Assessment of damages in cartel cases

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outline

- Importance of private actions for damages is recognised
- Current actions and plans by competition authorities
- The difficulties of damage quantification (focus on cartel infringements)
- Where authorities can help

An important role for private enforcement

- Deterrence
  - If there is an expectation of private actions for damages, this lowers the net expected benefits of the cartel
  - Importantly, the deterrent effect exerted by private enforcement will be greater for cartels causing the greatest harm
- Compensation
  - It is the only mechanism to compensate those who actually suffered from the cartel (fines charged by competition authorities do not benefit injured parties)
- Private resources helping a public good
  - Ideally, private enforcement would shift some of the burden of investigation to private hands thus saving public resources while achieving the same level of deterrence
  - However, are private parties in a good position to take on this role?

Challenges on the legal front

- Almunia gives great importance to a well functioning Europe wide system private anti-trust enforcement
  - (...) The other major initiative is about the right of individuals and firms to seek compensation for the damage caused by breaches of EU antitrust law. I will propose to the Commission an initiative designed to remove the major obstacles for damages actions before national courts.“
    - Presentation to the European Parliament of Work Programme for 2012, Joaquín Almunia, 22 November 2011

- But this requires that rules be implemented into the legal cultures of all member states which will guarantee effective access to justice for all European consumers and businesses harmed by anti-competitive conduct.
- The Commission has made rapid progress towards an efficient system to investigate and fine cartels (vide Leniency Notice and the new Settlement Procedure)
- In contrast, Europe wide legislation to improve access to collective redress for businesses and individuals who have been the victims of cartels victim still seems some way off

The right to compensation for damages

- The right to compensation includes reparation not only for actual loss suffered (damnum emergens), but also for loss of profit (lucrum cessans) and the payment of interest.
  - Actual loss means a reduction in a person's assets;
  - Loss of profit means that an increase in those assets, which would have occurred without the infringement, did not happen

- Assessing and proving the quantum of damages in actions for damages is often difficult. This is particularly true in competition law cases

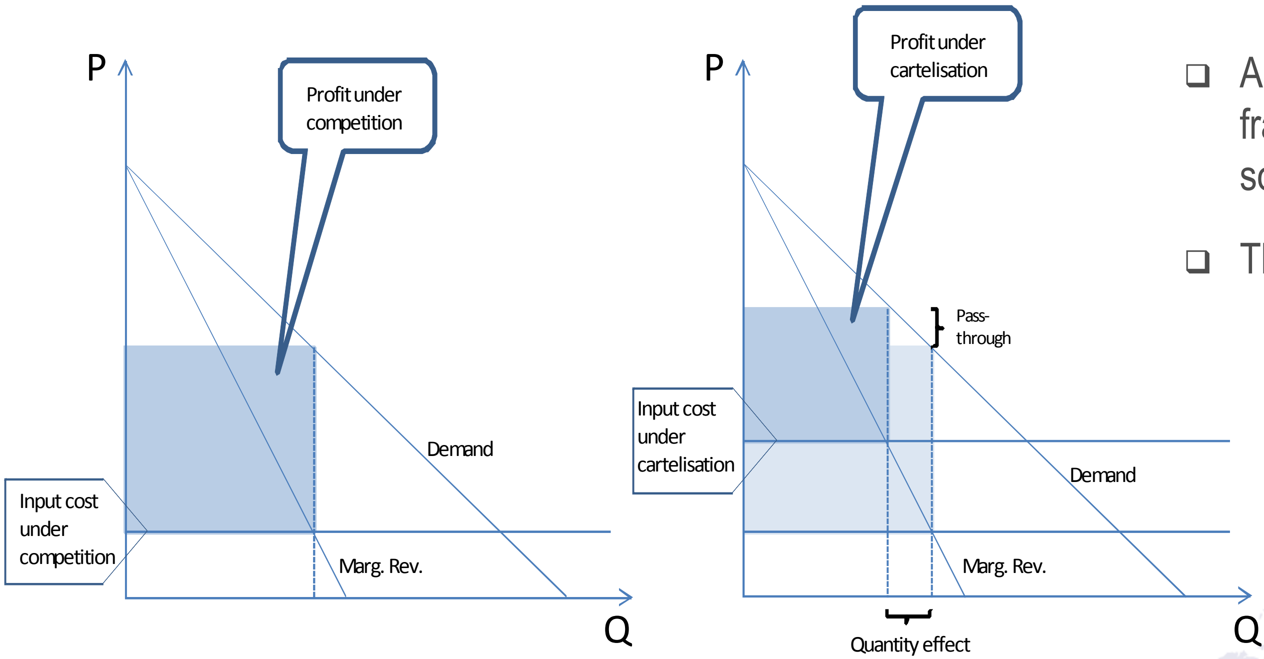
Challenges for quantification

- Quantification of damages in cartel cases requires identification of
  - The **overcharge** – leading to actual loss on the portion of the overcharge that is not passed on to downstream buyers
  - The **passed-on** component
  - The **quantity effect**, as a result of the passed on portion of the overcharge – leading to loss of profit
  - The foregone **profit** on units that would have been sold 'but for' the cartel

- We will look at each of these four elements in turn

The impact of cartelisation

- Cartel in an input market – impact on a firm with a degree of market power in its output market



- As the purchaser passes through a fraction of the price increase, it loses some sales in its output market
- The loss of profit is thus given by
  - cartel overcharge minus the pass-through times the quantity purchased
  - Unit profit times the number of units of lost sales

Total Damages = (overcharge per unit - pass-through) x quantity purchased + loss of profit on lost sales

- Note: this is a simplification of the effects – importantly, the demand facing the purchaser also changes if its competitors affected by the cartel change their prices

The overcharge

- What would the price have been in the absence of the cartel
- Infer on the basis of prices in non-affected markets or periods
- Difficulties
  - Price setting in oligopolistic markets is a complex process that depends on many factors many of which will not remain stable over a time period or across markets – so we generally don't have data points with 'everything else equal' but without cartel
  - In particular, prices vary due to demand conditions, cost conditions, changes in market structure and evolution of product characteristics
  - The cartelists have superior information on any of these elements to that held by claimants
  - The competition authorities, during their investigation of the cartel, may have access to information that could help injured parties considerably in their calculations

Overcharge

- Price - comparator based methods
  - Potentially huge number of factors need to be controlled for
  - Competition authorities currently help by providing some information about how the cartel operated (e.g. coordinating on fuel surcharges, agreeing on price lists, agreeing on whose turn it was to win upcoming auctions, committing not to lower prices in spite of declining demand)
  - But even this will provide only minimal assistance in estimating the actual impact on prices

- Should competition authorities, given their vastly superior access to information, make an effort to present some estimates of actual overcharge?

Overcharge

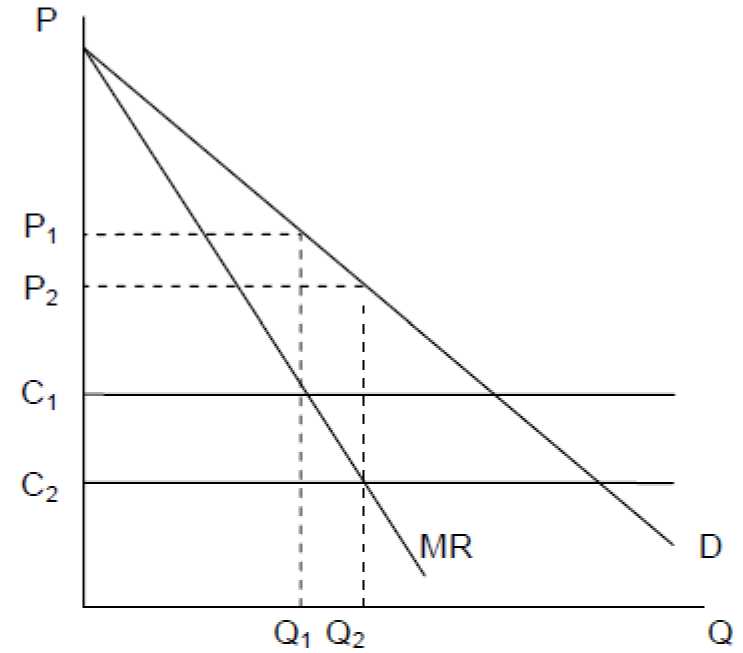
- Cost, profit – comparator based methods
  - It will be very difficult for claimants to have access information on the costs and profits of the cartelists in the affected markets
  - In negotiations, defendants may offer access to cost information but more likely to do so in relation to costs that were high in the period of the cartel
  - In general, access to favourable information (or difficult to decipher information) more likely to be granted
- Simulation methods
  - Not particularly advantageous to claimants as these methods often lead to an estimate of an upper bound for the overcharge
  - Models have (inevitably) a number of strong underlying assumptions and the cartelists are in a particularly good position to argue why these necessary assumptions are not met by their particular firm or market situation

Pass-on

- Pass-on (or pass-through) is the price increase that direct cartel purchasers are able to shift to their own purchasers
- In some markets pass-through can be very significant all through the supply chain and a large part of the overcharge is in fact supported by final consumers
- Quantification of pass-through is an extremely complex exercise both in theoretical and in empirical terms
- Theoretically, the rate of pass through in an oligopolistic market depends not on the elasticity of demand but on the rate by which this elasticity changes with changes in price (i.e. the curvature or second derivative of the demand function)
- From simple profit maximisation condition: $mc=p(1-1/E)$
  - A shock that affects marginal cost leads to re-adjustments in all three variables until the equation is restored: a slight increase in price will have correspondingly lower sales, higher demand elasticity and perhaps also a second order change in marginal costs
  - if elasticity increases rapidly the increase in price will be smaller
  - A shock that does not affect marginal costs will not lead to any direct effects on either quantity or price (if cartel only affects the firm's fixed costs there should be zero pass-through (e.g. m. hose)

Pass-on

- Simple rules of thumb are often misleading
  - approximations using linear demand functions can be very far off target;
  - the pass through rate is the ratio of the slope of demand to the slope of the marginal revenue curve
  - this is constant and equal to ½ in the case of linear demand but had completely different behaviour for more general functional forms
  - similarly for 'intuitions' such as pass-through is higher when elasticity of demand is lower
  - this is not even true with linear demand (where pass through is constant while elasticity approaches plus infinity)



- Pass through is actually even more complicated than this – we need to take into account the effects of competitors' responses on pass-through
  - Another 'intuition' that shouldn't be relied upon is that pass through is higher in more competitive markets
  - But one simple fact holds – pass through will be lower if only some competitors suffered from the cartel overcharge

Pass-on

- The authorities can help direct purchasers significantly by assigning the burden of proof of pass-on effects to defendants (cartelists)
- But what if the claimant is an indirect purchaser? (e.g. LCD cartel)
- This claimant will want to argue that a large part of the cartel overcharge trickled all the way down the supply chain
- Inevitably, any reasonable compensatory system would attribute a substantial burden of proof in relation to such a claim
- Discharging this burden of proof may be extremely difficult in practical terms
  - All the factors that need to be controlled for in calculating overcharge are compounded by the fact that these controls need to take into account several different levels of the supply chain
  - Other more direct purchasers may submit conflicting claims

Quantity effect

- The most straightforward component of the four (once overcharge and pass-through have been assessed...)
- The quantity effect is directly related to the elasticity of demand of the customers of the claimants
- Elasticity of demand can be estimated with price and sales data only (in the absence of demand shocks)
- This effect may be sizeable because, in aggregate, the downstream market is likely to have elastic demand
  - cartelists seek to set prices at levels for which demand for their products is relatively elastic
  - in a supply chain, an upstream seller faces a high demand elasticity when it's purchasers also face a high demand elasticity from their purchasers
  - this means that, at the cartel prices, purchasers from the cartel are likely to face high demand elasticity

- Relatively smaller role for authorities to play

Lost profit on foregone sales

- Here the claimant needs to assess the profit foregone on non sold units
  - Marginal profits may be higher than average profits
  - Need to assess which costs are fixed for the range of quantities in question
  - The burden of showing this would fall on the claimant
- Intuitively, foregone profits (per unit) would to be lower when quantity effects are high
- Claimants would be well placed to make a quantified assessment of lost profits per unit of lost sales

Where authorities can help

- Guidance on methodologies for damage estimation
- Focus some effort of the investigation on the aspect of effect
    - Cartel decisions by the Commission mostly do not look at the effects of the cartel
    - This in unhelpful to private parties seeking compensation for cartel overcharges.
    - May weaken the Decisions themselves - cartelists will argue that fines are disproportionate since the cartel had no effect
- Consider the allocation of burden of proof in relation to pass-on
- Give potential claimants access to at least some of the data collected from cartelists
- ... while not compromising the effectiveness of leniency