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Agenda

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# Coup de grâce? Private actions for damages in Europe

**Fines for breaches of competition law have reached record levels—so far this year the European Commission has imposed cartel fines of over €2 billion. Not content with this, the Commission and national competition authorities are putting in place rules to facilitate private actions for damages. Will this lead to even more cartel cases, or a culture of excessive litigation? How can an optimal system of public and private enforcement of antitrust law be designed?**

Recent years have witnessed a significant increase in fines imposed by the European Commission for antitrust law violations. Whereas in the decade from 1990 to 1999 the total fines imposed for infringements of Article 81 amounted to €870m, the Commission imposed a record total of over €1.8 billion in cartel fines in 2006 alone.[1] However, this new European record was broken just 16 weeks into 2007. With the latest fine imposed on the members of the Dutch beer cartel on April 18th,[2] the total so far this year has already topped €2 billion. In February, the Commission imposed the largest cartel fines to date on manufacturers of lifts and escalators amounting to a total of €992.3m.[3] This record-breaking pace of cartel fines notwithstanding, EU Competition Commissioner, Neelie Kroes, confirmed on March 8th that she intends to further sharpen the tools against cartelists.[4]

One of the changes that the Commission and certain other national competition authorities want to implement in tackling cartelists is for private actions for damages to play a greater role in antitrust law enforcement. This means that future cartelists will not only be challenged by the competition authorities, but also increasingly by private litigation. In December 2005 the Commission published a Green Paper setting out the conditions for bringing damages claims for infringement of EC antitrust law, and proposing options for the efficient implementation of a system of private enforcement of antitrust law to complement the public enforcement already in place.[5] The publication of a White Paper on damages actions is scheduled for later this year.

### The rise of private actions

**After the German competition authority, the Bundeskartellamt, fined the members of a cartel in the cement market a total of €660m in 2003, a firm specialising in damages claims has bought up claims from 29 customers of the cement cartel and has brought an action against the leading cartelists before the Regional Court of Düsseldorf. The plaintiff claims that prices for certain types of cement were, on average, around €20 above the post-cartel prices. According to the plaintiff, this overcharge inflicted harm totalling €152m to the 29 companies it represents, of which it claims at least 75% (€114m) as compensation. In February 2007, the Regional Court of Düsseldorf decided that the firm was entitled to bring the claim, and the next court hearing is expected to be held in late 2007.[1] Private actions such as these are expected to increase significantly following the recent spate of cartel findings across Europe.**

Note: [1] Landgericht Düsseldorf (2007), 'Schadensersatzprozess um Zementkartell wird fortgesetzt', press release 02/2007, February.

## Public versus private antitrust law enforcement

At a high level, an optimal system of antitrust law enforcement should balance two elements appropriately.

- **Public enforcement**—the competition authority-based system of public enforcement of antitrust laws, and the associated cases brought under Articles 81 and 82. This enforcement system is well developed and active in Europe, as the recent actions of the Commission demonstrate.

- **Private enforcement**—the private system of enforcing antitrust law operates alongside public enforcement. Cases under Articles 81 and 82 are brought by private individuals affected by the conduct in question either as follow-on actions to decisions

taken by a competition authority or as stand-alone actions. Follow-on actions complement the public system by potentially increasing the punishment of anti-competitive actions, whereas stand-alone actions may lead to additional detection of breaches of antitrust law—eg, in cases where the competition authority does not have the resources to conduct its own investigations. These private actions will typically take the form of litigation between the parties in national courts, although, in practice, many cases are settled in advance of the court hearing. Private damages actions serve several purposes, such as compensating those who have suffered a loss as a consequence of anti-competitive behaviour, and ensuring the full effectiveness of the antitrust rules by retaining an additional enforcement route alongside that of the competition authority.

When designing an optimal system of public and private antitrust law enforcement, there are important relationships between the current public enforcement regime and the private enforcement regime that is set up to sit alongside that public regime in any jurisdiction. If the public regime is relatively vigorous, the optimal design of private enforcement might be to focus on facilitating follow-on actions. In this scenario, a large number of infringements will be detected by the authorities without the need for private involvement, and private actions would therefore be most useful in enhancing deterrence by increasing the cost of infringements that are detected.

Conversely, if there is relatively little public enforcement, it is likely that there will need to be a more active private enforcement regime, both in detecting and deterring anti-competitive activity.

As discussed above, two types of private action can be distinguished: follow-on actions relating to the enforcement decisions of the competition authorities; and original (stand-alone) actions initiated by private parties. In the former, the competition authority issues an enforcement decision, and private individuals litigate on the basis of this decision. The decision of the competition authority can usually be treated as prima facie evidence of a breach of antitrust law, and there is therefore no need to demonstrate that anti-competitive conduct has actually taken place. Indeed, the European Commission explicitly states in its decisions that any person or firm affected by the anti-competitive behaviour in a particular case may bring the matter before the courts of Member States and seek damages, submitting elements of the Commission's decision as evidence that the behaviour took place and was illegal.[6] Hence, the primary focus here is on proving that plaintiffs have actually been harmed by the anti-competitive conduct and on determining the 'damage' for which they should be compensated.

In the case of original private actions, there will first be a need to prove that there has in fact been an infringement of antitrust law, before going on to assess the damages. As such, these actions are likely to be considerably more uncertain and costly for plaintiffs than follow-on actions, and require the plaintiff to have sufficient access to data to support the claim. From a public policy perspective, however, these actions can play an important role in the detection and/or deterrence of anti-competitive conduct.

The policy challenge is to establish a structure that makes the best of the public and private enforcement of antitrust law. To achieve this, it is important to take into account the way these two systems fit alongside one another, and to avoid either over- or under-enforcement of antitrust laws.

## An economist's look into the perpetrator's mind

Whether a firm engages in activity that could be a breach of antitrust law can be considered, in the most basic terms, as a calculation of whether it would be profitable for it to do so. A firm's expected benefit from anti-competitive conduct is determined by the higher profit that can be achieved (now and in the future) by breaching antitrust law, compared with the profit achieved by competing 'normally'.

However, when firms engage in anti-competitive conduct, they also face the possibility that the breach of antitrust law will be detected and a fine imposed. Thus, the expected benefit of the anti-competitive behaviour has to be balanced against its expected cost. The two main components of the expected cost of a breach of antitrust law are the expected fines imposed by the competition authority (and the reputational impact of this), and the potential damages that would be payable in the event of a successful private antitrust action.

In many cases firms may be able to assess the extra profit they may yield by engaging in anti-competitive behaviour (eg, colluding with competitors), but there is great uncertainty about the the expected lifetime of that breach of antitrust law and the probability of being caught, the fines that might eventually be imposed and the reputational impact, and the damages payable in potential private actions. Policy rules have been put in place to increase the likelihood of detection (eg, greater 'dawn raid' powers for the authorities, and the rules on leniency for whistleblowers), and the current emphasis on private follow-on actions is likely to increase the costs of joining cartels by increasing the likelihood of having to pay high damages.

Of equal policy importance is an assessment of the incentive structure faced by the victims of the anti-competitive behaviour—ie, the incentives of private agents to either launch follow-on actions after the competition authority has established a breach of competition law, or file an original complaint independently.

The decision of private parties of whether to launch an action will, again, depend on whether their expected gains outweigh the expected cost. The chances of success of a private action are normally significantly higher when litigation takes place on the basis of a prior enforcement decision of the competition authority. Success is more uncertain where the plaintiffs first have to prove that there has been an infringement of antitrust law, particularly in jurisdictions where there is limited access to confidential data from the defendant (discovery). The potential gains from launching a claim for damages have to be balanced against the expected cost incurred by the plaintiff—particularly internal management time and legal costs (the latter can be recovered in some systems if the case is won, but include the defendant's costs if the case is lost).

## Is the current system adequate?

As discussed, a crucial parameter for defining expected benefits for both plaintiffs and defendants is the probability that the antitrust law infringement will be detected. On the one hand, it determines expected gains from breaches of antitrust law as well as expected costs in the form of fines from potential private damages for firms. On the other hand, if the anti-competitive conduct has been established, it facilitates any claims for damages through follow-on actions by private parties. If no prior public enforcement has taken place, the probability of detecting an infringement of antitrust law crucially defines the chances of a successful damages claim.

For example, if a firm engages in anti-competitive conduct and expects that, if detected, this will result in a fine of €100m, but that the risk of been caught is only 25%, the expected fine that the firm takes into account in its decision of whether it would be profitable to engage in this anti-competitive conduct is only €25m. If, against this, the firm expects additional profits from the breach of antitrust law of €50m, it has a high incentive to engage in this anti-competitive conduct.

The empirical evidence regarding the incentives of firms to engage in anti-competitive conduct, as well of the incentives of private parties to launch damages actions, is still limited. As regards cartels—perhaps one of the the most studied examples—initial empirical evidence suggests that as few as one in 3–6 cartels is detected.[7] Given the absence of original private actions against cartels to date within the EU, this would imply a risk of a cartel being detected of between 17% and 33%.

These low detection rates clearly substantially undermine the potential disincentivising effect of fines. To effectively prevent the formation of cartels, fines would have to amount to 3–6 times the expected additional profits gained as a result of the cartel formation.

For example, in the case of the graphite electrodes cartel in the EU, the additional profit gained through the anti-competitive behaviour was estimated at approximately €722m, yet a fine of only €218.8m was imposed.[8] Assuming that firms more or less accurately estimated the amount they would be fined if detected, and bearing in mind that they could assume that the risk of being caught is around 25%, the 'expected cost' in the absence of any private actions for damages considered by the cartelists would have been around €55m. Assuming that the estimated gain of €722m resulting from the cartel formation approximately reflects the firms' expectations, the imposed fine could hardly be regarded as a substantial deterrent.

An OECD study found that the penalties (from both fines and damages) levied in the USA, which is generally regarded as having the most active regime for private enforcement of antitrust law, represented three of the four cases with the highest proportion of estimated harm covered.[9] The OECD estimates that, in the lysine cartel, penalties in the USA were 189% of affected trade, while those in the citric acid cartel were 142% of affected trade. The only other case in which the penalties exceeded affected trade was the German ready-mixed concrete cartel, with fines of 136% of affected trade. However, not even in these cases did the imposed fines amount to twice the harm the anti-competitive conduct inflicted on third parties. This implies that firms would have been deterred only if they considered that there was a greater than 50% chance of being detected.

## Balancing public and private enforcement

Empirical evidence suggests that the current level of antitrust law enforcement may not be sufficient to achieve an optimal degree of deterrence, hence allowing an unduly high level of cartel law infringements. At present, it seems likely that both increased detection and increased punishment may be required in Europe to effectively deter anti-competitive conduct. Thus, from this perspective, a significant increase in the level of private enforcement could be socially beneficial, but is still likely to leave enforcement in the EU at a non-optimal level as far as cartels are concerned. Both the low level of detection and, given this, the low fines imposed, demand an increase in private enforcement of antitrust law in order to increase the risk of detection as well as the

expected cost to cartelists, and thereby to achieve a socially optimal level of deterrence.

However, although the design of an optimal system of public and private enforcement of antitrust law seems to be straightforward in theory, any practical implementation faces significant difficulties. There is a risk of creating a system in which unmeritorious litigation can flourish, leading to a culture of excessive litigation giving rise to windfalls and high legal costs, and imposing unnecessary burdens on the parties and the judicial system (the USA is often cited as an example of such a culture). Indeed, from a theoretical perspective, it may be more efficient in this respect to have the competition authority levy fines up to the amount of the damage claim, as the deterrent effect would be the same but the costs of litigation would be avoided. These costs would result in higher prices to consumers and a decrease in welfare—ie, exactly the effect that the antitrust law is intended to prevent.

In addition, care has to be taken to ensure that a system of private actions does not undermine the effectiveness of leniency regimes. Leniency played an important role in many of the recent cartel cases: in the three 2007 cartel decisions that have taken place thus far, one or more cartelists was rewarded a 100% reduction of fines under the Leniency Notice because they provided decisive information about the cartel.[10] The power of leniency regimes could be weakened if no immunity from damages claims is granted.

Actions for damages regularly require the investigation of a broad set of facts. The difficulty with this kind of litigation is that the relevant evidence is often not readily available and is held by the party committing the anti-competitive behaviour. This may suggest that there could be a greater role for public enforcement of antitrust law in cases of cartels where private litigators have relatively limited powers to enforce disclosure of information compared with the competition authorities.

Original private actions may complement public enforcement, especially in disputes about business-to-business contracts and agreements, and alleged abuse of market power where the focus is more on establishing the economic case that there has been harm incurred. However, in both cases, difficulties in accessing the necessary data may constitute a substantial obstacle to a successful claim. It is therefore also important to get the legal rules on discovery right in order to make private actions for damages a successful competition policy tool.

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[1] European Commission (2007), 'Cartel Statistics', http://ec.europa.eu/comm/competition/cartels/statistics/statistics.pdf.
[2] European Commission (2007), 'Competition: Commission Fines Members of Beer Cartel in The Netherlands over €273 Million', IP/07/509, April 18th.
[3] European Commission (2007), 'Competition: Commission Fines Members of Lifts and Escalators Cartels over €990 Million', IP/07/209, February 21st.
[4] Kroes, N. (2007), 'Reinforcing the Fight Against Cartels and Developing Private Antitrust Damages Actions: Two Tools for a More Competitive Europe', speech given at the European Commission/IBA Joint Conference on EC Competition Policy, Brussels, March 8th.
[5] European Commission (2005), 'Damages Actions for Breach of the EC Antitrust Rules', Green Paper, COM(2005) 672 final, December.
[6] See, for example, European Commission (2007), 'Competition: Commission Fines Members of Beer Cartel in The Netherlands over €273 Million', IP/07/509, April 18th.
[7] See, for example, Connor, J.M. (2005), 'Optimal Deterrence and Private International Cartels', paper presented at the second biennial conference of the Food System Research Group at the University of Wisconsin, June.
[8] See Veljanovski, C. (2007), 'Cartel Fines in Europe', *World Competition*, **29**, March.
[9] OECD (2003), 'Hard Core Cartels: Recent Progress and Challenges Ahead', March.
[10] See, for example, European Commission (2007), 'Competition: Commission Fines Members of Gas Insulated Switchgear Cartel over 750 Million Euros', IP/07/80, January.