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UPPING THE ANTE: ADMINISTRATIVE PENALTIES AFTER SOUTHERN PIPELINE CONTRACTORS AND CONRITE WALLS (PTY) LTD / COMPETITION COMMISSION

On 4 August 2011, the Competition Appeal Court ("CAC") delivered judgment in an important case concerning the imposition of administrative penalties by the Competition Tribunal ("Tribunal") on firms that are guilty of the worst of competition law contraventions: the hard-core cartel behaviour of price fixing, market allocation or bid-rigging.

If recent media reports about Julius Malema's influence over the awarding of tenders are to be believed, the case should be of great interest to him.

The CAC's decision is a welcome attempt to bring clarity to an area which has caused confusion. Unfortunately, the judgment ultimately fails to provide a clear answer to the question which needed answering: How are the penalties to be calculated? Nevertheless, the decision has expensive consequences for businesses guilty of competition law contraventions. The financial risks of entering into a cartel, or failing to uncover and report it to the Competition Commission

("Commission") have become even greater – particularly for cartels that endure for a number of years.

The nature of administrative penalties

Administrative penalties are essentially fines which are imposed on firms which are found to have engaged in certain activities which the Competition Act ("Act") prohibits.

The exact nature of these penalties is unclear. The CAC has previously held that they are civil in nature as their purpose is not to punish criminals; they are corrective and non-criminal (*Federal Mogul Aftermarket Southern Africa (Pty) Ltd v Competition Commission and the Minister of Trade and Industry* [2005] 1 CPLR 50 (CAC)).[1] Their main aim is deterrence (*Woodlands Dairy v Competition Commission* 2010 (6) SA 108 (SCA)).[2] Administrative penalties, however, according to a recent statement of the Supreme Court of Appeal ("SCA"), "bear a close resemblance to criminal penalties".[3] The CAC has said, as a result, that "in their amount, their intended deterrent purpose and undoubted punitive effect and the fact that they are paid into the Consolidated Revenue Fund they bear a resemblance to fines" (*The Competition Commission v Pioneer Foods (Pty) Ltd*, case no. 91/CAC/FEB10 [2010] ZACAC 2 (15 October 2010)).[4]

In the light of the SCA's pronouncement, the CAC has now held, in the case under

[1] Para 11. In this case, the constitutionality of administrative penalties was questioned, unsuccessfully, on the basis that criminal sanctions were imposed without adequate safeguards. It might well be that that argument has been given a shot in the arm by the SCA's recent characterisation of their nature as criminal. In any case, considering the amounts at stake, one can expect every trick in the book to be tried to avoid their payment of such penalties. The CAC sought to pre-empt this in its decision in footnote 9 below in which it made clear that the fines might resemble criminal sanctions but that the proceedings were not criminal proceedings for purposes of the Constitution even though it likened Tribunal proceedings to akin to "criminal proceedings"

[2] *Ibid*.

[3] At para 10. The statement is *obiter.*

[4] Para 8.

discussion, that the penalties must be proportional as 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" (*Southern Pipeline Contractors and Conrite Walls (Pty) Ltd v the Competition Commission*, case no. 105/CAC/Dec10, 106/CAC/Dec10 (4 August 2011)).[5] The fine cannot "destroy the business of the offending party".[6]

Before considering the CAC decision in detail, let us turn to the background to the judgment.

Background to the CAC decision

The Tribunal's approach to imposing administrative penalties has not been tested on many occasions. Firms generally wish to settle matters in order to avoid the harsh glare that competition proceedings entail. The Tribunal sought in one of the few decided cases on penalties, in a matter involving an abuse of dominance by South African Airways, to apply a formula (see *Competition Commission v South African Airways (Pty) Ltd* [2005] 2 CPLR 303 (CT)). The various factors listed in section 59 of the Act (set out below in numbered paragraph 2) were each given a percentage weighting; a score was awarded for each factor, depending on the facts of the case.[7] The resulting percentage of affected turnover would be imposed as a fine.

The competition authorities reasoned that although they were empowered to impose a fine of up to 10% of the entire turnover of the firm, only the turnover affected by the prohibited act should be considered as there might otherwise be too remote a relationship between the infringement and the total turnover.[8]

The 10% figure of affected turnover has therefore generally been the reference point.

For example, the maximum penalty which the Tribunal imposed in arguably the most

[5] Para 9.

[6] *Ibid*.

[7] *Competition Commission v South African Airways (Pty) Ltd* [2005] 2 CPLR 303 (CT), para 341.

[8] *Ibid,* para 273.

egregious case which has come before it was 10% on the turnover of Pioneer's national bread turnover (less the Western Cape turnover) and 9.5% of the Western Cape turnover (*Competition Commission v Pioneer Foods (Pty) Ltd* (15/CR/Feb07, 50/CR/May08) [2010] ZACT 9 (3 February 2010)).[9] This was in the context of a cartel in the bread industry where the respondent had been obstructive, its main witness had lied, the collusion had affected the most vulnerable in society as it increased the price of a staple food, and it had endured for a long period of time. The Tribunal refused, nevertheless, to impose a fine of 10% of total annual turnover.

The Commission appealed to the CAC in order to impose a fine of 10% of the group's total annual turnover – a fine which would amount to R1.5 billion rather than R195 million. In the end, the parties settled that case, and a series of other investigations involving the Pioneer group, by the payment of an additional R250 million, the payment of R250 million to an "Agro-processing Competitiveness Fund" administered by the Industrial Development Corporation (which was, after National Treasury objections, later changed to a payment to the Treasury which would then channel the funds), price reductions on flour and bread to reduce its gross margin by R160 million, and an increase in capital expenditure by R150 million.[10]

Similarly inventive remedies are likely to feature in other proceedings.

The Tribunal had changed tack, in the meantime, in a case involving a sector in which cartels are rife: the construction industry. Southern Pipeline Contractors ("SPC") and Conrite Walls (Pty) Ltd ("Conrite") are avowed members of cartels in the supply of pipes and culverts to construction companies and other customers, and the manufacture of manhole rings respectively.

The Tribunal considered formulas which comparative jurisdictions use to calculate fines and decided that as those would lead to fines which well exceeded the cap set out in the Act, and

[9] Paras 173.3–174.

10 See the Competition Commission media release at: http://www.compcom.co.za/assets/Uploads/AttachedFiles/MyDocuments/Commission-settles-with-Pioneer-Foods2.pdf.

in applying its discretion after considering section 59 (see numbered paragraph 2 below) of the Act, that the maximum penalty or close to it would be imposed.

It decided in a carefully worded judgment that fines of 10% and 8% of *annual* turnover (as opposed to affected turnover) be imposed on SPC and Conrite (see *The Competition Commission v Southern Pipeline Contractors and Conrite Walls (Pty) Ltd*, case no. 23/CR/Feb09 (29 November 2010) ("the *SPC* and *Conrite* cases")). The fines amounted to about R17 million and R6 million each. That decision was appealed to the CAC and its eagerly-awaited decision has now been delivered. The question whether the CAC would agree that the starting point for imposing fines should be 10% of annual turnover has now been answered .

The CAC decision

The CAC bemoaned the lack of guidance which the Act – and the Commission itself – provide in calculating the penalties. Pointed comparisons with foreign law, where more precise, formulaic guidelines are laid down, were made by the Court. The CAC believed that the Tribunal had been tripped up by the architecture of section 59: the maximum cap of the fine is set out first in that section before the factors which need to be considered in arriving at the penalty. However, as the CAC explained, the Tribunal was required to consider all of those factors first before determining if the cap was exceeded; it could not start off by using the cap.

This criticism seems slightly overdone. The Tribunal did indeed consider all the factors set out in the Act. It considered each factor expressly in relation to SPC (bar for the conduct of SPC during the proceedings, although this was considered in other sections of its judgment) and to Conrite. The Tribunal then decided that the appropriate remedy would be a penalty close to the maximum allowed. Considering that no evidence seems to have been led that this was disproportionate, and that the CAC has a limited role in overturning the exercise of the Tribunal's discretion, the CAC clearly felt strongly that the Tribunal had erred. It therefore set out a new test.

How to determine the administrative penalty: the CAC's test (with some revisions)

In summary, the CAC has now – at least by implication – set out that the steps to determine an administrative penalty are as follows.

1. Has the firm contravened a section of the Act which allows for an administrative penalty to be imposed (for example, hard core cartel conduct, even for a first offence, or a repeated offence of other prohibitions)?
2. If so, consider *all* of the following factors of section 59(3) of the Act in order to determine the amount of the penalty to be imposed:

   2.1. the nature, duration, gravity and extent of the contravention;

   2.2. any loss or damage suffered as a result of the contravention;

   2.3. the behaviour of the cartelist;

   2.4. the market circumstances in which the contravention took place;

   2.5. the level of profit derived from the contravention;

   2.6. the degree to which the cartelist has co-operated with the Commission and the Tribunal; and

   2.7. whether the cartelist is a repeat offender.
3. Calculate the annual turnover which is attributable to the collusion [for the most recent year in which the respondent participated in the cartel]. Exclude turnover which although earned by the business in which the collusion took place cannot be attributed to the collusion.
4. Decide on a percentage of the turnover calculated in paragraph 3 in the light of the factors in paragraph 2. That amount – subject to paragraph 6 – will be the penalty. For serious offences the amount will seemingly range from 10% – 30%.

5. [Take into account the years for which the collusion took place by multiplying the amount arrived at by following paragraph 4 by the number of years for which the cartelist participated in the cartel (provided that one excludes years prior to the commencement of the Act in 1999).]
6. Does the amount exceed 10% of the firm's annual turnover in South Africa and its exports from South Africa, in the year preceding the imposition of the fine? If so, the penalty must be reduced so that it does not exceed this 10% cap [and is proportional].

What is required from any law – and in particular one which imposes penalties – is predictability. How does the above scheme meet this requirement?

Unfortunately, point 5 above has been placed in square brackets because of the lack of clarity as to its inclusion in the steps. Similarly, parts of paragraphs 3 and 5 are not clearly the step envisaged by the CAC (or at least, not that which it applied). Even more confusion is sown when the CAC applied its own guidelines to the facts, as is seen below.

The CAC's eloquent discourse on proportionality and the factors which dictate whether a "criminal" fine is proportional (set out above) is left hanging in the air. The CAC seems to be saying that the way the system is constructed will ensure proportionality owing to the cap of 10% on annual turnover, as this would prevent a company from going out of business. But that is not necessarily so: it may be that for various reasons some firms can easily survive a bigger fine and that others would be put out of business by a much smaller one. On what basis would those facts be considered? How exactly is "blameworthiness" determined? If those factors have to be taken into account for a fine to be proportional, when should this be done? Nowhere is the Tribunal – a pure creature of statute – empowered expressly to consider these factors. Must we understand that the CAC has read some of these additional requirements into the test? It is unfortunate that the Legislature – or at least the Commission – has not seen fit to provide more guidance, and it is hoped that this decision will prompt some action at the very least on the part of the Commission.

It may well be that the SCA will be called into action to consider the CAC decision on appeal.

What is remarkable about the CAC's judgment is that it used only the 2008 figures in working out the affected turnover for SPC. According to the CAC, it was "common cause" that those were the only figures available.[11] Why could the CAC not have required the parties to provide full accounts or referred the case back to the Tribunal for it to do so? We are not told. In the *Conrite* case, the CAC calculated the affected turnover as being the amount calculated over the entire life of the cartel and then multiplied the affected turnover by 8 – the number of years for which the cartel had persisted.[12] Considering that the SPC cartel had endured for 13 years but only one year was used to calculate the fine, this result (without extrapolating the 2008 figures for the life of the cartel) seems anything but proportionate – at least to Conrite's fine. What is even more striking is that the affected turnover which the CAC determined in the Conrite case was the entire affected turnover for the entire cartel which it then seemingly multiplied by the entire life of the cartel again.[13] This means that the fine was actually disproportionately large: 56% of the affected turnover.

If one considers the EU approach – which the CAC seems to have wanted to employ to a certain extent – we see that the EU starts off with a base penalty of up to 30% of the sales relating directly or indirectly to the cartel during the last full business year during which the cartelist participated in the cartel.[14] This base amount (before tax) is multiplied by the number of years of

[11] *SPC* and *Conrite* cases, para 50.

[12] It is not clear for how long the cartel endured: the Tribunal variously refers to it lasting for 6 or 8 years. The CAC seems to have found that it was for 8 years. See para 83 of the CAC decision and paras 102, 111 and 116 of the Tribunal decision (see discussion of the *SPC* and *Conrite* cases above).

[13] Compare para 82 (calculating the "total affected turnover for the entire period in which [Conrite] participated in the cartel") to para 83 (which multiplies the figure arrived at in para 82 "by 8, being the years of participation in the cartel").

[14] The European Commission's Guidelines can be accessed at: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:52006XC0901(01):EN:NOT

infringement, with an extra 15% to 25% added on for the mere fact of participating in a cartel. A 10% early-settlement discount is available. The maximum fine cannot exceed 10% of total turnover in the preceding year.

On the EU approach, one therefore works out affected turnover for *one* year and then multiplies that by the number of years for which the cartel persisted. That was not the approach which the CAC followed in either the SPC or the Conrite case, even though it seems that that is what is desired to do.

Leaving aside the flaws in the judgment exposed above, what is one to make of the percentages imposed: 7% for Conrite, but 20% for SPC, on the basis that the former was "part of a small cartel which serviced a relatively small market for a short period of time"?[15] When one works out what percentage of the most recent annual turnover each of those fines reflects, then Conrite was fined 2.6% and SPC 5.2%. Was the latter's conduct twice as bad as the former's? The behaviour of Conrite involved falsifying accounts and invoices and denying its true role in the cartel. The Tribunal suggested that the *SPC* and *Conrite* cases were worse than the *Pioneer* case.[16]

Unfortunately, the CAC decision which criticises the Tribunal for not undertaking a comprehensive evaluation of the factors in section 59 (set out above at numbered paragraph 2 above), even though, truth be told, the Tribunal did do so, is then guilty of the same sin: a close reading of the judgment will not allow one to understand how the percentages of 7% or 20% were determined, nor what the Tribunal will do in the future as a result.

Conclusion

The CAC has brought some clarity to this important area. It is clear that the CAC prefers to employ a concept of a fine which is a percentage of the affected turnover and which factors in the

[15] Para 80.

[16] See para 49 of the Tribunal decision (see discussion of the *SPC* and *Conrite* cases above).

duration of the cartel. This is to be welcomed as it provides certainty and will act as a deterrent for offences which greatly harm the well-being of consumers and economy. Unfortunately, the CAC has not provided a clear mechanism to calculate this penalty. Quite how the duration of a cartel should be factored into the penalties imposed is not explained or applied consistently. It is also not clear how one determines the range of the percentage to be used as the penalty. How does one determine whether a percentage of less than 10% of affected turnover is appropriate rather than 20%? Comparative law[17] shows us that for the worst offences, the United Kingdom uses 10%; the US uses 20%,[18] and the EU, Germany and the Netherlands use 30% as starting points and then take into account the duration of the offence and aggravating and mitigating circumstances. There is no clear starting point in the South African scheme. It is understandable, therefore, that the Tribunal resorted to 10% of annual turnover. It has to be asked, as the Tribunal does, if the EU, US and UK impose much larger fines than South Africa does (the UK's cap is 10% of worldwide turnover[19]), are South African fines a deterrent?[20]

Those companies which settled with the Commission which were parties to the same cartel as SPC and Conrite agreed to consent orders which required payment of penalties of 6.5% to 8% of turnover for 2008.[21] It is not clear whether this was affected or total turnover; it seems to have been total turnover in the relevant business except for in one case. Increasingly, judging from recent settlements with the Commission, the Commission is seeking to use total turnover as its base. The CAC judgment will no longer allow for that approach.

Ultimately, what is clear is that the Commission has been given the go-ahead to ask for

[17] See London Economics' Report prepared for the Office of Fair Trading, "An Assessment of Discretionary Penalties Regimes", accessible at http://www.oft.gov.uk/shared_oft/economic_research/oft1132.pdf, para 4.5.

[18] http://www.ussc.gov/guidelines/2010_guidelines/Manual_HTML/2r1_1.htm.

[19] See the Office of Fair Trading's guidelines at: http://www.oft.gov.uk/shared_oft/business_leaflets/ca98_guidelines/oft423.pdf.

[20] Para 96 of the Tribunal decision (see discussion of the *SPC* and *Conrite* cases above).

[21] Para 6 of the Tribunal decision (see discussion of the *SPC* and *Conrite* cases above).

fines on affected turnover which exceed 10% of affected turnover and which incorporate the duration of the cartel. The starting point can no longer be 10% of total turnover. But larger percentages – 30% and more of affected turnover multiplied by several years – will quite easily result in amounts which will be hit by the 10% total turnover cap. Cartelists – bid-riggers included – be warned.

Cases

Any questions or comment on the content of this *Sibergramme* may be directed to Robert Legh at rlegh@bowman.co.za.