

## ЭКОНОМИЧЕСКАЯ ТЕОРИЯ В ИСТОРИЧЕСКОМ РАЗВИТИИ

JEL: K21, K41

### Depreciating evidence in administrative adjudication: Rules on the sequence to present evidences\*

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The late choice of the type of alleged infringement in administrative investigations, when company (alleged infringer) presents evidence first and then responsible agency decides on the content of infringement on the basis of evidence produced by company has significant incentive effect. This rule demotivates alleged infringers to present evidence under the procedure of administrative inspection in time and as complete as possible. In addition, incentives to provide evidence are limited if the agency has the opportunity to select among different types of alleged infringement and to use evidence presented by company in its favor as evidence of a certain type of alleged infringement. Time sequencing of decisions when the choice of the type of infringement is made just after agency collects evidence from company inevitably results in decisions of infringement, which company then appeals in the court. The experience of Russian antitrust investigations — with two indicative illustrations (Novolipetsky metallurgical plant case and the case with largest Russian retailers specialized in computers and home electronics) shows the importance for the company of being suspected in certain infringement to decide on the amount of evidence. Incentives to provide evidence are studied through the lens of all-pay auction framework to explaining the effects of procedural rules in

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administrative enforcement that is inquisitorial in nature, in contrast to adversarial ones. It is shown that prosecutorial bias or asymmetric burden of proof is not necessary to suppress the incentives of the target of investigation to produce evidence.

*Keywords:* administrative enforcement, investigation, prosecution, adjudication, evidence.

## 1. Introduction

Efficient enforcement of legislation requires correct distinction between legal and illegal behavior, or high discriminatory power [Kaplow, 1994; Katsoulacos, Ulph, 2016].

In turn, proper evidence is necessary to make right conclusions. There are many legislative acts, enforcement areas (for the authors, nearest example is antitrust) where necessary evidence goes far beyond “naked” data and its consistent interpretation in the non-contradictory framework is required [Neven, 2006; Schinkel, 2007].

However, for antitrust enforcement the difference between data/information, on the one hand, and economic evidence, on the other, is the most visible, for cases decided according to the “effect-based” or the “rule-of-reason” approach [Neven, 2006; Katsoulacos, Ulph, 2016]. In order to assess behavior properly consistent explanation of reasons and effects of business practice under consideration is necessary in contrast to “pure data”.

Therefore, incentives of the parties of investigation of supposed law violation are of crucial importance. At first glance, incentives of the parties to provide evidence under investigation are self-apparent. The goal of the investigator who is the responsible agency is to prevent consumer welfare loss (or social welfare loss, depending on the welfare standard of enforcement established). The goal of the company is to avoid infringement decision with monetary sanctions and remedies.

However, besides the gains of the party (company), the rules of decision making influence the incentives to collect and to provide evidence in support of legal position. Among other procedural rules, time schedule of presenting evidence is important. There are circumstances when at the time of provision of evidence to the investigator it is unclear if additional evidence improves or disproves the position of the company under investigation.

Effects of information provision are the most obscure and therefore the most crucial for the incentives of the parties when one authority collects evidence, investigate conducts, prosecute *and* makes decision on his own — under so-called inquisitorial enforcement model [Asimow, 2015], in antitrust also known as administrative enforcement, in contrast to prosecutorial one [Jenny, 2016].

In Russia, infringements of administrative law are decided normally according to inquisitorial procedure. Three steps are made by the authorities. First, there is preliminary analysis when agency staff provide a quick look of the case and makes so-called “front-line” decision. Second, basing on “front-line” decision agency allows the alleged infringer to present the case, to provide the evidence and challenge the “front-line” hypothesis of administrative staff. Third, administrative reconsideration is possible, when party has a right to claim for challenging the decision by higher-level personnel. These three steps within the enforcement authority (under the common name of “Service” — e.g. Federal Tax Service, Federal Custom Service, Federal Antitrust, or Antimonopoly Service) are complemented by the possibility of judicial review in the Russian commercial courts as a fourth step. In the broad classification of administrative adjudication [Asimow, 2015],

Russian model of administrative adjudication is close to China, Argentina and Japan. The difference is that in contrast to European continental model, in Russia judicial review of administrative decisions covers not only procedural issues but also legal facts. Considering the claim to annul infringement decision of the administrative authority, courts can take into account new evidence, reasons, and arguments, and the court is empowered to substitute its judgment for that of the agency on factual and discretionary issues, as well as legal issues. The right to consider new evidence and establish new facts differentiates judicial review of administrative decision in Russia from power of courts, say, in US or UK, where courts consider only procedural issues under review. In terms of comparative analysis of adjudication [Asimow, 2015], Russian commercial courts provide open in contrast to closed review. In turn, difference from French or German system is that Russian commercial courts are not specialized on the claims to administrative authorities.

Open judicial review (the right to acquire new evidence, reconsider evidence and establish new facts) in Russia provides unique opportunity to compare (or course, with some limitation) the outcomes of inquisitorial and adversarial procedures. Under the review in commercial courts there are the same two parties, which are public enforcement agency and alleged infringer, and apparently the same case. The only important change is that procedure of consideration is adversarial not inquisitorial. However, the outcomes of the procedure under adversarial rules are often different.

In 2017, Russian commercial courts considered several thousands claims to annul decisions on administrative penalties. Defendants are Federal Tax Service (2176 claims), Federal Custom Service (2516 claims) and Federal Antitrust Service (2320 claims). Out these claims, from 36 (Custom Service and Antitrust Service) to 45 % (Tax Service) are satisfied. In addition, there were 7309 claims to annul infringement decisions of the Federal Antitrust Service, from which 32 % are satisfied. Even taking into account that claims for annulment are different from the general population of the cases, and they are skewed in favor of the cases where evidence in favor of infringement decisions is weaker (see [Priest, Klein, 1994]), the share of wrong convictions made by services is very large.

This share hardly can be explained by accidental errors of particular public servants. Recall that in every service there is a system of administrative reconsideration that corrects the mistake by lower levels on the complaint. Most of claimants in commercial courts first provides claims to the unit responsible for reconsideration. Administrative reconsideration units obtain expertise in the area of law and at the same time anticipate claims to the courts in case of negative decision on the claim. Expectations on the high probability of judicial review should correct possible prosecutorial bias, common for administrative model of adjudication [Wils, 2004] at least on the level of administrative reconsideration unit.

One observation that partly explains difference in the outcomes of administrative adjudication on the level of agency and judicial review in commercial courts is different attitudes of the companies to the presentation of information to the authorities, on the one hand, and to commercial courts, on the other. On the stage of administrative investigation, from “front-line” analysis to administrative reconsideration, inspected companies often refrain from providing evidence, while on the stage of judicial review present large amount of evidence.

Our explanation is that typically announcement of the content of alleged violation takes place at the end of initial stage of investigation (inspection). At the initial stages company should provide information not being confident in the concrete type of infringe-

ment alleged. Hence company does not know what kind of evidence supports its position in the best way. If the period of uncertainty about alleged infringement is long enough, during the whole period company is in disadvantage in comparison to the circumstances for presenting evidence when alleged infringement is defined with certainty.

But it is not only company that is affected by the rules of evidence presentation. If the target company under administrative investigation, or inspection, presents little evidence in her favor, administrative authority makes decision with lower amount of evidence under lower standards of proof. As far as decision relies on the contest between the alternative economic evidence presented, limited evidence produced by one party (company) suppresses the incentives of the other (authority). Decreasing amount of evidence results in the increase of probability of wrong convictions. Observed outcome is the increasing share of annulment of administrative decision.

The paper explains the negative impact that the sequence of information requests and information provision have on the incentives of the alleged infringer to produce economic evidence. Incentives of the company and antitrust authority are interpreted in the framework of all-pay auctions, when evidence presented is considered as a “bid” in the contest for favorable decision. We analyze the effects of the company’s disadvantage during the time of producing evidence, for the illustrative purposes assuming the procedure to follow the “reverse order” rule, when antitrust authority chooses and company recognizes alleged infringement after it provides economic evidence. Conceptual framework relies on the experience of Russian antitrust enforcement where procedures till now support the ‘reverse order’ rule of evidence provision and alleged infringement recognition. We show that this rule can even be socially beneficial but only if any legal errors of the authority of competition are completely excluded. Otherwise, this rule is welfare-detrimental.

The paper is organized as follows. Section 2 explains the experience of Russian competition law enforcement, which motivates the analysis of the effects of ‘time schedule’ (or steps sequencing) procedures. On the example of particular antitrust investigations, we show the roots of refraining to provide evidence. Section 3 briefly reviews understandings of legal uncertainty developed in the literature and explains the difference of our approach. Section 4 applies the framework of all-pay auction to the procedure of decision on infringement when company presents economic evidence before recognition of alleged infringement. Section 5 discusses the implications of the analysis for the organization of administrative proceedings in the field of competition legislation enforcement. Section 6 concludes.

## **2. Indication of the problem: uncertainty about type of infringement in the Russian antitrust investigations**

Russian competition law since its adoption in 1990 survived different waves of changes and amendments, especially after 2006. One of important amendments within the framework of so-called “fourth antimonopoly package” was of pure procedural nature. It regulates the time of the announcement of infringement alleged and requires notification on the initiation of administrative proceedings to contain the reasons to open proceedings and grounds for suspicions in competition law violation. Russian legal community considers this amendment as one of the most important steps forward in the process of improvement of the procedural rules in administrative investigation of violation of competition law.

Under investigation of the alleged violations of art. 10 and art. 11 of the Law “On protection of competition” (which are substantially equivalent to 101 and 102 TFEU articles) competition authorities (the Federal Antitrust Service, FAS hereafter, with a regional subdivisions) rely on the data provided by the companies as a response to informational requests. Till now, on the stage of front-line investigation, preparing data according to the requests of information companies did not precisely know what alleged infringement is.

Absence of the information on the nature of presumed violation suppresses the incentives to provide economic evidence during administrative investigation. That is why company often responses to the informational requests of FAS formally, provides scanty information and makes no efforts to prepare competing economic evidence. The same company after receiving decision on the infringement makes any effort to prepare appeal at the commercial court, hires independent lawyers and economic experts (sometimes several consulting companies or independent experts). Delay in the production of economic evidence cannot be explained by uncertainty about competition authority’s decision. If after company’s responses on information requests authority opens investigation, the probability of infringement to be found is very high — up to 90 % during last years. Nevertheless, during the stage of investigation (that can last up to several years) companies make significantly less effort to prepare competing economic evidence in comparison to the stage after infringement decision release and before filing an appeal to the commercial court of the first instance (during three months only).

The main reason for asymmetry of efforts made to provide economic evidence before and after infringement decision is that company does not know the precise type of alleged infringement literally until it receives decision of the commission of competition authority responsible for investigation of the case. There are at least two fears of wasting resources when economic evidence is provided before formal decision. First, economic evidence that plays in favor of company under one type of alleged infringement may not support its position under another one. Second, authority can even convert the evidence presented in favor of company under one type of alleged violation into the evidence, which is in favor of infringement decision under another type of violation. Two recent cases are expository in that respect.

One is the investigation against Novolipetskiy metallurgy plant (NLMK), one of the largest Russian steel manufacturers, in the case of prices on cold-rolled grain-oriented steel [Avdasheva, Tsytsulina, 2015]. During investigation most information requested was not on the level of delivery prices in the domestic market, but on the criteria of price differentiation for the groups of domestic customers. Company expected violation presumed to be the dissimilar conditions for equivalent transactions with different trading parties that gives some of them competitive disadvantage (para 1 art. 10, subpara 6, 8 of the Law “On protection of competition”). However, the decision issued was on excessive selling prices (para 1 art. 10, subpara 1). Economic evidence that company should present in her favor according two different types of violation differs. To disprove offense in dissimilar condition to equivalent transaction (discrimination) it is necessary to explain the reason for the differentiation of contract terms. To disprove offense in excessive pricing according to Russian Law On competition it is necessary to perform comparison of price level under consideration with the prices on comparable competitive markets with similar demand and supply conditions, and with “economically reasonable” costs and profit (art. 6 of the Law “On protection of compe-

tion”). All efforts to present economic evidence on the first issue are useless for company that tries to prove that price in the domestic market is not excessive.

In the second case the three largest Russian retailers specialized in computers and home electronics (Eldorado, Media Markt and Auchan) were under investigation of the complaint of domestic producer of home electronics. Information requests during investigation were devoted mostly to the explanations of business practice generally known as *slotting allowances* (marketing payments of supplier to retailers, all-quantity discounts, after-sales rebates, and payment delays) together with best-price requirements. Companies reasonably expected infringement decision to be in *abuse of collective dominance* in the form of making the conclusion of contracts subject to acceptance by the other parties of supplementary obligations (para 1 art. 10 subpara 3). Substantial part of economic evidence provided to the authorities concentrates on the point that slotting allowances became normal part of business practice all over the world, including Russian retail chains. Finally, infringement decision issued was on *concerted practice* (para 1 art. 11 subpara 1). Appealing (successfully at the end) the infringement decision in the commercial court companies provided the explanations that the structure and organization of the market of computer appliances and home electronics retailing do not support tacit collusion, and contract terms in question cannot be convincing evidence for concerted practice. In other words, only after receiving final infringement decisions companies start to present evidence exactly from the point they prepared on the stage of investigation.

The second case is probably the only example when companies sure that they are under investigation of abuse of dominance, receive infringement decision on concerted practice (that is investigation opened under one particular article of competition law results in infringement decision under another article). However, the companies sure that they are under investigation of abuse of dominance but not sure in the type of abuse of dominance, are not rare case in the Russian competition law enforcement. Keeping in mind that there are more than 3 thousand cases under investigation of abuse of dominance in Russia annually (see [Avdasheva, Golovanova, Katsoulacos, 2018]), it is not surprising that uncertainty about type of infringement attracts attention of legal and economic experts as well market participants.

Recently there were several attempts to improve the procedures of antitrust investigation in order to resolve the problem. The first proposal is to introduce in the administrative procedures an analogue of the *Statement of Objection* that authority should issue on relatively early stages of investigation. Recently exactly this amendment was under consideration of the Russian Duma (the lower house of the Russian parliament). The second proposal is the precise specification of the types of violation of competition law. Until now up to half of infringement decisions of the Russian competition authorities under art. 10 do not specify types of violations in terms of paragraphs of the article. In January 2015, Constitutional Court of the Russian Federation considered (and rejected) the request about the ‘incompleteness’ of this article of the Law “On protection of competition”. We do not want to discuss this decision. Just as a remark, we consider domestic debate on the (in)completeness of the description of the types and indicators of violation to take the wrong path. Forms of restrictions of competition cannot be described perfectly anyway, more important task is to develop clear standards of proof for specific cases and clear welfare standards of antitrust enforcement.

However, all these developments indicate comparative disadvantage of the company in the process of producing economic evidence under antitrust investigation. Disadvantage is not only painful for the alleged violator of competition law but also influence on the incentives to develop economic evidence suppressing the quality of contests of evidence under investigation and worsening evidentiary standards for competition authority. The probable outcome is welfare losses.

### **3. Literature review: incentives to produce evidence under inquisitorial enforcement and unknown subject of violation**

Incentives to provide evidence are of primary importance for the accuracy of the adjudication [Kaplow, 2015] that is critical for deterrence and welfare effects of enforcement [Kaplow, 1994]. Incentives to provide evidence are extensively studied to analyze the merits of different rules in the legal disputes, for example, impact of different fee-shifting rules [Baye, Kovenock, de Vries, 2005] on the amount of evidence presented by parties and outcomes of litigation. Following Tullock [Tullock, 1975] this approach uses the model of *all-pay auction* to explain the impact of different procedural rules. We do the same, but apply *all-pay auction* framework to explain the effects of procedural rules in administrative enforcement that is inquisitorial in nature, in contrast to adversarial ones. This approach differentiates the presented framework from the earlier work [Avdasheva, Shastitko, 2015].

All-pay auction framework may seem inapplicable to strategic interaction between responsible authority and the suspect for the enforcement of what is called public law — legal rules aimed to protect social welfare. Imagine however that competition authority decides on the case using the effect-based approach (rule-of-reason). Socially optimal cost of competition authority on collecting the evidence against the company is up to the prevented loss of consumer welfare (or social welfare, depending on welfare standard applied). In turn, cost of company on providing evidence is up to the welfare gains produced by business practice in question. Presentation and cross-examination of evidence in the framework of effect-based enforcement of competition policy can be considered as a contest before competition authority.

To explain the effects of procedural rules in the framework of inquisitorial model, we do not consider the latter as a system where evidence in favor and against the suspect is collected with the same efforts, and the evidence in favor of the suspect is not rejected. In spite of comparative analysis of adversarial and inquisitorial law enforcement model starts exactly from this point [Tullock, 1988; Pozner, 1988], we claim this understanding does not reflect the real-life application of administrative procedures at least in some classes of cases. Ideally, inspection is aimed at collecting information objectively, freeing the suspects from the burden of proof of innocence. However, real-life inspected company bears the cost of proving innocence.

The most important effect of the low incentives to provide information is the increasing probability of legal errors. Particularly, low incentives to provide information on the side of alleged infringer increase the probability of wrongful convictions, or Type I legal errors, which decreases deterrence effect of law enforcement [Gravelle, Garoupa, 2002; Polinsky, Shavell, 2000; Rizzolli, Stanca, 2012; Garoupa, Rizzolli, Rizzolli, Saraceno, 2013].

In competition policy, weaknesses of administrative enforcement that is based on inquisitorial model of enforcement is discussed on the example of the decisions of European

Commission. However, typically authors consider the very combination of investigatory, prosecutorial and adjudicative functions as an explanation of prosecutorial bias that limits the legitimacy of the decisions of competition authority [Wils, 2004]. Wils mentions three roots of prosecutorial bias, from which two are of mostly psychological nature (confirmation bias and hindsight bias), and one results from motivation of the authority (desire to show a high level of enforcement activity). Difference between observations of Wils and our framework is that we do not presume prosecutorial bias in the decision. We allow even no prosecutorial bias within the authority. Infringement decision results not from prosecutorial bias itself but from the little amount of evidence in favor of company. In turn, little amount of evidence results from the rules of sequential presentation of evidence that depreciate the value of information produced by company.

Our framework develops the notion of “procedural fairness” under administrative adjudication. Procedural fairness substantially influences the assessment of legitimacy of particular legal rules [Murphy et al., 2009]. In relatively young administrative jurisdictions the issue of procedural fairness is even more important [Deng, 2016]. In Russia specifically, unclear procedures and the absence of procedural fairness under administrative inspections explain large part of “barriers for business survival” [Aidis, Adachi, 2007].

## 4. Choice of the evidence presented under sequential decisions: an illustration

### 4.1. Basic assumptions

To analyze the impact of sequencing the evidence provision and information on suspect violation we introduce several assumptions. First, we do not discuss legality and illegality per se. Actions of the suspect are considered as legal if the latter presents enough evidence in favor of this conclusion. Neither we discuss legal errors in spite of our framework allows for important implications in this respect. We assume “fair” decision-making after the parties present economic evidence, there is no asymmetric allocation of the burden of proof.

We consider the following model of quasi-litigation within authority responsible for control and monitoring. Authority (A) asks suspect that is company (C) to present evidence on certain aspects of its activity. After C presents the evidence A decides on the infringement alleged and amount of evidence presented from his side. In case when authority waives from announcing infringement decision, it can present no evidence.

Value for the authority to prove infringement ( $v_A$ ) and value for the company to disprove the infringement ( $v_C$ ) are private values. Following tradition of modeling incentives of the parties in litigation [Baye, Kovenock, de Vries, 2005] let payoff of the party  $U_i$  ( $i, j = A, C$ ) depend on the decision (infringement is found or not) and quality of economic evidence presented. Quality of economic evidence positively and monotonically depends on the cost of “evidence production”  $e_i = \varphi(c_i)$ ;  $\frac{\partial \varphi_i}{\partial c_i} > 0$ ,  $i, j = A, C$ . If infringement is

found authority obtains  $U_A = v_A - c_A$  and company obtains  $U_C = -c_C$ , otherwise (if infringement is disproved), the parties obtain  $U_A = -c_A$  and  $U_C = v_C - c_C$  respectively. For the sake of simplicity, in further analysis we assume that one unit of cost results in one unit of evidence.

We do not discuss the origin of  $v_A$  and  $v_C$  in details. Value of “not to be found infringer” for the company can be understood as avoided penalties and burden of remedies

as well as loss of infringement. Value of “to find infringement” for the authority generally depends on the incentives it faces. Following the tradition of thinking about the incentives of the bureaucrats, we can imagine  $v_A$  being a weighted average of social welfare loss avoided by finding infringement and imposing remedies and individual payoff to the authority, which depends on the compensation and incentive scheme used. In extreme case, we can consider value of a case as contribution to the performance of authority. The latter particularly corresponds to the performance measurement that use “enforcement success” (share of infringement decisions either do not appealed or upheld by the courts). In the systems of performance measurement, indicators of enforcement success are not exception (see [Avdasheva, Golovanova, Katsoulacos, 2018] for the overview).

We assume that after parties present evidence authority decides on the case, and the decision depends on the amount of economic evidence presented.

If two parties present evidence of equal quality, probability of winning for every party is 1/2.

Therefore the pay-offs for the parties are:

$$U_i(e_i, e_j, v_i) = \begin{cases} v_i - c_i & \text{if } e_i > e_j \\ \frac{v_i}{2} - c_i & \text{if } e_i = e_j \\ -c_i & \text{if } e_i < e_j \end{cases}$$

In other words, the administrative case under some circumstances represents a kind of *all-pay auction*, traditionally used to explain effects of different litigation rules, including fee-shifting and allocation of burden of proof. Decision process is ‘fair’ in the sense that we do not introduce any presumption reflected asymmetry in cost of providing evidence by authority and company.

#### 4.2. “Second-move” type interaction

In contrast to traditional analysis of litigation as FPSB (first price sealed-bid auction) the procedure of decision-making on infringement according to the procedural rules applied in the enforcement agencies in Russia, is better described by the “English-type” or “second-price” all-pay auction.

The order of decision-making is not that authority and suspect produce evidence simultaneously and independently. Instead authority asks potential infringer to present evidence and then decides to produce evidence in favor of infringement decision including the type of infringer to refrain from opening the formal stage of investigation. In other words, suspect produces evidence without knowing the precise type of infringement alleged. Instead, authority decides on the infringement alleged after receiving economic evidence provided by company and before producing its own version of evidence, and/or borrowing the evidence from the information of the suspect.

Let’s show that this procedural rule at the same time disincentives companies to produce evidence and force companies to produce more evidence if they decide to do that, in contrast to benchmark case when *first* alleged infringement is announced to the parties and *then* parties simultaneously and independently produce evidence.

### 4.3. Incentives to provide evidence under different regimes of the choice of alleged infringement

Let us start with the case when there is only one type of alleged infringement. Assume uniform distribution of 'value of a case' for responsible agency and company on the intervals  $[0; \overline{v_A}]$  and  $[0; \overline{v_C}]$  respectively. Last move advantage allows the agency to 'overbid' the evidence presented by company if agency's valuation of case exceeds cost of producing evidence (recall that they are symmetric for the parties)  $v_A > c_A$ , presentation of evidence of 'higher quality' in this case increases the agency's utility. Both parties maximize net gains as a difference between value of the case and cost on information presented.

**Proposition 1.** Under sequential presentation of information, company that decides first may spend on evidence *less* or *more*, but agency always spends *less* than under simultaneous decisions.

**Proof.** For the company the probability to win the case depends on the cost of producing evidence ( $\frac{c_C}{V_A}$ ) and expected payoff is

$$EU(c_C) = \frac{c_C}{v_A}(v_C - c_C) + \left(1 - \frac{c_C}{v_A}\right)(-c_C) = c_C \left(\frac{v_C}{v_A} - 1\right),$$

which is increasing in  $c_C$  and strictly positive if  $v_C > \overline{v_A}$ . Expected utility is positive if company's assessment of value of the case exceeds  $\overline{v_A}$  and negative otherwise.

In Nash equilibrium  $c_C = \overline{v_A}$ ,  $c_A = 0$  if  $v_C > \overline{v_A}$  and  $c_C = 0$ ,  $c_A = \varepsilon$  otherwise.

It is enough for agency to provide very small evidence if company refrains from producing evidence.

Under the assumptions made on the distribution of valuations but under adversarial procedure cost on production of evidence by the both parties should be positive, and correspond to equilibrium bidding in all-pay auction with incomplete information and asymmetric bidders [Amann, Leininger, 1996]. Recall that in the benchmark case under simultaneous presentation of evidence equilibrium combination of

evidence presented is  $c_C = \frac{\overline{v_C}^2}{2}$ ,  $c_A = \frac{\overline{v_A}^2}{2}$ . In the equilibrium under simultaneous

presentation of evidence the winning party is the same as under sequential presentation, but there is no possibility to win presenting marginally small amount of evidence.

Important implication of the equilibrium bidding in incomplete information all-pay auctions is not only that company *spends less* to win the case (more precisely, whatever the asymmetry between parties is, in the all-pay auctions with incomplete information risk neutral party with high valuation never bids more than half of his valuation), but also that it is worth for the company to spend on production of evidence even if agency's valuation of case exceeds those of company.

From the proposition two lemma follows.

**Lemma 1.** If there are  $n \geq 2$  possible violations to be established, necessary amount of information produced by the company to win is multiplied by the number of possible descriptions of violations.

**Proof.** Assume that agency can produce evidence under  $n$  alternative alleged infringements with the same cost function. Agency selects the type of alleged infringements after it receives evidence from company. Under the rules described above two equilibria still exist but for the company cost of producing evidence, if it decides to produce any, at least doubles. Intuition is straightforward: probability to win the case is defined by the lowest amount of evidence produced in favor of defendant among all potential infringements. To ‘beat’ the evidence presented with lower cost agency chooses the type of infringement with lower  $e_c$ .

Expected payoff for the company changes as follows:

$$EU(c_C) = \frac{c_C}{nv_A}(v_C - c_C) + \left(1 - \frac{c_C}{nv_A}\right)(-c_C) = c_C \left(\frac{v_C}{nv_A} - 1\right).$$

Accordingly, the equilibrium is  $c_C = n\bar{v}_A$ ,  $c_A = 0$  if  $v_C = n\bar{v}_A$ , and  $c_C = 0$ ,  $c_A = \varepsilon$  otherwise. As in the case described above, agency produces zero or close to zero amount of evidence anyway. Company overspends on production of evidence not only in comparison to the benchmark case of simultaneous decisions, but also in comparison to the case of the only possible alleged infringement.

**Lemma 2.** Multiplicity of possible violations  $n \geq 2$  there is a possibility to convert evidence in favor of company (alleged infringer) in the evidence against company (in favor of infringement decision) increases the amount of evidence necessary to disprove violation.

**Proof.** Assume that in addition to the opportunity to decide on the alleged infringement ex-post agency can convert part of evidence produced in favor of company to the evidence in favor of one of the possible infringements. Assume that  $\alpha$  ( $0 \leq \alpha \leq 1$ ) is the rate of ‘conversion’ of the evidence in favor of alleged infringer to the evidence against alleged infringer. There are  $k = 1, \dots, n$  possible infringements. Agency first inspects the evidence presented by company, then chooses the alleged infringement and one of the potential infringements from available options with the highest  $\alpha$ , cost function of the agency changes as follows:

$$c'_A(e_{kA}) = c_A(e_{kA}) - \alpha c_{mC}, \quad m \neq k$$

Possibility to “convert” evidence reduces the probability to win the case for the company under given amount of evidence presented. Every unit of spending results in the lower increase of the probability to win the case, and expected payoff changes:

$$EU(c_C) = \frac{(1-\alpha)c_C}{nv_A}(v_C - c_C) + \left(1 - \frac{(1-\alpha)c_C}{nv_A}\right)(-c_C) = c_C \left(\frac{(1-\alpha)v_C}{nv_A} - 1\right).$$

Accordingly, the equilibrium is  $c_C = \frac{n}{1-\alpha} \bar{v}_A$ ,  $c_A = 0$  if  $v_C > \frac{n}{1-\alpha} \bar{v}_A$ , and  $c_C = 0$ ,  $c_A = \varepsilon$  otherwise. Authority again produces zero or close to zero amount of evidence anyway. “Overspending” of company increases with the rate of evidence conversion  $\alpha$ .

## 5. Importance of procedural rules on the order of information provision in administrative adjudication

Though very simple, the framework allows for welfare implications. “Procedural freedom” of inspecting agency and corresponding uncertainty about alleged infringement suppress incentives to provide evidence and discover facts for both sides — responsible authority and alleged infringer. Due to rules of the game, company either refrains from producing evidence at all, and authority correspondingly reduces cost on production of evidence to the minimum, or produces evidence at the costs that marginally exceed the value of a case for responsible authority.

Seemingly the rules of sequential presentation of information allow to decrease the costs of evidence collection by the authority. If companies are reluctant to produce reasonable amount of evidence, it has two effects: first, authority does not have to provide adequate amount of competing evidence in order to win the case, and second, authority cannot discuss the evidence presented by the parties. Here we might find elements transmission mechanisms to another type of legal uncertainty (mentioned above) and, correspondingly, to errors of I type especially. Since information is necessary for the assessment of particular conduct, low incentives to present evidence result in the increasing probability of legal errors that limits deterrence effect of law enforcement.

In the case of Russian model of “late choice of infringement” explains uneven allocation of companies’ effort to produce evidence between administrative investigation stage and commercial court litigation stage. In contrast to administrative investigation under appeal procedure, party knows infringement precisely and can produce evidence without “overspending”. Model also explains combination of large share of infringement decisions in the administrative investigations (for instance, about 80–90 % recently in Russian competition authority), large share of appeals to commercial court of infringement decisions (about  $\frac{1}{3}$  of all infringement decisions under art. 10 and 11), and relatively large share of infringement decisions reversed by commercial courts (about  $\frac{1}{4}$  of all appealing decisions). Important part of the story is not that responsible commission cannot assess the evidence presented by company, but that companies prefer not to produce evidence at the stage of administrative investigation. Finally, model explains relatively weak economic evidence in the antitrust investigations [Girgensov, Numerova, 2012].

The model also allows to get important policy implications. “Late choice” of type of violation undermines one of fundamental rights — the right on defense — if we include in the concept of right for defense the right of the party to defend itself with reasonable cost. This requires several important institutional arrangements. First of all, it is necessary to prescribe time of provision the information on alleged violation to the suspect. We cannot assess the appreciation of participants of the European competition enforcement of the rules on the *Statement of Objection*. However Russian experience stresses its importance.

Many discussions on legal developments are centered on the allocation of burden of proof between parties in the antitrust investigations and decisions. Our model shows that specific order of evidence presentation and infringement formulation can deteriorate party’s position even under symmetric allocation of burden of proof, or, in other words, under no prosecutorial bias. Therefore, rules on sequence of presentation evidence are crucial to support de-facto equality of rights under administrative adjudication.

Finally, our analysis highlights crucial condition for the success of the model of separation investigatory and quasi-judiciary units within the agency. According to our model this separation can be successful only if there is relatively large time gap between informational requests of investigator, announcement of alleged violation and the decision-making process, in order to allow the company to produce relevant amount of evidence specifically to that stage.

## 6. Conclusion

In the article we attract attention to the sequence of information provision and decision making as a source of disincentive for the object of investigation to present evidence unless she is not aware about the character of suspected law violation. On the regular basis this problem arises under administrative investigations. If responsible authority may announce (in some sense, may select) the content of alleged infringement after company discovers all information and present evidence, this step can substantially depreciate evidence as a proof. The effect of depreciation arises simply because authority decides on the amount of evidence produced after the company under investigation presents the evidence. In the equilibrium, infringement decisions are reached under zero costs of agency on evidence because alleged infringer spend zero on the evidence presentation. For the alleged infringement to be disproved, target of investigation should spend more than under simultaneous presentation of evidence. Necessary costs on evidence increases with the number of possible qualifications of violation and the share of evidence in favor of alleged violation that can be interpreted against the alleged violator under one of possible qualification of infringements.

Effect of evidence depreciation is sufficient to explain the reluctance of the targets of administrative investigations to produce evidence together with little evidence produced by the responsible agency to support infringement decision. Observation that the same parties, and especially alleged infringers produce much more evidence under judicial review, supports the framework developed. It means that prosecutorial bias or asymmetric burden of proof is not necessary to suppress the incentives of the target of investigation to produce evidence.

The framework draw attention to one important aspect of procedural unfairness under administrative adjudication that increases the probability of wrongful conviction and therefore limits the deterrence of the legal rules.

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## Обесценивание свидетельств в административных разбирательствах: о регламентации последовательности обвинения и представления доказательств\*

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Поздний выбор регулятором предмета обвинения в рамках административного расследования, когда компания (предполагаемый нарушитель) представляет сначала доказательства, затем регулятор принимает решение о предмете обвинения на основе свидетельств, представленных компанией, обуславливает значительный эффект на стороне стимулов. Такая практика демотивирует подозреваемых представлять свидетельства в рамках административной процедуры. Дополнительно, стимулы представлять доказательства ограничиваются, если регулятор имеет возможность выбрать из различных видов нарушений, предусмотренных законом, и использовать доказательную базу, собранную компанией в своих интересах как свидетельство иного типа нарушений, чем предполагалось на первоначальном этапе разбирательства. Временная последовательность решений, когда выбор вида нарушения происходит после получения регулятором свидетельства от компании, сопровождается решениями о нарушениях, которые затем оспариваются в суде. Российский опыт антимонопольных расследований — с двумя показательными иллюстрациями (НЛМК и крупнейшие розничные сети, торгующие компьютерами и бытовой электроникой), — демонстрирует важность для компании решения относительно представляемых регулятору доказательств. Стимулы представления свидетельств исследуются через призму моделей аукциона со всеобщей выплатой и последовательным представлением заявок. Показано, что инквизиторный уклон или асимметричность в распределении бремени доказательств необязательны для того, чтобы подавить стимулы объекта расследования представлять доказательства.

*Ключевые слова:* административное правоприменение, расследование, наказание, судебное решение, доказательства, свидетельства.

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