



Damages for bid rigging

The English High Court's idiosyncratic cost-based approach in *BritNed*

[*BritNed v. ABB* \[2018\] EWHC 2616 \(Ch\)](#) is the first English cartel damages judgment, and the first to consider margin, cost and econometric approaches to the quantification of damages. The judgment will reward careful reading. It is clear and transverse a wide range of issues that will govern damage actions in the future. Here the focus is on how the court quantified damages.

The power cable cartel

The European Commission found that ABB was member of a global cartel tendering for the supply of extra high voltage submarine and underground power cable projects during the period 1999 to 2009 ([Case AT.39610 - Power Cables](#), 2014). According to the Commission there was excess capacity which the cable producers dealt with by maintaining prices and allocating bids. ABB successfully bid to supply a submarine cable to BritNed's electricity interconnection project between the UK and the Netherlands. The final contract price was nearly €289m.

BritNed sought damages for the overcharge, lost profits and compound interest (the last two were denied). The court found no evidence of an overcharge – ABB made an 'honest and competent bid', and the key individuals negotiating the BritNed contract for ABB were unaware of the cartel. The court nonetheless awarded damages of €13m - €7.5m arising from 'baked-in' inefficiencies on the BritNed project; and €5.5m in "cost savings" (explained below). This was equivalent to a 4.5% gross margin.

The defendant's margin approach

The defendant's expert used a during-and-after gross margin comparison. ABB's gross margins were calculated by taking each project's revenues minus its direct costs, thus excluding common costs. The direct costs were determined by the expert and not as they appeared in ABB's books. These calculations showed that ABB's gross margin on the BritNed project was similar, and if anything, lower, than those for ABB's comparable post-cartel submarine projects. Therefore, said the defendant's expert there was no overcharge.

The judge, Mr Justice Marcus Smith, [416] was comfortable with this approach: "margin analysis represents a reliable tool for assessing the overcharge"; it was "more straightforward" than the claimant's

econometric analysis, and "tied very closely to the facts and to the data produced by ABB".

The court's cost-adjusted approach

The court took the view that the margin analysis missed two costs factors that warranted the award of damages.

There were 'baked-in' inefficiencies reflected in ABB's costs. ABB had used thicker more expensive cables than its competitors. This finding was based "on a few internal ABB documents and the fact that ABB lost bids in the post-cartel period". If ABB had used a thinner 1,000 MW cable there would have been an assessed 15% cost saving on the copper content which represented the equivalent of a 2.6% gross margin.

Secondly, because members of the cartel were allocated projects their overall tendering costs were lower. These 'common cost' savings, said the court, should be compensated. These were calculated by taking the difference in the average gross margin between ABB's cartel and non-cartel period projects of 5.65% (from Table 6 at [331]) multiplied by ABB's failure rate in securing projects in the post-cartel period. This "suggests that 1.9% of the overcharge is attributable to the cartel savings I have identified".

Baked-in inefficiencies

The evidence that there were 'baked-in' inefficiencies was, as already said, based on "a few internal ABB documents". These inefficiencies existed in both the cartel and post-cartel periods. This suggests that they were not due to the cartel at least on a 'but for' test. The alternative view taken by Smith J, was that the allocation of the BritNed project to ABB enabled it to secure a project it would not have otherwise, as shown by its near failure to secure comparable projects in the post-cartel period. This, however, leaves BritNed out of the equation. If the specification of a key component of the project was so obviously inefficient and expensive why was this accepted by BritNed which was capable of negotiating a lower price? (but see below).

Common cost savings

The court also awarded damages for 'common cost savings'. This was unusual and unconvincing for two reasons.

There were no 'cost savings' on the BritNed project

The cartel allocated tender projects to its members. 'It was this allocation of demand', said the court, 'that enabled higher prices than normal to be charged, even in periods when overall demand in the market was slack.' Smith J (457(7)(a)) then changes tack:

In other words, one factor comprising the difference of 5.6% between Cartel period margin and post-Cartel period margin is this, entirely illegitimate, saving in cost due to the control and management, by the Cartel, of supply to the market. This, unlike the baked-in inefficiency I have considered, arises through the operation of the Cartel generally and affects the cartel's common costs. Essentially, it represents the saving to the cartelists of not having to compete.

Higher project prices and lower common costs are two different things. The higher contract price, if there was one, exploited the inelastic demand moderated by BritNed's buyer power and was not cost-induced. On the other hand, common cost savings would not have directly affected the gross margin nor necessarily increased the contract price. Indeed, according to the court [457(e)] it did the opposite:

These [common cost] savings were competed away – in the case of the BritNed Interconnector – by ABB: but all that means is that ABB chose to allocate some common costs to other projects. That does not mean that BritNed is not entitled to a share of these cartel savings.

It is embarrassing to make the obvious point that since BritNed suffered no loss on this score it should not have been compensated. The court's proposition that BritNed should be compensated because ABB's other customers may have sustained 'losses', or more precisely not shared the profits from cartel behaviour, violates the fundamental principles of compensatory damages. Such a collective notion of 'average' losses was expressly and correctly rejected by Smith J [431] elsewhere in the judgment where he emphasises that the "issue before me" was the loss to the claimant:

I am concerned with the much narrower issue of the overcharge to BritNed arising out of a single, specific transaction: the contract for the supply of the BritNed Interconnector, ... Whilst, obviously, the general operation of the Cartel is highly material ..., it represents the starting point and not the end point of the quantification process."

There is another oddity with the court's approach. It is based on the view that overhead cost-savings arising from the cartel should be in effect 'passed-on' to the buyers, and that the relevant counterfactual for this head of damages was the cost structure during the cartel period. This is incorrect. The appropriate counterfactual is the common costs absent the cartel, which were higher. The common cost savings cannot be treated as a 'loss' even though if present the cartel members would have benefitted. The court's confusion here arises from

its focus on costs rather than the way the cartel was able to increase contract prices.

No Cartel gross margin difference

A further difficulty is the way the limited data available to the court was used.

The court had no data on common costs, or whether the cartel reduced common costs or how they were allocated between projects. It derived and imputed the reduction in common costs using the proportion of ABB's unsuccessful bids during the post-cartel period as a proxy. The court's logic was that if ABB lost 30% of the projects it tendered for in the post-cartel period but won all those during the cartel period (as it did), then 30% of the excess gross margin can be attributed to the costs it saved in avoiding unsuccessful bids.

There are two problems with the court's approach.

First, there is a minor error with the court's arithmetic. The average gross margin on the 14 successful ABB cartel submarine projects was an average of 26.7%. However, the 14 projects listed in Table 6 of the Judgment have an average gross margin of 27.4% suggesting an excess margin of 6.3%. If BritNed is included, it is 26.7% as stated in the judgment but this gives 15 not 14 successful projects. This alters the percentage cost saving using the court's formula in footnote 558 to $(5.6\% / 21) \times 15 = 4.0\%$; $5.6\% - 4.0\% = 1.6\%$, or without BritNed 2.1%, not 1.9% as stated in the judgment. (Note two features of the court's arithmetic - (a) its calculation can be simplified by multiplying ABB's post-cartel failure rate by the gross margin difference; and (b) it is based on the averages of all ABB cartel projects and not the BritNed project only).

The more serious problem is the data used by the court (again from Table 6) does not necessarily show that the average gross margin during the cartel period was 'excessive'. The court calculated and compared simple average gross margins for cartel and post-cartel periods. This assumed that the type and mix of projects in both periods were similar. They were not. The average contract price for all post-cartel projects is €1.3 billion (€2.2 billion for lost bids and €993 million for successful bids) compared to only €491 million for ABB's bids during the cartel period. The projects allocated to ABB during the cartel-period were on average one-tenth the size of comparable ABB projects in the post-cartel period. ABB's projects during the cartel period also varied markedly, with higher gross margins on small projects (several projects with contract values less than €10m had gross margins of 30% to 40%) which pushed up the cartel-period average gross margin.

Given these large differences in project size the more appropriate comparison would have been between weighted averages. Using contract prices as weights, the weighted average gross margin for the 15 cartel-period submarine projects was 20.8% compared to 20.3% for all post-cartel projects. This wipes out the difference in average gross margins relied on for Smith J's cost savings calculation.

The wider issues

Project based claim

The BritNed case differs from those usually associated with secret cartels. It concerned one massive infrastructure project where the specifications, terms and prices were bespoke, and directly negotiated by the parties. This influenced the judgment in several ways. First, it could not be argued that the claimant was ignorant of the nature of the costs, project specifications and reasonableness of the price. The court found that BritNed was able to negotiate reductions in ABB's price to such an extent that it concluded that there was no 'overcharge'. Secondly, it enabled the court to undertake a very detailed forensic examination of the documentary and witness evidence on how the bid was put together, the knowledge of those putting together the bid, the knowledge of the claimant, the history of negotiations and way the contract price was negotiated. As the court said it was concerned with the specific circumstances of and loss to the claimant, and not the loss in general or on average to purchasers of ABB's submarine cable projects during the cartel period.

Counterfactuals

The court set out a counterfactual which was at odds with the way it quantified damages. The court said that the correct approach to measuring the overcharge should be the difference between the prices agreed and price in the absence of the cartel whichever party BritNed would have contracted with it in the counterfactual. The counterfactual was not, said the court, a comparison between ABB's submarine project prices during and after the cartel-period. Yet the counterfactual adopted by the court was a hybrid of these two. The only comparison made in the Judgment was between ABB's prices, costs and margins on different projects. There was no data on the tenders of other members of the cartel or those not in the cartel, and crucially how many competing bids there were for each ABB tender or the dates of the various ABB tenders which might be useful to determine whether market conditions had changed over what was a very long period. To put it bluntly, data on the pivotal variables which drove the court's judgment – the intensity of competition and common costs – were not investigated but simply inferred from the Commission's Decision that ABB was involved in a bid-rigging cartel between certain dates. This is a major concern given the court's stiff criticism of the claimant's econometric evidence for failing to adjust for differences between projects and over time. Here no adjustment at all was deemed acceptable by the court.

There is another concern. The defendant's expert compared ABB's gross margin for the BritNed project with the gross margins of comparable ABB submarine tenders. This was accepted by the Court. This does not seem the appropriate comparison. All comparable ABB post-cartel tenders were unsuccessful bar one as the court pointed out. So, the Defendant's expert was not comparing actual prices in the two periods, but the BritNed contract price with ABB's unsuccessful offer prices in the post-cartel period. Arguably the latter failed because they were too expensive suggesting that the relevant post-cartel counterfactual prices may have been lower than those used by the Defendant's expert, although there is no evidence for this.

Costs and experts

Both parties used their economist to make statements, or refuse to make statements, about costs – whether they were legitimate, reliable, efficient and so on. As the court pointed out the two economists were not experts in submarine cable projects and their costs (echoing criticism made in *Sainsbury's v. Mastercard* about the use of economists to make factual statements). ABB, said the court, should have organised evidence on costs from those with competence in the area.

On common costs, which were crucial to the way damages were arrived at, there was no evidence on their magnitude, how they were allocated and how they changed over time. Instead these were inferred by the court using a simple (untested) arithmetic calculation that assumed that they were significant and would have been averaged over all ABB projects apart from the BritNed project. The (ir)relevance of this exercise has already been discussed. One can easily guess the court's reaction had one of the experts had advanced a similar 'broad brush' approach to quantification.

Conclusion

The court's award of damages for common cost savings is misconceived. It was based on the unusual proposition that a claimant who did not suffer this 'loss' was nonetheless entitled to compensation because other purchasers harmed by the cartel did not share in the profits from the defendant's illegal behaviour. Both parties are unhappy with the decision and have been granted leave to appeal.

My December Casenote will look at whether it was reasonable for the Court to have rejected the Claimant's econometric evidence.

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