COMMENTS BY HERBERT SMITH LLP, GLEISS LUTZ AND STIBBE ON THE DRAFT COMMISSION NOTICE ON DIRECT SETTLEMENTS IN CARTEL CASES

27 December 2007

1. GENERAL COMMENT

1.1. Herbert Smith LLP, Gleiss Lutz and Stibbe ("the Alliance") welcome the opportunity to comment on the Commission's draft legislative package on settlement proceedings in cartel cases as published on 26 October 2007[1].

1.2. Whilst the Alliance supports the Commission's proposal to provide an alternative route to closing cartel investigations, care must be taken to ensure that the settlement procedure achieves the correct balance between the desired procedural economies and appropriate protections for the parties to the alleged infringement while, at the same time, offering an attractive and realistic alternative to fighting cartel allegations.

1.3. Our comments on the Commission's proposals are not exhaustive and are principally directed at the key issues. Our central points are as follows:

- Sufficient incentives: The discounts available for early settlement must provide the parties with a sufficient incentive to forego some of their rights of defence (including the inherent limitations on their ability to successfully appeal the Commission's decision). Unless the discount is pitched at the right level, the settlement process risks redundancy. In considering the appropriate discount, the Commission should bear in mind (a) the relationship between the amount of information provided to the parties and their willingness to settle – the more information provided to the parties on the case held against them, the more willing they will be to settle and (b) the reward which is necessary to provide a sufficient incentive will vary from case to case. Accordingly, it is important that the Commission retain a degree of flexibility in terms of both the stage in the proceedings when settlement is offered and also the discount that is applied in each case. We recommend that the minimum discount offered in all cases should be 20% and that the Commission set a ceiling well above this to allow for the possibility of larger discounts in appropriate cases – e.g. if a settlement offer is made before a Statement of Objections is issued.
- Rights of defence: In return for settlement, the Commission is asking the parties to give up a large number of procedural protections. There are some serious questions that arise in this context, and in particular the extent to which the parties will be adequately informed of the case against them before submitting a written settlement submission ("WSS").
- Protection from disclosure applications in civil proceedings: The proposal requires the parties to express both their interest in settling, and their settlement submission in writing. There are obvious concerns with this requirement and the potential for third party complainants to seek such documents via pre-action disclosure applications in civil proceedings, in England and Wales (and potentially in the US). There is no clear explanation as to why the Commission proposes to require these submissions in writing and why the requirements are different from those under the Commission's leniency programme.
- Relationship between leniency and settlement: The procedures should be better aligned, especially in respect of the co-operation obligation imposed upon leniency applicants.

1.4. We have also addressed other more minor points in Section 6 below.

[1] The draft legislative package consisting of a proposal for a Commission Regulation amending Regulation (EC) No 773/2004, as regards the conduct of settlement procedures in cartel cases ("the Draft Regulation") and the draft notice on the conduct of settlement proceedings in view of the adoption of decisions pursuant to Article 7 and Article 23 of Council Regulation (EC) No 1/2003 in cartel cases ("the Draft Notice").

2. SUFFICIENT INCENTIVE TO ENGAGE IN EARLY SETTLEMENT

2.1. The level of the reward for agreeing to early settlement must be sufficient to make it attractive for parties to settle and forego some of their rights of defence (including the right to an oral hearing and to submit representations on the Statement of Objections). Most importantly, the discount offered must be sufficient to compensate the parties for the practical limitations placed on their ability to appeal the Commission's infringement decision. In order to obtain early settlement, the parties must have (a) acknowledged unequivocally their liability for the infringement and (b) expressed their agreement with the maximum fine proposed by the Commission. This will make it difficult to mount any appeal that is not based on grounds of equal treatment (between itself and other parties to the alleged infringement who agreed to early settlement) or on procedural grounds. This limitation on the party's rights of appeal is significant. According to one economic study[2], the percentage reduction of fines imposed in cartel decisions which were successfully challenged before the European Courts was 19.3% (and this was before the introduction of the new Fining Guidelines[3]).

2.2. The incentives for the parties to the alleged infringement to agree to early settlement will depend on the extent to which the Commission's case against them is disclosed. In most cartel cases, the parties are likely to require a significant amount of information on the Commission's case before they would be willing to engage in early settlement discussions - unless the evidence of cartel behaviour is completely unambiguous or the discount offered is substantial. The decision makers within the undertaking may have been unaware of the participation in the alleged cartel, and even once an undertaking has carried out an internal audit, it is unlikely to be in a position to assess its position without the full evidence held by the Commission (especially in cases where the individuals within the undertaking who may have participated in the cartel have left (or even died) and the current management has no knowledge of the firm's past involvement).

2.3. While it is difficult to determine the exact extent of the information that will be provided in accordance with paragraph 17 of the Draft Notice (the alleged facts, the Commission's classification/legal treatment of those facts, the gravity and duration of the alleged cartel, the attribution of liability, estimation of likely fines and the evidence relied upon), the information is unlikely to be as extensive as that provided in a Statement of Objections, and there is a concern that this limited disclosure will be insufficient in many cases to convince the parties that they are better off engaging in settlement discussions.

2.4. A recent example of settlement discussions at the national level, which the Commission may wish to consider, is the process adopted by the UK's Office of Fair Trading ("OFT") in respect of its investigation into the so-called retail price initiatives in the UK dairy industry. In that case, it was only once the Statement of Objections was issued, and the parties were provided with non-confidential versions of the documents on the OFT's file, that the OFT commenced settlement discussions. The OFT appears to have been of the view that without the Statement of Objections and the redacted copies of the documents on the OFT file, the parties would have been unconvinced of the case against them and unwilling to engage in settlement discussions. The OFT also appears to have been of the view that the procedural economies obtained as a result of reaching settlement agreement at this stage – including the removal of a right to an oral hearing and the limited responses to the Statement of Objections – were sufficient to justify a 35% reduction in penalty.

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[2] C. Veljanovski, European Commission Cartel Prosecutions and Fines, 1998-2007 – A statistical analysis (2007).

[3] Guidelines on the method of setting fines imposed pursuant to Article 23(2)(a) of Regulation No 1/2003 (2006/C 210/02).

2.5. It is, in our view, crucial that the Commission remains flexible in terms of the stage in the investigation at which settlement is offered. In particular, we consider it important for the Commission to leave open the possibility of entering into settlement discussions both after and before a Statement of Objections is issued.

2.6. The Alliance also considers it important for the Commission to retain the discretion to offer different rewards in different cases, albeit within a specified range. A flexible discount level would enable the Commission to choose a figure which reflects the advantages of early settlement, including procedural economies (for example, the earlier the settlement can be achieved the higher the discount) as well as the strength of the Commission's case.

2.7. It may also be useful to apply a range of rewards rather than one fixed percentage figure in each case, with those parties which are most efficient in their settlement discussions receiving the higher end reward. Provided that clear rules are established and applied, it would be difficult for parties to establish "unequal treatment" and we do not believe varied discounts would increase the possibility of appeals to the Court of First Instance on grounds of discrimination. Alternatively, the Commission could retain a discretion to lower the generally applicable discount to penalise those parties which "drag their feet" in settlement discussions and thus prolong the Commission's final decision as to whether to accept settlement for all parties.

2.8. Overall, the Alliance is of the view that the reward for settlement should be a discount of at least 20%. A reward below this level is expected to be insufficient in nearly all but the most unambiguous cartel cases.

2.9. In order for the reward to be meaningful to the parties, they must also have a clear understanding of how the basic fine against them is calculated. To date there have only been three decisions from the Commission based on the new Fining Guidelines and none of those have yet been tested in court. It is therefore currently expected to be difficult for parties to assess whether the basic fine from which the reward for co-operation will be discounted is in the right range (although the Commission's practice of carefully detailing the procedure followed to reach the final penalty in the three decisions that have already been published is clearly very helpful). We understand that the Commission is considering delaying the introduction of the settlement legislative package until there is some further jurisprudence on the application of the new Fining Guidelines. Ideally, it would be helpful if there was experience of not just the Commission but also the European courts in assessing penalties under the new Fining Guidelines before the new legislative package for settlements is introduced.

3. THE RIGHTS OF DEFENCE

3.1. The rights of defence held by a party to an alleged infringement of European Community law essentially consist of: having the Commission's objections put to them in writing, the provision of an opportunity to respond to the Commission's objections in writing, full access to the Commission's file (including to all exculpatory evidence), the right to an oral hearing and rights of appeal.

3.2. In exchange for agreeing to settle a case, the Commission's proposals require the parties to accept a "watered down" version of key procedural rights. For example, the proposed regulation envisages that the parties to early settlement would be unable to request the opportunity to develop their arguments at an oral hearing or obtain access to the Commission's file unless the Statement of Objections does not endorse the contents of their WSS.

3.3. While it is clearly necessary for the parties to the alleged infringement to forego some of their procedural rights in order for the Commission to achieve procedural economies and justify the reduction in fine, the balance struck needs to be appropriate.

3.4. It is clear from the draft legislative package that the Commission has been acutely aware of this issue and has taken a number of steps to ensure that the rights of defence are protected. However, there remain some areas where we have concerns:

- First, it appears from the Draft Notice that the parties to the alleged infringement will be required to declare (in writing) their willingness to engage in settlement discussions without having had the Commission's case (in terms of the objections and evidence relied upon) put to them. Without this information, the parties to the alleged infringement will be unable to determine whether there is a case to answer and whether it is appropriate for them to express an interest in engaging in settlement discussions.
- Secondly, it is not clear at what point in the settlement discussions the parties will be provided with the details of the Commission's case: the alleged facts, the Commission's classification/legal treatment of those facts, the gravity and duration of the alleged cartel, the attribution of liability, estimation of likely fines and the evidence relied upon (as set out in paragraph 16 of the Draft Notice). While paragraph 15 of the Draft Notice indicates that the timing and disclosure of information is in the Commission's discretion, paragraph 17 of the Draft Notice provides that the parties will be entitled to have the information set out in paragraph 16 disclosed to them before the Commission has "*granted such time-limit [for the submission of the WSS]"*. It is presumed, but this is not clear, that this means that the parties who have engaged in settlement discussions will be provided with the information specified in paragraph 16 at the latest before the Commission sets the deadline for submission of the WSS, rather than before the actual deadline for the submission of the WSS.

  If the information set out in paragraph 16 of the Draft Notice is not disclosed until the date when the Commission sets the period for the submission of the WSS, the time limit "XXX" - contemplated in paragraph 17 of the Draft Notice – needs to be of a sufficient length to enable the parties to have an adequate opportunity to respond to the Commission's potential objections and the proposed penalty calculations. The timetable contemplated in paragraph 17 of the Draft Notice does contemplate a two way procedure but it is crucial that the parties have the opportunity to discuss both the facts and evidence put forward by the Commission and the basis for the Commission's penalty calculations before submitting their WSS. The Commission may have drawn the wrong assumptions from the evidence obtained and the parties to the alleged infringement should have the opportunity to put the facts straight. Ideally, of course, the information set out in paragraph 16 of the Draft Notice should be submitted at a far earlier stage of the Commission's discussions to enable the parties to the alleged infringement to have an opportunity to influence the Commission.
- Thirdly, the Draft Notice does not make clear how the Commission intends to provide the parties to the alleged infringement with the information described in paragraph 16 of the Draft Notice, and in particular whether it is to be disclosed orally or in writing. Written disclosure is clearly preferable due to reliability issues and the risks of misinterpretation that would arise if the information was disclosed orally.

3.5. It is also very important that the Commission allows a sufficient opportunity for the parties to the alleged infringement to have an input into the penalty calculation. The Commission's Fining Guidelines [4] confer a wide discretion on the Commission to determine the level to be applied at key steps – including the gravity of the alleged infringement and mitigating and aggravating factors, and the parties perform an important role in assisting the Commission's application of these factors.

3.6. As a separate point, the Commission should be aware that there is the potential for parties to express an interest to settle simply in order to ensure early disclosure of the Commission's evidence (given that the parties must express their initial interest in settling prior to seeing any evidence at all from the Commission as regards the allegations). This risk could be avoided if the Commission delayed opening settlement discussions until after issuing the Statement of Objections.

4. DISCLOSURE APPLICATIONS

4.1. The Draft Notice proposes that the parties to the alleged infringement will be required to submit a WSS to the Commission setting out, amongst other things, an unequivocal acknowledgment of liability. This WSS will follow an earlier written statement setting out the party's interest to engage in settlement discussions.

4.2. As the Commission may be aware, claimants in civil proceedings in England and Wales may be able to seek access to these documents under a pre-action disclosure application in the High Court. There may also be a similar right of discovery over such documents in the US proceedings. Given these risks, it is not clear why the Commission has proposed that the initial expression of interest and settlement submission must be in writing and, in particular why the Commission has not taken the same approach to settlement submissions as it has to corporate statements submitted under the leniency programme, and allowed submissions to be made orally. While we understand that the Commission may encourage the party to prepare a single document to sign at the Commission's premises and to avoid copies being made (which could be discoverable), this may not always be practical - and surely an oral statement, which the Commission types up and the parties confirm (as in the leniency process) would lead to the same result?

4.3. While the Commission appears to recognise the risks in disclosing submissions made by the parties who agreed to early settlement [5], the Draft Notice is equivocal with the statement in paragraph 35 that: "*normally public disclosure of documents or written or recorded statements received in the context of this Notice would undermine certain public or private interests…*". The Draft Notice should be unequivocal in its support for maintaining the confidentiality of these documents as any risk of disclosure, albeit small, is likely to heavily dissuade companies from agreeing to early settlement.

[4] Guidelines on the method of setting fines imposed pursuant to Article 23(2)(a) of Regulation No 1/2003, 2006/C 210/02.

[5] Further, Wouter P.J. Wils in his presentation at King's College, London, Centre of European Law, 10 December 2007 indicated that the Commission would restrict third parties obtaining access to WSS and other documents obtained under the settlement procedure.

4.4. In this respect, the Commission should extend the restrictions on access to the corporate statement contained in the Commission's Leniency Notice[6] to the WSS. In particular, only the parties to the Statement of Objections should be able to obtain access to the WSS and only on the condition that the party will not make a copy of the information contained in the WSS and will only use the information contained in the WSS for the purpose of judicial proceedings connected with the Commission's application of Article 81 EC to those facts. Similarly, the Settlement Notice should also contemplate that use of the information contained in the WSS for a different purpose may lead the Commission to ask the Court to increase the relevant undertaking's fine and to the extent external counsel is involved, that it may report the individual to his or her law society with a view to disciplinary action (there should, however, be an exception allowing for disclosure required for accounting obligations).

5. THE RELATIONSHIP BETWEEN LENIENCY AND SETTLEMENT

5.1. The parties' rights and obligations under the settlement procedure and the leniency procedure should be better aligned, not only in respect of the rules on written and oral submissions but also in respect of the obligation for full co-operation.

5.2. Specifically, we would like to see a clear statement from the Commission on whether the co-operation obligation imposed upon leniency applicants means that leniency applicants must engage in settlement discussions and indeed take up the Commission's offer on settlement. For example, it is questionable whether a leniency applicant which has received provisional immunity has any interest in settling given that it is due to receive 100% reduction in fines. A leniency applicant could hold others "hostage" by refusing to follow the settlement procedure, and thereby obliging the Commission to still go through the "normal" procedure of issuing a full Statement of Objections and possibly even having an oral hearing. In a cartel with only three or four participants, such behaviour could clearly undermine the procedural efficiencies gained from the settlement process. The Commission has two options: either it imposes an obligation on the recipient of provisional immunity to settle, or it clarifies that a refusal by the recipient of provisional immunity will not jeopardise the settlement process in respect of the other cartel members. We would recommend the latter course of clarification.

6. OTHER ISSUES

6.1. The Commission's ability to withdraw from settlement proceedings: The Commission should be aware of the significant disincentive that is posed by the Commission's ability to withdraw from the settlement proceedings after the WSS has been submitted. The Alliance suggests that the Commission consider whether this is justified and consider whether the Commission's position should be binding at this stage.

6.2. Confidentiality of settlement discussions (1): The Commission's Q&A makes it clear that a party engaging in settlement discussions with the Commission is unable to disclose the content of those discussions. There is a concern that this restriction is at odds with the object of equal treatment and there is no reason advanced for this restriction. If anything, the only justification is to allow the Commission to "play off" the parties against each other. In reality, however, allowing such communications may facilitate settlement by enabling all parties to convince themselves they are being treated in the same way.

[6] The Commission notice on immunity from fines and reduction of fines in cartel cases, 8 December 2006 (OJ C298/17).

6.3. Confidentiality of settlement discussions (2): It is not clear whether a party to settlement discussions is able to disclose the fact of those settlement discussions (as opposed to the content of the discussions). National laws may well require disclosure in certain situations and the Commission should acknowledge this possibility.

6.4. Withdrawal of WSS: The Draft Notice indicates that the "acknowledgments" provided by the parties are, in effect, to be considered "without prejudice". There are concerns as to how realistic this may be and the impact of the withdrawn WSS on the position of the party who submitted the document, should it become accessible to third parties.

6.5. Inconsistencies in the use of "shall", "may" and "will": The Draft Notice contains inconsistent use of "shall", "may" and "will". It is not clear whether the appointment of the joint representative will be a mandated requirement in all scenarios, or whether it will be a matter for the Commission's discretion. The same applies to paragraph 26 of the Draft Notice, where the Commission indicates that in the absence of a response to the Statement of Objections which confirms that the Statement of Objections corresponds to the contents of the settlement submissions, the Commission *may* disregard the undertaking's request to follow the settlement procedure. To avoid violation of the principle of equal treatment, paragraph 26 should read "the Commission *shall* disregard the undertaking's request …"

6.6. Appointment of a joint representative: It is understood that the Commission's requirement for a joint representative for a parent and subsidiaries is designed to achieve procedural economies and does not have any bearing on legal treatment. It would be helpful if the Commission makes this clear in the Draft Notice and explicitly states that the appointment of a joint representative does not prejudge parental liability issues.

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