

Cartel Damages

Some practical and policy issues

The calculation of damages in price fixing cases is not easy. It requires estimates of the competitive conditions which would have existed in the absence of the cartel, in many cases for the previous decade or decades. The factual and counter-factual burden, and costs to potential Claimants to establish a damage claim is therefore exceedingly high, especially when it is appreciated that a successful cartel has thrived by concealing and misleading its customers and law enforcers. Here we consider some general and evidentiary issues surrounding private actions in cartel cases.

Calculation of 'but for' prices

The principles governing damages in cartel cases are easy to state but difficult to implement. They are the same as those in tort i.e. they seek to award a sum in monetary compensation sufficient to put the victims in the position they would have been had the cartel not overcharged its customers. This requires that the Claimants' estimate the 'but for' or counterfactual competitive prices for each product and each year on the assumption that the cartel did not exist. Obviously this price is not observed, and will be hard to determine given that actual prices will change and fluctuate for reasons unrelated to the price-fixing conspiracy.

The most common method of estimating 'but for' prices is the so called 'before-and-after' approach. This takes the price before the cartel and the price after the cartel has been disbanded, and in the simplest case draws a straight line between the two to calculate the 'but for' prices over the intervening years. This assumes that a) the before and after prices are the competitive prices; and b) the prices over the intervening period of cartelisation are not influenced by other market factors.

There are obvious problems with this approach. First, the start and end prices may not be competitive or non-collusive prices. The cartel or less overt collusion may have existed prior to the start date for the cartel established by an antitrust authority. The cartel members may also not bring down prices to their competitive levels after the cartel has been detected if they know that fines and damage claims will be based on post-cartel prices, or if they have unilateral market power. Even ignoring these considerations, the approach can easily generate nonsensical results if post-cartel prices are higher than pre-cartel prices. The 'before-and-after' method would

estimate 'but for' prices higher than actual prices, and that the cartelists' had 'undercharged' and benefited their customers! This underscores the fact that prices don't move in straight lines nor are they immune from market forces simply because a cartel exists. A credible estimation procedure must take into account evidence of changes in market conditions over the period of cartelisation if it is to survive forensic attack. The 'but for' price estimates must incorporate changes in demand and supply-side factors (such as capacity constraints), foreign exchange movements for traded goods, and so on.

One approach that seeks to systematically adjust for the myriad factors which influence prices within a specified model of oligopolistic interaction is econometric analysis. This is a sophisticated before-and-after approach which can take account of the non-cartel factors which affect prices, and provide estimates of the cartel-only effects. While better, it is not without its problems – often the data is inadequate; the technique can be challenged on modelling and statistical grounds; and the approach may not be readily assimilated or accepted by a judge, especially if the findings are not corroborated by more 'common sense' evidence.

Victims' loss, cartelists' gain, or ...

While the general rule is that damages should be based on the victims' loss, it is not clear that this is necessarily the optimal damage rule. The simple mechanics of overcharging indicate that private actions may result in cartelists not bearing the full costs of their illegal actions. This is so for at least two reasons. First, the cartel will have restricted output and if the cartel has persisted for some time, the higher costs may knock some firms out of the market for which compensation is not claimed. This generates what economists call a deadweight loss equal to the difference between what customers would have been willing to pay for the lost output minus the avoided production costs. This loss is in addition to the wealth transfer from the overcharge equal to the quantity sold times the price difference. Thus even a compensatory damage measure should, all things equal, be increased to reflect the deadweight loss. While this loss is not directly measurable, it can be calculated using estimates of elasticities.

Second, the *modus operandi* of cartel is concealability. As a result many cartels are not detected. Optimal

sanctions require that the failure to prosecute all cartels be taken into account by raising the penalty above the compensatory level. Thus if only one in four cartels are discovered and successfully prosecuted, then optimal damages should be four times the victims' losses i.e. multiplied by the reciprocal of the successful prosecution rate. Moreover, if not all victims make claims in each cartel case, either because the individual losses are too small or the costs of mounting an action too high, then there should be a further uplift. This provides a justification for the US triple damage measure, although the assumption that only one in three cartels is prosecuted lacks scientific backing.

An alternative measure of damages under consideration are those based on the offenders' gains i.e. restitutionary damages. In the simplest case this is the same as compensatory damages i.e. equal to the wealth transfer brought about by the overcharge. In other cases, the two may diverge if victims incur additional costs or the impact on profits of the price increases differ between offender and victims. However, gain-based damages would not deal with the deadweight loss and concealability points raised above.

Another consideration is that price fixing is a *per se* offence under EC law (Article 81), and in some Member States a criminal offence. If the concept of an efficient cartel is not admitted, then compensatory damages would merely make the cartelists indifferent between price-fixing and competing, whereas they should positively tip the balance toward the latter. If a thief steals your property, it is insufficient to ask him to give it back when caught! It follows that optimal sanctions require that the penalty exceed compensatory damages. In practice this deterrence objective of cartel laws is bolstered by substantial fines and custodial sentences. However, what impact these multiple sanctions should have on the calculation of damages in private actions is problematic.

Legal and enforcement cost allocation

The legal costs of mounting a damage claim are significant. Indeed, they could easily be prohibitive if liability has not yet been admitted or determined by an antitrust authority. Moreover, evidence on the cartelists' activities is often, if not always, very limited because cartels operate in secret and do not tend to keep records. When firms fix prices they impose a range of predictable losses on customers which are avoidable. Indeed, under conditions of effective competition, the costs of detecting

and punishing cartelists are not legitimate business costs of the victims. Thus an optimal sanctioning scheme would require that the cartelists bear the full costs of public and private actions to detect and punish them. This cost allocation rule should be applied in private damage claims.

Direct purchasers & passing-on

In US law only those who are direct purchasers of the cartelists' products have standing to sue for damages (*Illinois Brick*). Most cartels involve primary or intermediate products – vitamins, cement, copper tubes – that are processed and form input costs along several stages of the supply chain. Thus a copper tube cartel may result in a distributor being overcharged, which is then passed on in higher prices from the distributor to a fabricator, the fabricator to the boilermaker, then onto the builder, and finally the householder. If each had standing to sue, there would be a danger of high legal costs and duplicative claims. Thus the direct purchaser limitation makes practical sense.

However, one potential obstacle to a successful claim is the so-called passing-on defence. It is not clear whether such a defence exists in English law. It is correct that if a direct purchaser has fully or partially passed on the overcharge downstream, then the absence of a passing-on defence would lead to over-compensation of direct purchasers, but not necessarily overpayment by the cartelists. A passing-on defence would, however, require the courts to apportion losses which would significantly increase legal costs and lower the Claimants' probability of success. The Claimants would be required not only to go through expensive accounting and competitive analyses to determine the extent of the overcharge, but also to examine and defend counter-claims that they partially or fully passed on the overcharge to their customers. This is a potentially large hurdle. It is therefore crucial that those contemplating a claim start off by assessing the theory and evidence concerning the incidence of cartel overcharges until such time as the law is clarified.

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