

Kluwer Competition Law Blog

A Setback for Cartel Enforcement in Ireland: the Court of Appeal's Judgment in the Commercial Flooring Bid-Rigging Cartel

Paul K. Gorecki (The Economic and Social Research Institute, Trinity College Dublin) · Thursday, November 8th, 2018

Introduction

In Ireland's first bid-rigging case the Court of Appeal in its 20 June 2018 judgment decided that: (i) the €7,500 fine imposed by the Central Criminal Court on Brendan Smith was unduly lenient and raised it to €45,000; but (ii) that it was not unduly lenient of the Central Criminal Court to have imposed fine of €10,000 on Aston Carpets and Flooring Limited (Aston Carpets) or not to have imposed gaol time, either custodial or suspended, on Brendan Smith for breaching competition law.

The Court of Appeal's twenty four paragraph judgment is a major setback for criminal cartel enforcement in Ireland. The effectiveness of Ireland's Cartel Immunity Programme (CIP) is lessened because, contrary to prior expectations, no gaol time is being served. The Court of Appeal does not dispute the finding of the Central Criminal Court that the commercial flooring bid-rigging cartel "*didn't involve a cartel.*" The €45,000 fine, based on the cartel-induced increase in profits, is underestimated by a factor of around five and imposed on the wrong target (i.e. Brendan Smith not Aston Carpets). Finally, the Court of Appeal judgment leans against the movement towards greater consistency in competition enforcement across Member States and the EU.

Cartel Immunity Programme Effectiveness Reduced

Like many EU Member States Ireland has a CIP, a vitally important tool for cartel enforcement and detection. Prior to the commercial flooring bid-rigging case there was an expectation that the next criminal conviction in a hard core cartel case would result in gaol: (i) in 2012 the maximum gaol time on conviction for such an offence was raised from five to ten years; (ii) all of the individuals convicted in the earlier Citroen Dealers Association (CDA) price fixing cartel had received suspended gaol sentences; and, (iii) the judge in that case stated that, "*I say once more that if the first generation of carteliers have escaped prison the second and present generation almost certainly will not.*" Application of the US sentencing guidelines to the facts of the commercial flooring bid-rigging case would indicate a sentence of between 10 to 16 months gaol as appropriate.

The lack of a goal time in the commercial flooring bid-rigging case is likely to reduce the incentive for individuals to participate in the CIP, thus lessening its effectiveness as a method of detecting cartels. After all, why seek leniency when the only penalty – even after a successful appeal by the Director of Public Prosecutions (DPP) to the Court of Appeal on grounds of undue leniency – for an individual is, arguably, a low fine?

Bid-Rigging Isn't Really a Cartel

The Central Criminal Court took the view that the commercial flooring bid-rigging cartel “*didn't involve a cartel.*” The bid-rigging consisted of successful cover bidding on sixteen contracts for larger customers, typically multinationals, involving Brendan Smith and David Radburn (representing another commercial flooring business) between 1 January 2011 and 30 April 2013. The Central Criminal Court took the view that these bid-rigging arrangements were not a cartel because, *inter alia*, they did not involve the organisation (e.g. the CDA, a trade association), monitoring/detection (e.g. employment of a mystery shopper) and punishment (e.g. paying a fine) that characterized the CDA price fixing cartel. However, this approach does not take into the differences between the two cartels. The two firm bid-rigging cartel did not need such complex arrangements to be effective at raising price. For example, since the winner of a commercial flooring tender became public knowledge there was no necessity for an elaborate monitoring/detecting mechanism.

It is thus not surprising that one of the grounds that the DPP argued that the Central Criminal Court's sentencing was unduly lenient was the fact that the Central Criminal Court stated that commercial flooring bid-rigging cartel was “*not a cartel in circumstances where the evidence established the existence of a cartel.*” A corollary of this position is that the sentence imposed by the Central Criminal Court would accordingly be lower, other things being equal.

The Court of Appeal decided, however, neither to discuss nor address this particular DPP ground for appeal. If left to stand then it is likely that in future cartel cases the CDA price fixing cartel will be the benchmark. Even if a bid-rigging (or other hard core) cartel is highly effective at raising price and thus damaging consumer welfare, then unless the cartel matches the way the CDA price fixing cartel operated it will not be considered a cartel and will as a result have a corresponding lesser sanction.

Sentencing: Missing the Target

The sentencing by the Court of Appeal hit the wrong target. Brendan Smith is fined based on the illicit financial gain of Aston Carpets.

In raising Brendan Smith's fine from €7,500 to €45,000 the Court of Appeal argued that the

... fine should more closely have reflected the actual financial gain accruing from the activity in question which was in the region of €31,000. The court is also of the view that, save in exceptional circumstances, a fine should be for a sum greater than the financial gain so that it satisfies the requirement that it is punitive and acts as a deterrent. The court will therefore impose a fine of €45,000 on [Brendan Smith].

The main beneficiary of a cartel induced price increase is typically the business(es) involved and their shareholders through increased profits or lower losses. It is thus appropriate that any fine should be imposed on those businesses and that the fine should not only reflect the magnitude of the illicit monetary gain but also serve as a general deterrent to other potential cartelists. Such an approach creates the correct incentives since the business has a strong motivation to insure that it (including its representatives) is not breaching competition law by introducing, for example, appropriate compliance and other policies.

Sentencing: Estimating Cartel Profits/Fines: Is €31,000/€45,000a Credible Estimate?

The Court's €31,000 estimate of the cartel induced profits and a fine of €45,000 are based on improbable assumptions. A more appropriate estimate of the cartel induced profits is €22,000, while a fine that would "*punitive and acts as a deterrent*" would be €245,000 or 5.4 times the actual fine imposed by the Court.

The Court of Appeal relies on the operating profit as an estimate of the additional profit gained by participating in a cartel. The eight contracts that Aston Carpets won under the bid-rigging cartel were worth €556,000, the operating profit, €31,000. The operating profit likely overestimates the cartel induced additional profits. If Aston Carpets and Carpet Centre, the other firm in the bid-rigging arrangements, had competed rather than colluded via bid-rigging then it is likely that the winner of the eight contracts would still have earned an operating profit, albeit not as large.

In the evidence given before the Central Criminal Court, Aston Carpets operating profit margin on the eight contracts was 4.39%; on the remainder of its business where there was no collusion, 1.3%. The difference in the operating profit margin – 3.1% – may be considered an indication of the magnitude of the cartel induced profits, in which case the cartel induced profits are €22,000 not €31,000.

The Court of Appeal took into account the fact that not all cartels are detected and successfully prosecuted. The Court uses a factor of 1.5 (i.e. €45,000/€31,000=1.5). There is no discussion of the origin of this factor in the Court's judgment, except the remark that "*a fine should be greater than the financial gain so that it satisfies the requirement that it is punitive and acts as a deterrent.*"

Following the methodology of the Court of Appeal the fine or cost should be greater than the gain to the cartelists. This serves as a general deterrent to potential cartelists. It reflects a view that the cartel members trade off the benefits of participating in the cartel in terms of higher profits, p_m , against the fines imposed by the court, F . However, the probability of detection by a competition agency (P_d) and the probability of successful conviction (P_v) also need to be taken into account. Thus F must be set such that,

$$p_m < p_d \cdot p_v \cdot F,$$

where both p_d and p_v fall between 0 and 1. This expression can be rearranged as:

$$F > p_m / (p_d \cdot p_v).$$

In the instance case since the Court has determined p_m is €31,000 and F is €45,000 then this implies that $p_d \cdot p_v$ is equal to 0.66. Is this a reasonable estimate?

An examination of the outcome of the seven previous criminal cartel prosecutions in Ireland since 2000 results in $P_v=0.71$, while reference to work conducted on EU cartels suggests $p_d=0.13$, yielding in 0.09. The Court's use of 0.66 appears biased upwards resulting in a fine that is biased downwards.

But what should the fine be such that it is punitive and acts as a deterrent? Applying the formula for F and assuming that the cartel induced additional profit is €22,000, implies a fine of €245,000. Hence the Court of Appeal fine of €45,000 should be increased by a factor of 5.4.

An alternative method of estimating the fine that should be imposed on the undertaking which reflects the cartel induced gain in profits as well as the loss consumers suffer because they can no longer purchase the product or service at the higher price is to use the EU and/or US sentencing guidelines for cartels. If these guidelines are applied to the commercial flooring bid-rigging cartel then this implies that the fine on Aston Carpets should be either €224,540 (EU fining guidelines) or between €155,680 and €311,360 (US sentencing guidelines).

Hence using the preferred estimate for the cartel induced profits of €22,000 provides an estimate – €245,000 – that is consistent with the EU and US sentencing guideline estimates for cartels.

The European Union Context

Irish competition law is firmly grounded in European competition law. The Competition Act 2002, for example, in its preamble mentions that it makes new provisions “*by analogy with Article 81.*” With its single market imperative European competition policy strives to achieve a consistent and robust enforcement of competition law across Member States, with a consequent convergence in approach toward enforcement. The treatment by the Central Criminal Court and the Court of Appeal of the commercial flooring bid-rigging case leans against this trend. The view that a bid-rigging cartel is somehow of lesser importance than a cartel characterized by price fixing as in the CDA cartel case flies in the face of EU competition law, while the fine imposed on Aston Carpets is out of line with the fining guidelines of the European Commission. It is to be hoped that next time the courts in Ireland deal with a cartel case greater attention is paid to the European precedents and methodology in characterizing a cartel and in setting fines, while referencing US sentencing guidance for individuals.

This blog is based on a Munich Personal RePEc Archive paper: <https://mpra.ub.uni-muenchen.de/89817/> and an earlier Kluwer Blog on the Central Criminal Court sentencing which may be found at: <http://competitionlawblog.kluwercompetitionlaw.com/2017/08/21/sentencing-irelands-first-bid-rigging-cartel-case-unduly-lenient/>. The author was a member of the Competition Authority between 2000 and 2008, prior to the commencement of the commercial flooring case investigation. The

author was not involved for either side or for any third party in the commercial flooring bid-rigging cartel case. The usual disclaimer applies. The blog pays attention to the competition infringements only: the company director also received a suspended sentence for obstruction of justice. The Court of Appeal judgment may be accessed at: <http://www.courts.ie/Judgments.nsf/bce24a8184816f1580256ef30048ca50/2cb5947905448052802582c0005552e4?OpenDocument>

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