Inability to Pay – First cases and practical experiences

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1. Introduction

In the Heat Stabilisers decision the Commission accepted a claim for inability to pay (hereinafter ‘ITP’) under point 35 of the 2006 Fining Guidelines and significantly reduced the fine of one company in view of its difficult financial situation. The Commission had rejected ITP claims in all previous cases. Subsequent to Heat Stabilisers, the Commission reduced companies’ fines on the basis of ITP in three more decisions, namely Bathroom Fittings, Pre-stressing Steel and Animal Feed Phosphates. These ITP claims were accepted in the midst of an economic and financial crisis of unprecedented magnitude in the history of EU antitrust enforcement.

The purpose of this article is to discuss the ITP provision in the context of the 2006 Fining Guidelines as well as to describe its legal background and implementation in light of recent Commission decisions. It should however be emphasised that ITP assessments continue to be refined with each case and the application of point 35 is an evolving process.

2. A difficult balance between deterrence and the social cost of bankruptcy

According to point 35 of the 2006 Guidelines the Commission may ‘in exceptional cases…take account of a company’s inability to pay in a specific social and economic context’ provided that the fine ‘would irretrievably jeopardise the economic viability of the undertaking concerned and cause its assets to lose all their value.’ The thresholds to be met by companies in order to qualify for a reduction under point 35 (and its predecessor under the 1998 Fining Guidelines) have traditionally been high. The wording of point 35 makes it clear that ITP reductions will only be granted exceptionally and this restrictive approach has been confirmed by the Commission’s practice. There are a number of reasons why ITP reductions should be limited to the very minimum.

Deterrence is a primary objective of the Commission’s fining policy. (2) Point 4 of the 2006 Guidelines states that ‘fines should have a sufficient deterrent effect, not only to sanction the undertakings concerned (specific deterrence) but also in order to deter other undertakings from engaging in, or continuing behaviour that is contrary to Articles [101 and 102 TFEU] (general deterrence).’ Any deviation from the level of deterrent fines can distort the attitude of firms in the sense of making it more attractive for them to commit an infringement. With the exception of certain defined mitigating factors as well as reductions granted under the leniency and settlement notices, reducing the fine amount below the deterrent level risks leading to under-enforcement in the area of antitrust. Indeed, a likely adverse effect of a generous ITP policy would be an overall reduction of consumer welfare due to companies’ perception of increased opportunity for avoiding or reducing fines.

Furthermore, despite the significant fines imposed in recent years, the Commission's fines rarely reach a level that would jeopardise a company's existence and accordingly require downward adjustment. In particular, the 10% cap under Article 23(2) of Regulation 1/2003 normally ensures that fines are not excessive since it aims to protect companies against fines ‘which could destroy them commercially.’ (3) The notion that companies are generally able to absorb fines amounting to 10% of their turnover has been confirmed during the almost 50 years of application of Regulation 17/62 and Regulation 1/2003. Point 35 therefore normally only comes into play as an ultima ratio in those few instances where this may not be the case. (4)

It must also be borne in mind that the Commission has in principle no legal obligation to take into account the financial situation of a company when setting fines since the fact that a fine brings about the insolvency or liquidation of a company is not prohibited by Community law. (5) In fact, it would be misleading to consider that the market structure resulting from a cartel should act as a reference. Some of the market players that are only viable at

(1) The content of this article does not necessarily reflect the official position of the European Commission. Responsibility for the information and views expressed lies entirely with the authors.

(2) See, e.g., Case C-289/04 P - Sbowa Denko v Commission, [2006] ECR I-5859 para. 16.

(3) Case T-71/03 etc., Tokai Carbon etc. v Commission, [2005] ECR II-10, para 389.

(4) While ITP reductions may also be granted to companies whose fine remains below the 10% cap, reductions have in the four decisions to date been granted to monopoly companies or companies with a limited product portfolio that were of relatively small size and whose fine reached the 10% cap.

(5) Case T-25/05, KME Germany etc. v Commission, judgment of 19 May 2010, para. 167 (not yet reported); Case T-62/02, Union Pigments v Commission, [2005] ECR II-5057, para. 177.
cartelised price levels may naturally exit to restore the market structure that would have emerged without the cartel, leaving only those players that are efficient enough to be viable at competitive price levels. It would thus be paradoxical for the Commission to be obliged to preserve the cartelised market structure. While the Commission has decided to go beyond its legal obligation and to take a company’s financial situation into account under point 35, it will only do so under certain, very narrowly defined circumstances.

Moreover, the EU Courts have repeatedly emphasised that fine reductions granted in view of the precarious financial situation of a company risk conferring ‘unjustified competitive advantages to undertakings least well adapted to the market conditions.’ Indeed, one of the adverse consequences of ITP is that fine reductions are more likely to be granted to companies that are inefficient, badly managed or over-leveraged whereas soundly managed companies in good financial health have little chance of seeing their fines reduced.

ITP can also exacerbate opportunistic behaviour of companies. The prospect of a fine reduction may incentivise companies to exploit their informational advantage with regard to their current and future ability to pay a fine by artificially creating conditions of insufficient liquidity and distress.

In conclusion, the application of point 35 is a corrective measure that carries the risk of severe drawbacks for consumers in both the short and the long run. The Commission’s ITP policy therefore has to carefully balance two opposing objectives. On the one hand, the Commission has to maintain a sufficiently deterrent level of fines — a key instrument to ensure competitive markets and enhance consumer welfare — while, on the other hand, it has to avoid social costs due to bankruptcies of the companies fined. It is only when the social cost of bankruptcy is significant enough, as it arguably has been in the midst of the crisis, that it might counterbalance the drawback of granting a reduction in fines.

3. The Commission’s ITP practice under the 1998 and 2006 Fining Guidelines

Under point 5(b) of the 1998 Fining Guidelines, account was to be taken, ‘depending on the circumstances’, of a company’s ‘real ability to pay in a specific social context.’ This assessment was to be made after the fine calculation had been carried out, i.e. after application of the 10% cap and reductions under the leniency notice. As mentioned earlier, no ITP reduction was granted under the 1998 Fining Guidelines.

The Commission’s main reason for rejecting an ITP application was that the company’s financial situation was not sufficiently critical to warrant a reduction (7) but it also took account of insufficient evidence put forward by the company (8) and/or the lack of a specific social context. (9) In two of the three Graphite cases, the Commission rejected the ITP application of SGL Carbon under point 5(b) but granted a reduction of 33% to take account of the company’s precarious financial situation in combination with the fact that a fine had been recently imposed on the same company. (10) Point 5(b) of the 1998 Fining Guidelines also provided that the Commission could take into account ‘a specific economic context’. The economic context constituted a ‘stand-alone’ ground for reduction which was applied in the French beef case when the Commission granted a reduction of 60% in light of the mad cow disease affecting the beef sector at the time. (11) Under the 2006 Fining Guidelines, the economic context constitutes one of the elements of the ITP test under point 35.

The 2006 Fining Guidelines further clarify the conditions for ITP and provide for more transparency for companies, taking into account Commission experience and Court case law under the previous Guidelines. Point 35 lists five conditions to be met in order for a company to qualify for full or partial reduction of a fine, namely (i) an ITP request by the company, (ii) a risk of bankruptcy, (iii) causality between the risk of bankruptcy and the fine, (iv) loss of asset value and (v) a specific social and economic context. These conditions, some of which are closely intertwined, will be discussed in detail below in light of recent cases.

The number of ITP applications under the 2006 Fining Guidelines has increased from zero in 2007 (three decisions), nine in both 2008 (seven decisions) and 2009 (seven decisions), to 25 in 2010 (five decisions to date). The Commission has in parallel intensified its ITP review, further developed its methodology for assessing these claims and devoted additional


(8) See, e.g., Commission decision of 19 September 2007, COMP/39168 — Fasteners, paras. 681 et seq.

(9) See, e.g., Commission decision of 3 September 2004, COMP/38069 — Copper plumbing tubes, paras. 833.


(11) Commission decision of 2 April 2003, COMP/38279 — French beef, paras. 180 et seq.
resources to the task of examining ITP requests. As mentioned earlier, in *Heat Stabilisers* the Commission for the first time granted an ITP reduction of around 95 % to a company under point 35. A few months later the Commission reduced fines for five companies in *Bathroom Fittings* (three companies by 50 %, two by 25 %), for three companies in *Prestressing Steel* (by 25 %, 50 % and 75 % respectively) and for one company in *Animal Feed Phosphates* (by 70 %). To date, the Commission has granted ITP reductions to ten companies under point 35 of the 2006 Fining Guidelines in 20 decisions. In comparison, the Commission had granted no ITP reductions and only two reductions taking into account the financial situation of a company in more than 80 decisions adopted under the 1998 Fining Guidelines. All successful ITP applicants to date have been relatively small companies, almost all of them mono-product companies and the fine in each case was capped at 10 % of their turnover. It should be noted in this context that the 10 % turnover cap has in practice led to much bigger fine cuts than reductions granted under point 35. In those decisions where the fines reached the 10 % cap for a large number of companies (*Bathroom Fittings, Prestressing Steel*), the application of the cap led to significant fine reductions in absolute amounts whereas the adjustments on ITP grounds were small in comparison. This illustrates that the 10 % turnover cap successfully operates as the main instrument for protecting companies from bankruptcy, even in times of severe economic crisis.

4. The conditions of ITP under point 35 of the 2006 Fining Guidelines

4.1. Company’s request

Point 35 requires a request by the company, i.e. the Commission does not carry out ITP assessments *ex officio*. While the request does not immediately need to be accompanied by supporting evidence, the Commission will ask for ample and detailed financial information in due course. The assessment of the financial situation is carried out for all companies close to the time of adoption of the decision and on the basis of up-to-date information, irrespective of when the request was submitted.

4.2. Risk of bankruptcy

At the heart of the ITP analysis is the question whether the fine would irretrievably jeopardise the economic viability of the company. To answer this question, a large amount of financial data is needed. The Commission, by way of standardised requests for information, obtains the company’s financial statements (annual reports: balance sheet, income statement, statement of changes in equity, cash-flow statement and notes) in respect of (usually the last five) previous financial years, as well as projections for the current year and the next two years. In addition, the Commission takes into account relations with outside financial partners such as banks, on the basis of copies of contracts concluded with those partners, in order to assess the company's access to finance and, in particular, the scope of any undrawn credit facilities they may have. The Commission also includes in its analysis the relations with shareholders as well as the ability of those shareholders to assist the companies concerned financially. By analogy with the assessment of ‘serious and irreparable harm’ in the context of interim measures, the Commission bases its assessment of a company’s ability to pay on the financial situation of the group as a whole. This includes in particular the company’s shareholders, irrespective of whether they have been found liable for the infringement. The Commission may also take into account the financial ability of minority shareholders to give assistance. The Commission’s analysis examines the equity and profitability of the companies, their solvency, liquidity and cash flow, to evaluate the risk of bankruptcy. The analysis is both prospective and retrospective but with a focus on the present and immediate future of the company. The analysis is of a dynamic nature and takes into account the consistency of data submitted for the company’s past and projected future performance. The analysis also extends to possible restructuring plans and the progress made with them.

The Commission relies on information provided by the company and/or by its shareholders. Full disclosure and prompt delivery of the information requested are therefore essential for ITP assessments. Since the burden of proof for establishing the alleged critical financial situation is on the company, any refusal to supply relevant information may lead to rejection of the ITP request. As mentioned earlier, the Commission will carefully compare the company’s projections for the future with its past performance and assess the consistency of the data. In this respect, audited financial data or

(17) Undrawn bank facilities are not included in the balance sheet.


(13) Attempts to mislead the Commission by, e.g., providing incorrect information may result in the application of an aggravating circumstance or in the imposition of a separate fine pursuant to Article 23(1) of Regulation 1/2003.

prospects already approved by the board are of greater evidentiary value. There have been instances where companies that had not made provision for a potential fine invoked the adverse consequences that the fine would have for them because their ‘surprised’ banks would cut credit lines, thus causing liquidity problems. However, it is the company’s responsibility to inform stakeholders such as banks and others of the possible imposition of a fine in a timely manner, i.e. following receipt of a statement of objections. The inclusion of an accounting provision for the potential fine amount would also seem appropriate after receipt of the statement of objections. Although accounting provisions do not guarantee the availability of liquid assets to pay the fine, they constitute an important first step in alerting stakeholders and in reducing profit available for dividends and taxes. Finally, it should be noted that the Commission will look very closely at measures that financially weaken a company during the period preceding adoption of the decision, in particular following the sending of the statement of objections. Without there being a need to prove intent to avoid paying a fine, the Commission may take into consideration conscious decisions of the company or its shareholders that weaken the company’s ability to pay; such considerations may contribute to the rejection of an ITP request.

The Commission’s financial analysis is summarised in the decision, so as to allow each company to review the individual motivation applicable to its ITP application. The information regarding the financial situation of each company is highly sensitive and confidential vis-à-vis the other parties but the decision notified to the parties will normally disclose the identity of those companies whose ITP applications were accepted or rejected.

4.3. Causal link between the risk of bankruptcy and the fine

The text of point 35 requires a causal link between the fine on the one hand and the financial distress (i.e. risk of bankruptcy) of the company on the other (‘imposition of the fine…would irretrievably jeopardise…’).

In parallel with the assessment of the company’s financial situation with and without a fine, the Commission analyses any indications pointing to the absence of a causal link. Causality may be lacking, e.g. (i) if the company’s financial distress has been deliberately brought about, (ii) where the company is in such serious financial distress that it would go bankrupt even without the fine or (iii) where the fine is very small in comparison with the overall turnover and assets of the company, in which case the fine cannot be considered to have a decisive impact on the company’s financial situation.

4.4. Loss of asset value

According to point 35, a fine reduction may be granted if the fine would ‘cause [the company’s] assets to lose all their value.’ This language originates from Court case law, according to which the fact that a company is liquidated in its existing legal form and hence may adversely affect the financial interests of the owners, investors or shareholders, is not incompatible with Community law since ‘it does not mean that the personal, tangible and intangible elements represented by the undertaking would also lose their value.’ In other words, not the legal existence of a company or its owners’ financial interests should be protected but the value of the company’s assets as such, including e.g. production facilities and employees. The judgments (and point 35) reflect the fact that the primary focus of modern insolvency/bankruptcy legislation no longer rests on the liquidation and elimination of insolvent companies but aims to ‘turn around’ and continue their business as a going concern. Bankruptcy or insolvency therefore does not automatically result in asset loss, which must instead be assessed on a case-by-case basis.

The Commission — contrary to the wording of point 35 — does not require a ‘total’ asset loss. Such literal interpretation of point 35 would likely lead to the systematic rejection of all ITP claims. Assets rarely lose ‘all their value’ since they normally retain a certain operational and resale value even in the case of bankruptcy or liquidation. A ‘significant’ asset loss is sufficient. In principle, it is for the company to demonstrate that in the case of insolvency or bankruptcy, the company or its assets were unlikely to continue as a going concern and hence its assets would exit the market, stand idle, be dismantled or be sold at discounted prices. In practice, the Commission undertakes a forward-looking analysis on the basis of the available evidence and assesses whether there are credible alternatives for the company to continue its business as a going concern ‘within a reasonably short period of time’ (e.g. an acquisition by a financially strong buyer that continues the business without significant job cuts). In the absence of such alternatives, there is normally ‘a sufficiently high risk’ that the company’s assets would lose a significant part of their value.

(20) Article 28 of Regulation 1/2003.
4.5. Specific social and economic context

The specific social context and the specific economic context are closely intertwined since the economic situation will, for example, be a relevant factor when assessing the possible social consequences of a company’s bankruptcy.

The social context already formed part of the ITP test under the 1998 Fining Guidelines. It continues to be an important element of ITP under the 2006 Fining Guidelines since one of the main objectives of ITP is to prevent negative social consequences resulting from the disappearance of a company. Under the 1998 Fining Guidelines the Commission assessed in particular the risk of job losses as a result of a fine. This was confirmed by the EU Courts, which have considered in this respect ‘the consequences which payment of the fine would have, in particular, by leading to an increase in unemployment or deterioration in the economic sectors upstream and downstream of the undertaking concerned.’ (2) It is for the company to produce information which allows the Commission to assess the specific social context. (3) The burden of proof is also on the company to demonstrate that the alleged adverse effects (e.g. redundancies) will be caused by the fine and not by other circumstances. (4) The likelihood of an increase in permanent unemployment and the resultant social consequences have been the focus of the Commission’s assessment of a specific social context in recent cases under the 2006 Fining Guidelines. The Commission examines in particular whether the company’s bankruptcy would lead to redundancies in view of, e.g., its individual situation (e.g. restructuring plans), but also given the economic situation in the sector concerned and the economic situation in the region or country where the company is located. The current economic crisis with high unemployment rates in many countries renders the existence of a specific social context more likely.

When examining the specific economic context the Commission assesses in particular the economic situation of the sector concerned. (5) Elements that may be relevant for a finding of specific economic context include, e.g., overcapacity, falling prices, falling demand or other negative economic indicators. The Commission also takes into account the impact of a general economic crisis on the sector concerned and on the companies affected. In this respect, the Commission considered, e.g. in Bathroom Fittings and Prestressing Steel, that companies in those industries were experiencing severe difficulties resulting from dysfunctional credit markets at the height of the crisis.

5. Conclusion

ITP is a corrective measure that carries risks of severe drawbacks for consumers’ welfare in both the short and the long run. Given these adverse effects, the ultimate ratio nature of this measure must be emphasised. ITP reductions will continue to be granted only on a very exceptional basis and after a careful review of the stringent conditions set forth under point 35 of the 2006 Fining Guidelines. Ten companies have benefited from ITP reductions to date. The Commission has refined its methodology, further expanded and standardised its requests for information and devoted substantial resources to dealing with ITP claims. These measures reflect the importance that the Commission attaches to assessment of the financial situation of companies in distress and illustrate the considerable efforts made by the Commission to strike the right balance between its antitrust enforcement mandate and the need to avoid severe social costs that may result from companies’ bankruptcies triggered by fines.

(4) Case T-25/05, KME Germany etc. v Commission, judgment of 19 May 2010, para. 170 (not yet reported).
(5) This was also the case under the 1998 Fining Guidelines. In FNCBV, the General Court confirmed that the Commission had been correct when reducing the fine by 60% in view of the specific economic context, given that the beef sector was marked by a serious crisis following the mad cow disease outbreak (Cases T-217/03 and T-245/03, FNCBV and others. v Commission, [2006] ECR II-4987, para 351; the General Court increased the reduction to 70%).