

## Cartel Damages Under the New EU Directive

The new EU Antitrust Damages Directive<sup>i</sup> (“Directive”) will make it easier for those indirectly affected by cartels to pursue damages claims. Claimants will be able to recover losses even if they did not directly transact with any of the cartel members. The Directive facilitates this by introducing a “passing on” presumption – that an overcharge levied on a direct buyer was passed on, at least in part, to an indirect buyer (i.e., that the direct purchaser did not absorb the full overcharge). The onus will be on the indirect buyer to prove the extent of the overcharge that was passed on and the loss suffered.

The Directive will make it easier for claimants, particularly indirect buyers, to bring follow on cartel damages actions. But successful claims will require a clear demonstration of the level of pass-on and its distribution amongst direct and indirect buyers. Estimating the pass-on will involve detailed analysis of market structure, competitiveness, mark-ups, and demand and supply elasticities in all the affected downstream markets.

This note discusses the presumption of pass-on under the Directive and describes the standard economic approach and its limitations in estimating the distribution of cartel damages through a chain of direct and indirect buyers.

### THE DIRECTIVE ENCOURAGES PRIVATE ANTITRUST DAMAGES CLAIMS

The Directive is claimant-friendly as it establishes a number of measures to facilitate antitrust claims by, among other things:<sup>ii</sup>

- making it easier for claimants to access evidence;
- treating the decision of a national competition authority as proof of infringement;
- establishing a rebuttable presumption that cartels cause harm; and
- clarifying that the period of time within which victims can bring an action for damages is at least five years, and, importantly, that it is suspended from the moment a competition authority starts investigating an infringement until at least one year after the infringement decision has become final.

The Directive also allows infringers to defend themselves against a damage claim by invoking a passing on defence. Defendants will need to prove that cartel overcharges (or underpayments in the case of a buyers’ cartel) were (partially) passed on by the claimants to their own customers.<sup>iii</sup>

### THE DIRECTIVE PRESUMES THAT CARTEL OVERCHARGES ARE PASSED ON

The pass-on presumption affords infringers the opportunity to limit claims provided they can demonstrate that cartel overcharges were passed on through a chain of buyers. The onus will be on defendants to quantify the portion of the estimated overcharge passed on from direct to indirect buyers and ultimately to the final consumer. Direct buyers of the cartelised product pay the overcharge. But the buyers will pass on either all or a portion of the overcharge to their own customers, so that the direct buyers’ net loss may be less than the amount of the full overcharge. The indirect buyers (the customers of the direct buyers) may also be able to pass on some of the overcharge and this process will

continue until the overcharge filters through to the final customers. Thus, an unknown proportion of the overcharge may be passed on through each successive link in the supply chain. This poses a problem for claimants, defendants and the courts – not only is it necessary to examine market conditions in the cartelised industry to estimate the overcharge but it will also be important to understand the state of competition in the indirect buyers' markets in order to understand the effect of the overcharge on the costs, sales, and profits of downstream buyers.

Many cartels arise in intermediate goods industries that feed into a chain of buyers before reaching the final consumer. In such sectors, the extent of the loss to indirect purchasers may be difficult to quantify. Defendants will inevitably plead that buyers have passed the overcharge on to successive downstream purchasers. Direct and indirect buyers are likely to claim that they were unable to pass on all or a substantial portion of the amount of the cartel overcharge. As overcharges are dissipated through a chain of firms and purchasers, the extent of harm and its distribution amongst different parties becomes increasingly difficult to quantify.

## WHO BEARS THE BURDEN OF THE CARTEL OVERCHARGE?

Economists view cartel overcharges as a form of tax to determine their effects and incidence. As with the incidence of a tax, the incidence of the cartel overcharge falls on the group that ultimately has to pay the overcharge, which depends on the responsiveness – or price elasticity – of demand and supply in all the affected downstream markets. The demand and supply elasticities are in turn determined by market structure and the nature of competition in all the markets downstream of a cartel.

If there is effective competition in the direct buyers' market, standard economic models predict that buyers will be able to eventually pass on the full cartel overcharge to their customers.<sup>iv</sup> If all markets in the supply chain are competitive, then the overcharge is passed on the chain of buyers to the end consumers. Thus, under competitive market conditions the burden of the cartel overcharge may be largely borne by the final consumers while the damage suffered by the direct and indirect purchasers who are *not* the final consumers may be limited.

If, on the other hand, the markets downstream of a cartel are not effectively competitive, then downstream firms may be able to pass on to their customers only a portion of the overcharge. To illustrate the issue, consider the simplified Cournot<sup>v</sup> model of competition. A simple version of this model<sup>vi</sup> suggests that the proportion of the overcharge passed on increases with the number of firms in the market approaching near complete pass on if there are a large number of buyers at each stage.

## PASS-ON AFFECTED BY MARKET ELASTICITY OF SUPPLY AND DEMAND

Simple economic models, based on the number or concentration of buyers, can be helpful in providing rules of thumb for estimating the damages claims of each class of victims. However, the attractive simplicity of this approach is deceptive because of its failure to consider substitution between the cartelised product and substitutes at each stage before final consumers, the time required for each stage to adjust capacity discussed above, and price mark-ups which are discussed in the following section.

If, for example, direct purchasers respond to the cartel overcharge by substituting other products<sup>vii</sup> or changing their production technology<sup>viii</sup>, then irrespective of the competitiveness of direct purchasers' markets only a portion of the increase would be passed on. More precisely, the portion passed on would depend on the competitiveness of these purchasers (such as in the Cournot example above) and the **net** increase in these purchasers' costs after taking account of such substitution measures. Similar considerations would apply with respect to the pass-on by the buyers of the direct purchasers' products and so on until reaching final consumers. And, since such switching decisions would not, in

general, be instantly implemented the portion passed on might well change over the lifetime of the cartel. An understanding of these market-specific effects is fundamental to determining pass-on and will have a direct bearing on quantifying the overcharge and incidence of damages.

## MARK-UPS

In some markets firms price their products by using “rule of thumb” markups of their costs. In such cases the firms’ initial responses to a cartel overcharge would be to raise prices by more than the overcharge. Firms’ ability to maintain such an elevation will be limited by competition between them. But the important point is that for such firms, the cost passed on inclusive of such a markup may be greater for a time than the proportion of the overcharge it bears.

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## ABOUT US

Economists at The Brattle Group have extensive experience assisting clients and their legal counsel in antitrust and damages cases. Our approach is based on a careful assessment of the evidence presented by the parties to determine the competitive effects of firms’ conduct in affected markets.

We apply economic and financial models and statistical tools to quantify the level and incidence of economic harm. Brattle experts have provided economic analysis in some of the world’s largest and most complex cartel and damages cases. We apply our expertise in a wide range of markets and routinely provide written and oral testimony before competition authorities, Courts and international arbitration tribunals.

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<sup>i</sup>On 17 April 2014, the European Parliament adopted a text of the [Directive on antitrust damages actions](#), governing actions for damages under breach of competition law which was agreed between the European Parliament and the Council during the ordinary legislative procedure. The agreed text of the Directive has been sent to the EU Council of Ministers for final approval. See: <http://ec.europa.eu/competition/antitrust/actionsdamages/documents.html>

<sup>ii</sup>[http://europa.eu/rapid/press-release\\_MEMO-14-310\\_en.htm](http://europa.eu/rapid/press-release_MEMO-14-310_en.htm)

<sup>iii</sup>The Directive creates a significant difference between EU and U.S. antitrust laws as generally only direct buyers can claim damages in the United States. The "Illinois Brick doctrine" (*Illinois Brick Co. v. Illinois*, 431 U.S. 720 (1977), US Supreme Court) prevents, with limited exceptions, indirect purchasers of goods or services from recovering antitrust damages from violators.

<sup>iv</sup>Standard economic models for competitive industries generally assume that unit costs are constant once firms have time to adjust their capacity. If so, then a competitive buying industry facing a persistent cartel will eventually fully pass-through the overcharge. But this means of course that even such an industry may bear a portion of the overcharges before being able to fully make the requisite changes in capacity. Hence, the persistence of the cartel and the speed at which capacity can be adjusted for each downstream industry are complexities that need to be assessed in implementing the Directive in particular cases.

<sup>v</sup>Cournot competition is an economic model used to describe an industry structure in which firms have market power and decide the amount of output they will produce (as opposed to deciding on a price to charge). The model assumes that each firm aims to maximise profits, based on the expectation that its own output decision will not have an effect on the decisions of its rivals.

<sup>vi</sup>This can be illustrated by considering, for example, the direct purchasers. Assuming demand is linear and marginal costs are constant, then the proportion of the overcharge (OC) passed on by them will be  $OC \cdot (n/(n+1))$ , where  $n$  is the number of direct purchaser firms. Thus, with two direct purchasers they will pass-on only 50% of the overcharge they pay. Whereas with three direct purchasers 75% of the cartel overcharge will be passed-on to their customers, i.e.,  $3/(3+1) = 75\%$ . The same type of calculation then applies to the buyers of direct purchasers and to the buyers from them, etc. This approach suggests that the pass-on will be between 50%-100% of the overcharge depending on the structure of the market, and be at the higher end of this band as the number of firms increase. As the number of Cournot firms increases, each firm's degree of market power decreases. So, for example, with 999 firms, 99.9% of the overcharge is passed through, which is nearly the same as under perfect competition.

<sup>vii</sup>For example, increasing their use of aluminum if faced with a steel cartel.

<sup>viii</sup>Such a change could be fairly small, such as steps to reduce scrappage or, alternatively, using a different process entirely.