

Memo

To: **European Commission**
Date: 15 July 2008
From: NERA Economic Consulting
Subject: **Comments in relation to the White Paper on damages actions for breach of the EC antitrust rules**

Introduction

1. On 3 April 2008 the Commission published for public consultation a White Paper on damages actions for breach of the EC antitrust rules (the "White Paper").¹ The primary objective of the White Paper is to ensure that full compensation is available to the victims of antitrust infringements; the Commission notes that this could also provide additional deterrence against infringements contemplated in the future.
2. NERA welcomes this opportunity to comment on the proposals put forward by the Commission. As an economic consulting firm, we limit our observations to some of the economic aspects of the White Paper. In particular, we address the following issues:
 - 2.1. The principle of "full compensation" for "all victims";
 - 2.2. The deterrent effect of private action;
 - 2.3. The role of collective action in the new framework;
 - 2.4. Issues relating to the quantification of damages;
 - 2.5. The "passing-on" defence;
 - 2.6. The allocation of the costs of private action;
 - 2.7. Practical issues in meeting the standard of proof; and
 - 2.8. The interaction with the leniency programme.

¹ European Commission, White Paper on damages actions for breach of the EC antitrust rules, 3 April 2008.

1. The principle of "full compensation" for "all victims"

3. The White Paper sets "full compensation" of the victims of antitrust infringements as its "first and foremost objective".² It also recalls the confirmation by the European Court of Justice in *Manfredi* that "any individual" who has suffered harm from antitrust breaches is entitled to compensation.³
4. From an economic perspective, antitrust infringements in general result in two types of undesirable consequences:⁴
 - 4.1. Distributional impact: where the antitrust breach leads to a distortion of prices (relative to a competitive counterfactual), this will have distributional consequences for the agents in the economy. For instance, a cartel that increases prices to consumers will lead to a transfer of wealth from consumers to the firms in the cartel.
 - 4.2. Efficiency impact: in addition to price effects, antitrust breaches can also be associated with volume effects. For instance, the price rise imposed by a cartel will typically lead to a reduction of the volume of trades which would otherwise have taken place. As those trades would have involved positive surplus, their disappearance represents a net *deadweight loss* to the economy, rather than just a transfer between groups.
5. The principle of full compensation to the victims of breaches has a very clear distributional rationale. In this light, it may indeed seem "fair" to seek to compensate the victims of the infringement for their losses, and to seek to do so for indirect as well as direct purchasers, as advocated by the Commission.
6. In practice, it is clear that compensating all victims will involve substantial difficulties. Indeed, the class of victims of antitrust infringements is not limited to (direct and indirect) purchasers. For example, a cartel may also harm direct and indirect suppliers of cartel and of non-cartel members in the relevant market, as well as providers of complementary products.
7. When one in addition considers the efficiency losses which generally arise from antitrust infringements, it becomes clear that there will be even more severe practical difficulties in

² Ibid., p.3.

³ Ibid., p.4, and Joined Cases C-295–298/04, *Manfredi*, [2006] ECR I-6619. See also Case C-453/99, *Courage and Crehan*, [2001] ECR I-6297.

⁴ This paradigm applies most straightforwardly to cartel cases. In Article 82 cases and vertical agreements, the analysis can become substantially more complicated.

trying to fully compensate all victims for their losses. Indeed, some of the victims of the antitrust breach may have been altogether priced out of the market, so that they would not even have traded with the infringing entities. This raises difficult evidential issues, as full compensation of individuals who did not engage in transactions (but claim that they would have done) is not easily administrable, despite their being real victims of the competition breach. Accordingly, it will be very unlikely that damages can be reliably established for all the victims of the infringements at hand.

2. The deterrent effect of private action

8. The deterrent effect of the competition regime can be assessed by considering the position of an undertaking that is contemplating a violation of the competition rules. Assuming the undertaking is rational,⁵ it will take into account the risk of being caught and punished, whether by administrative proceedings or private action, and weigh it against the expected benefits from the contemplated anticompetitive practice. In a greatly simplified setting (e.g. abstracting from procedural/transaction costs and considering only a single period), for ease of exposition, the expected loss from being found to infringe the competition rules could be thought of as follows:

$$\begin{aligned} \text{Expected Loss} &= \text{Expected Administrative Fine} + \text{Expected Damages} \\ &= (p_1 * p_2 * F) + (q_1 * q_2 * D) \end{aligned}$$

Administrative enforcement: p_1 denotes the probability of the practice being detected by a competition authority; p_2 is the probability (conditional on a practice being detected) of an infringement being proven to the necessary standard by a competition authority; and F is the fine imposed by the competition authority.

Private enforcement: q_1 denotes the probability of being sued for damages; q_2 is the probability (conditional on a suit having been filed) that the relevant court is persuaded by the case; and D represents the damages that would be due.

9. Given constant enforcement resources, so that the probabilities of detection and successful discharge of the standard of proof are unaffected, it is clear that raising the level of fines

⁵ Rationality is an important behavioural assumption, which has been used in other contexts in economics to model the trade-off faced by individuals contemplating an infringement – for an application in the context of crime, see Becker (1968), "Crime and Punishment: An Economic Approach", *The Journal of Political Economy* 76(2), pp. 169–217. The reality is however likely to present greater complexity. In particular, as firms are in fact aggregations of individuals, it is possible that the incentives of those various individuals or groups of individuals may not be perfectly aligned, leading to so-called principal-agent problems. For instance, if mid-level executives face different trade-offs from the firm as a whole, they may be undeterred despite very high costs and probability of detection at the level of the firm. On principal-agent problems, see *inter alia*: Salanié (2005), "The Economics of Contracts: A Primer", MIT Press; Sappington (1991), "Incentives in Principal-Agent Relationships" *Journal of Economic Perspectives* 5(2), pp. 45–66.

or damages that can be levied increases the expected loss from violating the competition rules. This in turn provides a greater incentive not to engage in such conduct.

10. By seeking to reduce the "legal and procedural hurdles"⁶ to private action, the proposals advanced by the White Paper are likely to have an effect on several of the elements constituting the expected loss:
 - 10.1. Removing such hurdles could encourage the victims of antitrust breaches to launch more actions for damages, thereby increasing q_1 .
 - 10.2. Some of the measures put forward by the Commission may facilitate the discharge of the standard of proof where an infringement has taken place (e.g. the proposal to achieve a minimum level of disclosure *inter partes* across the EU), thereby raising q_2 .
11. We would also note that in theory, requiring infringers to provide full compensation (including for the efficiency losses arising from their behaviour) would in general make the absolute value of the damages they have to pay larger than the absolute value of the benefits they would derive from an antitrust breach. This is because economic inefficiency entails a deadweight loss from the perspective of society as a whole, which the infringer could not compensate on the basis of its illegitimate profits from the infringement. While this is subject to considerable practical problems, as highlighted above in Section 1, it clearly contributes to the deterrent effect of the proposals (by making the size of D larger).
12. We therefore agree with the White Paper's assessment that directionally, other things equal, deterrence will be greater if the White Paper's aims are realised.⁷
13. From the perspective of deterrence, we also agree with the White Paper that damages should not be limited to follow-on actions after the findings of competition authorities.⁸ While in a "follow-on only" system it would still be possible for victims to complain to the competition authority, wait for its findings, and then seek compensation through a subsequent damages action, it may very conceivably be optimal in many cases for victims to shortcut the process and bring the case to court immediately. Were that option not to be available, the overall probability of detection of violations of the competition rules would probably be reduced.

⁶ White Paper, p.1.

⁷ We note, however, that if increased deterrence was the only policy aim, there would be alternatives to achieve it, for instance by raising the level of administrative fines.

⁸ Ibid., p.3.

3. The role of collective action in the new framework

14. The White Paper makes some proposals in favour of collective action, through the introduction of mechanisms for "representative actions" and "opt-in collective actions".⁹ Economics provides a clear rationale for collective action in that it allows for the spreading of the fixed costs of legal action across a wider base. From this perspective, the advocacy of collective action mechanisms by the White Paper would seem justified as a matter of principle, and is likely to increase the viability of damages actions for low-value claims that would not be worthwhile when considered individually.
15. In practice, many important practical questions will need to be settled for the establishment of an effective collective redress system. For instance, a key issue in such systems concerns the homogeneity requirements that ought to be applied in order to define a "class" of claimants. In terms of the Commission's proposals, this would relate to how wide the set of "identified" or "identifiable" victims represented by a qualified entity can be, and to how inclusive a particular opt-in collective action can be.^{10, 11}

4. Issues relating to the quantification of damages

16. The White Paper clarifies that the entitlement to full compensation encompasses the actual loss as well as the loss in profits of the victim, with interest.¹² This raises the question of how the quantification of damages should be carried out in practice. The Commission declares in the White Paper its intention to draw up some guidance in this respect. We would welcome any further clarifications that the Commission can provide on its thinking regarding the appropriateness of the various approaches on the menu of available quantification techniques, whether non-econometric (e.g. cost-based, yardstick, before-and-after approaches) or econometric, all of which may involve a multiplicity of parameters. Further guidance may also provide a degree of transparency which could increase the comfort of victims when coming forward with private action claims, thereby encouraging their taking action, while at the same time enabling defendants properly to develop their case.

⁹ Ibid., p.4.

¹⁰ These issues are discussed to some extent in the Commission Staff Working Paper accompanying the White Paper; see paragraphs 46 et seq.

¹¹ For an overview of the economics of class certification, reference is made to Johnson and Leonard (2007), "Economics and the Rigorous Analysis of Class Certification in Antitrust Cases", *Journal of Competition Law and Economics* 3(3), pp. 341-356.

¹² White Paper, p.7.

17. In expectation of further guidance from the Commission on these issues, for the time being we set out some general observations that in our view should be taken into account for a complete assessment of quantification approaches.
18. A fundamental problem of damages quantification relates to the definition of the relevant counterfactual, against which the loss suffered by the victims in the actual realisation of events can be measured. For example, while we can observe the historical prices in an industry that has been cartelised, we cannot observe the prices that would have obtained but for the cartel. The most immediate candidate proxies for this missing counterfactual may be thought to be the market situation prior to the infringement, or the outcome of a similar market in another region unaffected by the infringement. However, these are not generally appropriate, and there is a need to control for the various other independent influences which would have affected the situation. For instance, in this cartelised industry example, the behaviour of the price of raw materials and inputs could potentially distort the true extent – upwards or downwards – of any price increase observed for the cartelised goods.
19. Therefore, the quantification exercise should as far as possible seek to establish causality between the behaviour that is being challenged and the harm suffered by the victims. As the market outcome is normally the result of a complex interaction between a multiplicity of variables, there is a need to isolate the impact of the unlawful practice from that of the remaining variables. Econometric techniques may make particularly useful contributions in this respect.
20. The White Paper is intended to apply to both Articles 81 and 82. In some settings within the scope of the White Paper, the estimation of the counterfactual is relatively well understood. This is notably the case for allegations of cartelisation and of exploitative behaviour. However, for exclusionary (as opposed to exploitative) Article 82 cases, determination of the counterfactual is currently highly underdeveloped. In such cases, the damages discussion is also in any event very substantially more complicated, given that in the short term customers and suppliers may benefit in the context of such abuses as predatory pricing, while competitors are harmed, with the opposite effect in the long run, at least for consumers and suppliers.
21. In addition, there is a danger that the system could become a vehicle for rent-seeking activities, in terms of actual victims seeking more than fair compensation and in terms of unaffected parties seeking to leverage the system and unfairly obtaining damages. This concern may be particularly relevant in the context of actions based on Article 82, where there may be less clarity as to the level of harm and even the identity of the victims.¹³

¹³ However, the issue cannot be excluded in the context of Article 81 either.

22. In terms of the quantification methods to be preferred, the Commission expresses the concern that damages estimation can "become excessively difficult or even practically impossible, if the idea that the exact amount of the harm suffered must always be precisely calculated is strictly applied". Moreover, "far-reaching calculation requirements can be disproportionate to the amount of damage suffered".¹⁴ Accordingly, the Commission then mentions "approximate methods of calculation" and "simplified rules on estimating the loss".
23. While – other things equal – simplicity is clearly a desirable feature of quantification techniques, other things are unfortunately not always equal. More sophisticated techniques can in many cases provide not only significantly more precise estimates of the harm caused, but also inform on the question of whether the harm is imputable to the defendant. While this may be at the cost of simplicity, the trade-off involved cannot be properly assessed *ex ante*, and the preference should in our view be for a pragmatic, case by case assessment of the amount of "sophistication" that would be reasonable and sufficient in the circumstances.
24. In any event, one cannot overemphasise the importance of rigorously testing the appropriateness of the selected approach.¹⁵ It is essential that any models used for the quantification of damages provide an appropriate reflection of the mechanism of rivalry between the firms in the industry and are based on adequate assumptions.

5. The "passing-on" defence

25. The White Paper proposes that defendants should be entitled to invoke the "passing-on" defence against the claimants.¹⁶ However, in light of the "distance from the infringement" of indirect purchasers, it expresses concern that these may find it "particularly difficult to produce sufficient proof of the existence and extent of passing-on". The Commission therefore proposes to lighten the victim's burden in such cases, so that indirect purchasers can rely on a rebuttable presumption that the overcharge was passed on to them in its entirety.
26. While the motivation of the Commission is understandable, we consider that such a presumption (of full, as opposed to partial passing-on) is too strong from an economic perspective, as there can be no expectation that it would generally hold for the market structures that may become the subject of attention in the context of damages disputes. As

¹⁴ Ibid., p.7.

¹⁵ For an overview of testing procedures in the context of econometrics, see *inter alia*: Hendry (1995), "Dynamic Econometrics", Oxford University Press; Johnston and DiNardo (1997), "Econometric Methods", McGraw-Hill.

¹⁶ White Paper, p.8.

an alternative approach, the following measure may arguably be preferable: if a defendant relies on the passing-on defence against a claimant and succeeds, then that position becomes binding in any suits by customers of that claimant. This could lighten the burden of indirect purchasers where applicable, while avoiding issues of double-recovery in such instances.

6. The allocation of the costs of private action

27. In its discussion of the costs of damages actions, the White Paper notes that the "loser pays" principle may discourage victims with meritorious claims, and proposes to give national courts some discretion as to the cost allocation rules to be implemented, preferably upfront in the proceedings.¹⁷
28. This proposal however presents certain risks. As the Commission notes, the "loser pays" principle serves as a filter for unmeritorious claims. Introducing discretion with regard to the cost allocation rules may reintroduce a degree of arbitrariness in the system; in particular, it is very unclear on what basis courts should decide to deviate from the standard costs rules, especially at the beginning of procedures.
29. Further, while the White Paper considers the costs of the claimant and defendant to the proceedings, it does not adequately deal with the impact of private damages on third parties, in particular in terms of their resource requirements to respond e.g. to a subpoena. Whether third parties ought to be compensated for their costs in complying with information requests that do not concern them directly is a real question that merits reflection.

7. Practical issues in meeting the standard of proof

30. The White Paper proposes that "final decisions" of National Competition Authorities ("NCAs") should be binding on national courts across the EU, with the aim of achieving a more consistent application of Articles 81 and 82, as well as increasing the effectiveness and procedural efficiency of actions for antitrust damages.¹⁸
31. It stands to reason that in circumstances where a claimant can rely on a prior finding, the damages procedure could be considerably simplified and accelerated. However, this is naturally only applicable where the "same practices and same undertaking(s)" are involved, and in practice those situations are likely to be more limited than might be hoped for. For instance, a finding that an infringement was occurring in one country will

¹⁷ Ibid., p.9.

¹⁸ Ibid., p.6.

not in general translate straightforwardly to the same practice taking place in another Member State, where circumstances may have been very different.

32. The White Paper also puts forward proposals to ensure a minimum level of disclosure *inter partes* for EC antitrust damages across the EU.¹⁹ We agree with the Commission's assessment that there often exists an information asymmetry between the claimants and defendants which needs to be resolved, lest the claimants be forced to rely on assumptions which may easily be inappropriate, thereby discouraging in turn the recourse to private action. This is a highly relevant concern for a range of economic quantification methods, which can prove very data intensive.
33. The Commission further proposes some structure to frame such disclosure obligations. In particular, it is suggested that the claimant would have to prove that "the envisaged disclosure measure is both relevant to the case and necessary and proportionate".
34. Such limitations are understandable and easily rationalised. In particular, we consider that the confidentiality of the information should in general be weighed carefully by the courts. This would in turn ensure that private action procedures are not instrumented for purposes other than the compensation of incurred damages. Conversely, however, it will be important for courts not to err towards under-disclosure. For purposes of damages quantification, it is often difficult to determine precisely *ex ante* the range of information that is strictly necessary and proportionate. The information that is strictly necessary *ex post* may well be a subset of the initial information requested, but it is possible that this subset could not have been identified without prior analysis of the full data and information. Accordingly, national courts should evaluate carefully the representations of both claimants and defendants to determine whether data and information requests are necessary and proportionate in nature.
35. A particular illustration of an area where there may well be material asymmetric information between claimants and defendants concerns the "passing-on" defence. As noted above, the White Paper proposes that defendants should be entitled to invoke this defence, and would be required to meet a standard of proof no lower than that imposed on the claimant to prove the damage. Since much of the information pertaining to this issue is likely to rest with the claimant, disclosure obligations will also be important in this area. A complementary interrogation relates to the extent to which the claimant itself should be required to address the passing-on issue to justify its claims, as it would normally be best placed to provide relevant evidence (e.g. on the elasticity of demand for its products).

¹⁹ Ibid., p5.

8. The interaction with the leniency programme

36. The White Paper also considers the issue of the interaction between leniency programmes and actions for damages.²⁰ This is an important consideration; should an inappropriate balance be struck, the effectiveness of the leniency system could potentially be compromised, with firms reluctant to blow the whistle, thereby resulting in a reduced probability of detection and of successful public enforcement of Article 81. This would seem highly undesirable in light of the White Paper's aim to "preserve strong public enforcement of Articles 81 and 82".²¹
37. The Commission is conscious of this issue when it puts forward for consideration a proposal to limit the civil liability of the immunity recipient to claims by his direct and indirect contractual partners. While this runs counter to the principle of "full compensation" for "all individuals", this and other alternative proposals should be studied carefully so as to achieve an appropriate balance to preserve the effectiveness of the leniency programme.

Concluding observations

38. NERA Economic Consulting welcomes the consultation initiated by the Commission on the important issue of ensuring that damages actions for breach of EC antitrust rules are not unduly impeded.
39. The Commission has opened a valuable debate in a number of important areas. We hope that this Memo provides some helpful practical and theoretical comments on these, and look forward to contributing further in the future.

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²⁰ Ibid., p.10.

²¹ Ibid., p.3.