third law and economics approach, the dissertation discusses a movement which has become known under the term *Responsive Regulation*. Its proponents first examine the relationship between the authority and the undertaking from a game theoretic perspective, identifying an “enforcement dilemma” between the authority and undertakings to which they apply the so called *tit-for-tat*-strategy. The authority is then to translate this strategy into practice with an enforcement pyramid that organizes the instruments available against the infringer in ascending order according to their degree of compulsion and punishment. The aim is thus to make the choice of a strategy that is (more) oriented towards punishment and deterrence or towards persuasion contingent upon the level or lack of cooperation while taking into account different motives for breaches of law shown by empirical social research. In recent times, the approach has been combined with the idea of *Restorative Justice*, i.e. the goal of restoration and compensation for the victim. A flexible settlement procedure makes it possible to implement both concepts to quite a large extent. In this respect, the option to settle, being a consensual element in the enforcement pyramid, shall have priority over contentious repressive procedures. The dissertation shows this on the example of the Australian competition authority’s (ACCC) enforcement practice. Additionally, the chapter deals with selected procedural elements in the USA, the United Kingdom and Germany. Recently, *Responsive Regulation* has also been recommended as a model for the EU.

The author takes a critical view of this approach: The propagated *responsiveness* is difficult to operationalize in practice. Moreover, the required augmented flexibility in the authority’s sanction practice is associated with a wide margin of discretion that creates a danger of arbitrary or even abusive applications of law. *Responsive Regulation* orientates enforcement primarily towards steering the future behaviour of undertakings, thus loosening the connection to the past infringement, though only the latter legitimizes the sanction. The author’s core thesis is that, while the basic concept is inspiring, the overly broad discretion provided to the authority coupled with the use of severe sanctions encounters significant objections founded on the rule of law. Furthermore, there are tight legal limits for transferring the concept to European Competition Law.

Part 3: The Commission’s settlement procedure

The third part examines options to settle fine proceedings before the European Commission. For this purpose, the dissertation first summarizes the development and the system of the conventional consensual procedures with their respective legal standards. In the following, the dissertation concentrates on the European Commission’s *settlement package* from 2008 that has set up a *settlement procedure for cartel cases*. The package comprises the Commission Regulation No 662/2008 amending Regulation No 773/2004 relating to the conduct of proceedings by the Commission pursuant to Articles 81 and 82 of the EC Treaty, a Commission notice as well as additional memos in the form of frequently asked questions.

a) Causes and reaction in terms of legal policy

The thesis first looks into the *causes for the creation* of the settlement procedure, inter alia by analysing Commission caseload data. Ultimately, the dissertation is critical of the settlement

procedure in its present form. The author acknowledges a need for action from a competition policy perspective in view of very long processing times and the problem of caseload resulting from the leniency notice. However, the settlement procedure as set up by the European Commission is considered an inappropriate reaction. The author sees the causes for the problems as lying not in the procedural design of the standard proceedings, but in the fact that administrative fine proceedings are regularly followed by expensive and time consuming appellate proceedings. In terms of legal policy, the settlement procedure is considered a problematic way to avoid this burden, as it covers the underlying causes at the expense of new disadvantages instead of correcting them. In the author's view, a preferable approach would be to reduce the appeal rate by improving the quality of decision-making in general, in particular through a more transparent calculation of the fine (p. 556 et seq.). Alternatively, after further reform measures, a separation of the investigational and adjudicative functions at the Commission should be considered.

b) Course of proceedings

Subsequently, the dissertation analyses the complex *course of the settlement procedure* and classifies it under the existing variants of EU competition procedure as well as under the comparative system developed in the first part. Drawing on the results of the economic analysis in the second part, this process is criticised for its implications for EU competition procedure (p. 662 et seqq.), e.g. with regard to the fact that it facilitates the hidden concessions analysed in the second part.

c) Practically relevant legal problems

The main focus of the third part is on an enquiry into *key legal problems of practical relevance* that occur *during the course of settlement procedure*. Among the questions addressed are in particular the *competence* of the Commission to establish the settlement procedure, the compatibility with the undertakings' *right of defense*, the legal *admissibility of a fine reduction* in return for a settlement with a waiver of certain rights, *binding effects* during the course of the procedure, *legal remedies* of the companies affected, the *legal situation in case of a breakdown* of a settlement and the implications for *participation rights of third parties*. Throughout, the analysis takes into account legal changes subsequent to the entry into force of the Lisbon Treaty with its binding charter of fundamental rights.

Particularly important results and main thesis of this part are:

- aa) The European Commission has the *competence* to introduce the settlement procedure via tertiary legislation³. The implementation of settlement solutions is limited only by the requirement to respect the institutional balance, in view of a conceivable systematic elimination of judicial control. The limits that follow from this requirement are only vaguely delineated in case law. Currently, the Commission does not exceed them.
- bb) The legal *validity of a waiver of fundamental rights* as part of the settlement procedure requires, with regard to the case law on Art. 6 ECHR in connection with Art. 48 II, 52 III of the Charter of Fundamental Rights, that the parties concerned have a viable alternative to a settlement with a waiver of fundamental rights. This is only the case if the difference in the burden associated with contentious proceedings and a settlement remains sufficiently limited, even if accounting for informally granted concessions. The author considers this result to be consistent with the economic analysis in the second part (*the innocence problem*).

³ Id est based on power conferred onto the Commission in a regulation, here Regulation (EC) No 773/2004, to make more detailed rules needed to aid the application of EU competition procedure.

- cc) The legal validity of the required waiver of individual representation by companies forming part of the same corporate group is brought into question if it has to be declared before the company has been notified of the essentials of the objections.
- dd) The Commission is *not allowed to consider the following conduct as* a cooperation that *mitigates the fine* or otherwise tie it to a fine reduction, partly because this conduct does not, which is required by ECJ case law, facilitate the Commission's task of finding infringements of the EU competition rules and bringing them to an end, and partly because of the proportionality principle in view of the significance of fundamental procedural rights (p. 786 et seqq., 860 et seqq.):
- a legal qualification of the facts if a comprehensive acknowledgement of the facts is to be made regardless,
 - an indication of the maximum amount of the fine the parties would accept,
 - waiver of comprehensive access to file and/or a formal oral hearing,
 - appointment of a joint representative by companies in the same corporate group (undertaking).
- However, according to the author, an opportunity to successfully *enforce* these limits only exists in certain cases where not all parties participate in the settlement procedure (*hybrid cases*). In addition, the author points out that in competition law factual, legal and normative questions are often inextricably intertwined. This explains the often unclear terminology of the European Court of Justice and may qualify the practical relevance of the distinction.
- ee) Within the above limits, the parties have a *right to a decision* about a settlement procedure *that does not exceed the Commission's discretion*.
- ff) The *withdrawal options of undertakings* are to be judged differently depending on whether the various declarations they make during the course of a settlement procedure are revocable. The Commission may opt out freely until the procedure has been completed.
- gg) As such, the Commission is not prevented by law from using the parties' acknowledgements in evidence after a *settlement attempt has failed*; the dissertation does not consider this evidence to be legally excluded. However, in view of the unclear legal situation, the Commission's announcement not to use the acknowledgments after a settlement failure creates legitimate expectations that enjoy legal protection.
- hh) The parties are not able to challenge a Commission decision adopted at the end of the settlement procedure with respect to the facts acknowledged as well as important procedural errors due to the doctrine of *estoppel* (or *venire contra factum proprium*). The remaining *appeal opportunities* are usually unattractive for the settlement parties, as they would imply losing the substantial indirect benefits of a settlement procedure.
- ii) The settlement procedure restricts rights of third parties. The author considers this to be permissible under applicable law, but open to criticism both from a legal perspective as well as with regard to the law and economics analysis developed in the second part.

Part 4: Evaluation in terms of legal policy, suggested improvements and perspectives

The results of the first three parts are brought together in the fourth part to evaluate the settlement procedure in terms of legal policy and make suggestions for improvements that take into account the need for correction from a (law and) economics and legal perspective. To this end, the dissertation firstly assesses the settlement procedure based on the theories

discussed in the second part, and the recommendations developed in the second part are translated into specific suggestions for the settlements procedure (pp. 963 – 980).

The author classes the settlement procedure as a specific application of *plea bargaining* in the sense of the *shadow-of-trial* model. Based on a summary application of the findings from the second part, the author recommends key measures as safeguards against agency problems, *prosecutorial bias*, external effects and for an improved, albeit only incompletely achievable control of hidden sanction reductions. In order to mitigate agency problems, the author proposes extending the Commission's internal *peer-review* to the settlement procedure, and to introduce specific *transparency measures*. Prosecutorial bias can be counteracted by promoting *debate-like elements* in the procedure. To reduce existing information asymmetries, the dissertation advocates allowing for *settlement discussions also after* the Commission has notified to the undertakings a so called *statement of objections*, thus at a stage at which companies have a right of access to the file as a whole, and not merely to incriminating information at the commission's discretion.

With respect to the current design, the author considers *efficient competition law enforcement* in the meaning of the second law and economics approach to justify settlements as assured only insofar as one takes an isolated, overly narrow view solely at the "official" fine reduction of 10%. As recommendations in the sense of recognized (minimum) conditions, care must be taken to ensure that *settlement reductions of all kinds are kept as low as possible*, to preserve the attractiveness of the *leniency program* by retaining a *sufficient gap* between the potential reductions available and the fine as it would stand without them, and to tightly limit any loss of deterrence due to agency-costs, information asymmetries and external effects on private competition law enforcement.

From the perspective of *Responsive Regulation*, the settlement procedure is in principle welcome as an additional variant of competition law administrative fine proceedings, but insufficient in its current form. However, the author considers a comprehensive orientation towards this theory not appropriate from a law and economics point of view; legally, under the current regulation 01/2003, it would be permissible only with significant qualifications.

The *current design* is, in the author's view, *usually rather unattractive* for undertakings. In this respect it appears that the Commission will enhance the official reduction of fines by means of additional concessions and benefits which are problematic from a law and economics point of view as well as with respect to the rule of law. The author sees the first settlement cases as indicating such a practice.

Finally, the author examines *perspectives* for possible future development, namely:

- a) the scope of the settlement procedure should be extended *at most to vertical agreements*;
 - b) it is desirable that the Commission promotes and *rewards compliance-efforts* by companies on the basis of a general, scientifically based approach;
 - c) *integrating compensatory measures* for the benefit of victims into settlement procedures can be attractive for companies and victims, but is unrealistic in the foreseeable future;
 - d) a *waiver of legal remedy* would be legally permissible, but – contrary to occasional demands – *cannot be a legally permissible component* of a settlement with a reduced fine in European law, and that
- a) taking a realistic view, *mandatory judicial control* should be introduced in the settlement procedure *only as a last resort*, after the other recommendations have been implemented without success.

Finally, the dissertation points out *need for future research*: From a *law and economics point of view*, once a sufficient number of cases has been completed, empirical research about the effects of settlements on private competition law enforcement is desirable in order to improve the coordination of public and private enforcement.

From a *legal perspective*, challenges for guaranteeing the rights of the defense will arise in the context of parallel settlement procedures in several jurisdictions. Generally, the author considers a continuous critical review and analysis of the ongoing proliferation of settlements in cartel cases to be necessary.