



# Volume effect damages in cartel cases

Why pass-on gives rise to offsetting lost volume damages.

The [EC Damages Directive \(2014/104/EU\)](#) reiterates that the purpose of damages is full compensation and no more (Art 3). The prospect that claimants may be “unjustly enriched” has led to an obsessive focus on the pass-on of cartel overcharges to the exclusion of lost profits damages which accompany pass-on. This Casenote explores the role of lost volume damages, and why the Damages Directive will lead to the under compensation of claimants.

## Pass-on in EU Law

The overcharges paid by a purchaser are the core of the award of damages against members of an illegal cartel. The direct purchaser who initially pays the overcharge will often pass a proportion, and maybe all, of this on to its customers in higher prices. The Damages Directive says that this amount should be deducted from the overcharges loss of the purchaser (Art 13). The European Commission is required to publish Guidelines on pass-on in the near future (Recital 42).

The Damages Directive goes further. In what amounts to re-writing of the civil law of most Member States, it sets out two new rebuttable presumptions - that an infringement has caused harm; and that direct purchasers will pass-on at least some of the overcharges to their customers (Art 14). Combined with the right to sue, the rebuttable presumption of pass-on serves as a “sword” which benefits indirect purchasers and end consumers by allowing them to reclaim their losses (Art 14). It also acts as “shield” or defence which enables defendants to reduce or even eliminate their exposure to damage claims (Art 13).

## Pass-on means lost volume damages

It is elementary economics that an overcharge of, say, 20% to 30% which increases the costs of a direct purchaser imposes at least three losses:

1. the overcharge (**overcharge**)
2. lost profits on the reduced sales (**volume effect**), and
3. the real economic loss (**deadweight loss**)

The first two losses are recognised in the Damages Directive as overcharge and lost profits damages respectively. The third is not and can be ignored for the present purposes (although the EC Commission’s [Practical Guide to Damages Quantification \(2013\)](#) describes it as a lost volume damages).

The law entitles direct purchasers to claim the amount of the overcharge they have not passed-on to their customers in higher prices. This avoids their unjust enrichment and supposedly gives them full compensation. But in practice this invariably guarantees that they are undercompensated.

The reason is due to the elementary economics proposition that pass-on and volume effects are inextricably intertwined. When the direct purchasers raise their prices they suffer a loss in sales, and hence sustain a further loss in terms of the profits thereby sacrificed. This volume effect cannot be observed from market data or company purchase invoices as it represents hypothetical sales which have not been made because of the impugned conduct. Indeed, it can give rise to a more troublesome consideration – what might be called the “lost firm” effect if the overcharge pushes some higher cost purchasers out of business.

The EC Damages Directive notes the relationship between overcharges and lost sales in its preamble (Recital 40) but then proceeds to ignore it. This bias against lost volume damages is also reflected in English law. The Court of Appeal in [Devenish v Sanofi-Aventis \[2008\] EWCA Civ 1086](#), dealt briefly with the issue in dismissive terms. Longmore LJ (para 148 (ii)) in *obiter* said that “if no or a few damages are awarded, that does not mean that such damages are inadequate; loss of a possible sale is less serious than actual out-of-pocket loss”. His Lordship was wrong; as is the Damages Directive.

## Importance of Lost Profits

How important is the lost volume effect? The answer is potentially very important. It can be shown using the economists’ oligopoly models that under various plausible specifications of demand and supply conditions that the lost profits due to the volume effect can be substantial, and sometimes larger than the pass-on of the overcharge. Hence the failure to take account of the volume effect when adjusting for pass-on means that direct purchasers are under-compensated. In cases where the lost volume damages exceed the pass-on adjustment, even the award of the full overcharge would undercompensate direct purchasers.

It has been suggested that the Damages Directive does not compromise the claimants’ right to a lost profit claim (Art

13.3). This is correct but does not meet the above criticism. If pass-on and lost volume damages occur at one and the same time; and pass-on is the *sine qua non* of lost volume losses; then lost volume damages should be central to any rule or guidance on pass-on. A lost profits claim on account of reduced sales is not a secondary and/or ancillary claim but an inevitable complementary head of damages.

In summary, economics and legal consistency require that where pass-on is pleaded, the claimant must be entitled to overcharge plus lost volume damages.

#### Presumption of volume damages

While one is hesitant to suggest a further codification of the law of damages (which seems to be the effect of the Damages Directive) there is a case for a corrective legal “presumption” that pass-on gives rise to a (offsetting) claim for lost profits. Namely, that where cartelists raise a pass-on defence in an effort to reduce their exposure to overcharge damages; it should automatically create a presumption that the claimant has suffered lost volume damages. If the simple economics is correct you cannot have one without the other.

Indeed one can go further and require defendants to estimate the volume effect as part of the proof of pass-on they are already required to satisfy (Art 13). This would smooth the procedural and evidential obstacles faced by claimants as they could rely on this estimate to calculate the profit loss uplift to their claim implied by the defendants’ defence.

The position of indirect purchasers who plead pass-on is different as they are not liable (obviously) for lost volume damages. They should not bear the burden of establishing the associated lost sales since that does not affect either their gross or net compensation.

The attraction of the proposed presumption is two-fold. It puts lost volume damages on an equal footing to overcharge damages, and deals with a source of under-compensation. Secondly, it softens the blow to claimants at each stage of the supply chain caused by the pass-on defence, and the uncertainty surrounding its impact. It does this by exposing defendants to a second head of damages which will caution them from raising the defence as a matter of course and in a simplistic way – that the overcharges were all passed on, and ultimately borne by the end consumer who has often little incentive to sue.

#### Gains based damages

Volume effects play another role, this time in assessing the relationship between gains based and overcharge damages. To reiterate the legal principle – damages should compensate not punish. Therefore quantum is based on the claimants’ losses not the defendants’ gains.

In *Devenish* this proposition was tested in the English Court of Appeal. The claimant, a direct purchaser, sought to circumvent the pass-on defence by claiming gains based damages (known as an “account for profits”). The court rejected this because the claim was in essence overcharge damages in different guise, and the prospect that *Devenish* would be overcompensated as it most likely passed-on the overcharges in higher prices. Moreover, if it was allowed gain based damages and the indirect purchasers overcharge damages, the defendants would be exposed to damages up to twice the amount of the overcharges

Notwithstanding this, the perception that gains based damages are greater and/or easier to estimate than compensatory damages is wrong. It is incorrect because of the volume effect but this time as it affects members of a cartel. When cartelists raise their prices two offsetting factors occur - they gain increased profits from the sales they make; but lose the (pre-price increase) profits on the sales they do not make in order to raise their prices. As a result their net gains are less than the overcharges, and would under compensate direct purchasers.

#### Summary

The European Commission’s endorsement that indirect purchasers have standing to sue has increased the complexity of damage calculations considerably. The Damages Directive recognises that pass-on is part of this complexity; but fails to take account of the inevitable lost profit damages. As a result the Directive is incomplete, and its focus on pass-on risks the significant under compensation of those harmed along the supply chain.

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