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The Damages Lie in the Details: Why the Proposed Directive Fails in Harmonizing Incentives to Sue Across the European Union

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I. INTRODUCTION

One of the two main objectives of the proposed EU Directive ("EU Directive") is to ensure effective compensation of victims of infringements of EU competition rules.[2] Effective compensation throughout Europe has two components: first, an average level of compensation in the European Union that matches the average amount of damages ("Effectiveness Objective"); second, a regional distribution of awarded damages that reflects the regional distribution of harm in Europe ("Harmonisation Objective").

In the following, we argue that the EU Directive will potentially achieve its first goal, i.e. the Effectiveness Objective, but may fall short of the second one, the Harmonisation Objective. For the example of the passing-on defense and interest payments, we substantiate our claim by showing that major options remain unspecified and, hence, depend on actual national court practice. To the extent that the decision of where to bring a case has implications on: i) which cases are brought, ii) which firms are sued, and iii) which customers are compensated, this will also have an impact on the regional distribution of damages awarded and the regional location of firms paying the damages.

II. FACTSHEET OF THE DIRECTIVE

On paper, the EU Directive has something for both supporters and opponents of an effective litigation environment in Europe.

Pro-defendant commentators may highlight the commitment to single damages (instead of triple damages as in the United States), no presumptions on the percentage overcharge (in contrast to the Hungarian approach of a rebuttable percentage overcharge of 10 percent), a potentially ineffective opt-in class action procedure (in comparison to the opt-out class action procedure in the United States and the recent U.K. proposal), and the explicit acknowledgement of a passing-on defense (in contrast to U.S. practice, but also to what was until recently considered to be the legal situation in Germany).

In addition to the expression of general support by EC and EU courts for the position that every citizen in Europe should have the right to effective compensation, pro-claimant commentators may claim victory due to the fact that a presumption on the existence of damages

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[2] The other main objective is to optimize the interaction between public and private enforcement.

in follow-on claims is granted, and that this presumption holds both for direct and indirect purchasers. They may also look favorably on the proposal to accept interest payments from the moment when damages were incurred (and not only from the point in time when the claim was brought to court), and on the proposal to establish joint and several liability, except for the case of leniency applicants.

Neither side can claim victory as regards the level of disclosure proposed. This is because the EU Directive aims at a moderately intensive disclosure procedure and, within a framework allowing a passing-on defense, broad disclosure provides strategic advantages both for claimants (to get sufficiently detailed information to substantiate their claim) and for defendants (to build their passing-on defense). Equally, an efficient out-of-court settlement procedure may be considered a plus for both parties, as it helps to accelerate conflict resolution.

III. A SNAPSHOT OF OPEN LITIGATION PROCEEDINGS IN EU CARTEL CASES

Besides lawsuits on national cartel cases (which typically are prosecuted in their home jurisdiction), European cases offer some flexibility to the claimant as to where to file the case. In broad terms, jurisdiction can depend on the defendants' or the claimants' place of business, the country in which the infringement took place, or the place where damages were incurred. The variety of potential grounds for establishing jurisdiction in European cartel cases gives plaintiffs room to maneuver in deciding where to bring a case and allows for a decision to be made in response to the perceived benefits of a particular jurisdiction for a particular case.

Table 1 shows the ten cartel cases with the highest ever cartel fines imposed by the Commission. Of these cases, the last column provides—based on publicly available information—their current status regarding court proceedings and the jurisdictions where the case is pending.

Table 1: EU cartel cases with the highest fines and jurisdiction of court proceedings:

Year	Case name	Amount in €	Court proceeding initiated
2012	TV and computer monitor tubes	1 470 515 000	-
2008	Car glass	1 354 896 000	DE
2007	Elevators and escalators	832 422 250	NL, DE
2010	Airfreight	799 445 000	NL, UK
2001	Vitamins	790 515 000	DE, UK
2008	Candle waxes	676 011 400	UK
2010	LCD	648 925 000	UK
2009	Gas	640 000 000	-
2010	Bathroom fittings	622 250 782	-
2007	Gas insulated switchgears	539 185 000	UK, NL, DE

Source: Website of DG Comp, CDC, Hausfeld UK and own research. There may be several parallel court proceedings pending within one jurisdiction.

In addition to these ten largest cases (largest with respect to the amount of the administrative fine), initiation of litigation proceedings has been reported for the Sodium Chlorate cartel (NL), Synthetic Rubber (U.K.), Marine Hose (U.K.), Carbon Graphic (U.K.), Credit Cards (U.K.) and Hydrogen Peroxide (DE and Finland). Note that only cases are

mentioned for which proceedings have been formally opened; more recent cases are potentially still in the dark and will become visible only in the near future.

This litigation activity on EU cartel cases is complemented by litigation activity on national cases. Taking the example of Germany, court proceedings are initiated, for instance, in cartel cases related to the following products: cement, fire fighting vehicles, carbon paper, large steam generator, calcium carbide, flake board, road salt, rail tracks, TV air time marketing, and gambling markets.

Taking into account the limited range of this research, the potential clearance of some cases through settlements, and the fact that more recent cases are still outside the courtroom, this shows that the amount of private litigation is impressive with most EU cartel cases being brought to court. This is possibly already a result of the public support of European institutions for private litigation and in anticipation of the proposed EU Directive. It indicates a trend that effective compensation for victims of infringements of EU competition rules will be achieved in general, i.e. the Effectiveness Objective will be achieved.

Table 1 also shows a strong regional concentration of jurisdictions where private damages claims in cartel cases are brought, with a focus on the United Kingdom, Germany, and the Netherlands and often with parallel filings in those three jurisdictions by different claimants or claimant groups. For instance, in the Gas Insulated Switchgear cartel case, a cartel related to equipment for electricity production, various national energy firms and grid operators pursued their interest in various jurisdictions in parallel, e.g. NationalGrid in the United Kingdom, TenneT in the Netherlands, and Energie BW in Germany.

In the following we discuss whether the proposed EU Directive will bring a change to that regional concentration through harmonization of the rules throughout Europe.

IV. LEEWAY WHEN QUANTIFYING DAMAGES

The proposed EU Directive addresses the question of quantification of harm in Article 16. Here it states:

> Article 16, Quantification of harm
>
> 1. Member States shall ensure that, in the case of a cartel infringement, it shall be presumed that the infringement caused harm. The infringing undertaking shall have the right to rebut this presumption.
>
> 2. Member States shall ensure that the burden and the level of proof and of fact-pleading required for the quantification of harm does not render the exercise of the injured party's right to damages practically impossible or excessively difficult. Member States shall provide that the court be granted the power to estimate the amount of harm.

Evidently, the EU Directive does not address most of the details pertaining to the quantification of damages. It is only the presumption—applicable for follow-on claims—that the infringement caused harm that is provided for guidance as well as a general reminder that effective compensation shall not be rendered impossible through an implausible distribution of the burden of proof or through excessive requirements on the standard of proof. In the field of the quantification of damages the EU Commission leaves it up to the accompanying Practical Guide to offer some non-binding guidance on how to quantify damages.

Over the course of this section, we will first introduce the main concepts regarding the quantification of damages in cartel cases and we discuss the topic of passing-on and interest payments as regards the available room to maneuver in interpreting these concepts despite the guidance given by the EU Directive.

The process of quantifying cartel damages can be broken down into several steps:

A. Quantifying Damages—Calculating Total Profit Loss

First, the price that would have prevailed in the market had a cartel not been in existence, known as the "but-for" price, is quantified. The difference between actual, potentially cartel-inflated prices and cartel-free, but-for prices is known as the "overcharge," whereas the unit overcharge multiplied by the amount of the cartelized product that the victims actually purchased is the total overcharge. Applying interest to the historical total overcharge results in the calculation of the present value of the total overcharge.

As a result of the overcharge effect, victims may also have purchased fewer of the cartelized input products and more substitutable products than they would have but for the cartel. This is known as input substitution. Alternatively (or in addition), they sold their output product at a price that is higher than the price that they would have charged but for the cartel. The change in their output price times the amount of the output product that the victims actually purchased is known as the passing-on effect.

In the case of a passing-on effect, the affected customers potentially sold fewer of their output products than they would have but for the cartel. The difference between the lost revenues and the saved costs is known as the output effect. The sum of the overcharge and the passing-through effect is known as the profit loss on actual sales. The output effect is also known as the profit loss on lost sales.

The sum of the profit loss on actual sales and the profit loss on lost sales, meaning the sum of the overcharge, the passing-through effect and the output effect, is known as the total profit loss. Again, applying interest to the historical total profit loss results in the calculation of the present value of the total profit loss.

The EU Directive acknowledges all of these components (see Article 12- 15, and Chapter 4.4. of the proposed EU Directive), and hence, contributes to the transparency of which components have to be considered when quantifying damages.

In the following, we argue however that there is, while acknowledging an important step towards harmonization, still substantial leeway in how these components are weighted, resulting in substantial differences in expected damages in different jurisdictions depending on the different legal practices.

1. The Passing-on Defense—The German Court Example

As a first example, consider the topic of the passing-on defense. With regard to this topic, the proposed EU Directive declares:

Article 12, Passing-on defence

1. Member States shall ensure that the defendant in an action for damages can invoke as a defence against a claim for damages the fact that the claimant passed on the whole or part of the overcharge resulting from the infringement. The burden of proving that the overcharge was passed on shall rest with the defendant.

2. Insofar as the overcharge has been passed on to persons at the next level of the supply chain for whom it is legally impossible to claim compensation for their harm, the defendant shall not be able to invoke the defence referred to in the preceding paragraph.

Besides the specific provision in the case of a legal impossibility to sue for damages on the next level of the supply chain, the EU Directive acknowledges a passing-on defense and shifts the burden of proof in demonstrating passing-on to the defendant.

This is in line with a recent decision by the German Supreme Court in the carbon paper case (BGH, 28.June 2011, KZR 75/10) where the Court—in addition to the affirmation of the standing of indirect customers—clarified that a passing-on defense is applicable in German proceedings. This is established through a two-step procedure ("Vorteilsausgleich"/ set-off of benefits) within which, first, the damages are established by measuring the overcharge and, second, by reducing the damages appropriately in the case where passing-on can be established.

The two-step procedure (instead of a single step) is legally important as it allows for the burden of proof to be allocated separately for the two components. It lies with the defendant to show pass-on. Within this context, the Supreme Court clarifies that the claimant only has to disclose relevant information within narrow boundaries. Depending on how broad or narrow these boundaries are defined, the pass-on defense may become more or less significant in German court practice.

2. The Passing-on Defense—The Dutch Court Example

As an alternative example of national court practice, consider the recent decision (February 4th 2013: LJN: BZ0403, Rechtbank Arnhem, 208812) by the Arnhem Court in the Netherlands. In reference to the gas insulated switchgears ("GIS") cartel, the Arnhem Court ruled that ABB must pay the national grid operator TenneT compensation for losses it suffered as a result of ABB's participation in the cartel.

In this case, ABB argued that TenneT did not suffer any damages, as it passed on the GIS installation costs through the electricity prices charged to their customers. For the question of whether damages have incurred, the court rejects the relevance of pass-on. Rather, it is only for the quantification of the compensation amount awarded to the direct purchaser that pass-on becomes relevant.

The question of whether the percentage of the damages passed on should be deducted from the damages suffered by the direct purchasers, and claimed by the parties that suffered indirectly, hinged in this case on the fact that the damages were the result of capital investment that had not as yet completely depreciated. As the depreciation period applied by TenneT is not completed yet, and the grid charges applied by TenneT are regulated by the Dutch Competition Authority based on actual costs, an automatic passing-on of awarded damages can be expected and a passing-on defense does not apply.

This argument by the Arnhem Court, if considered a broader principle, enables an alternative solution for the compensation of indirect purchasers: Direct purchasers might be awarded the full overcharge if they commit to pass on part of the awarded compensation to indirect purchasers. Whether or not this procedure will be considered as an alternative of general relevance by Dutch courts or whether it will only be specific to this case remains to be seen.

3. The Passing-on Defense—Leeway for Differences

According to those two example cases the Dutch and German courts seem to be pursuing a comparable path regarding the question of whether damages have been incurred in the first place—both courts reject the relevance of passing-on. According to the decision, it is only for the quantification of the compensation amount of the direct purchaser where passing-on becomes relevant. This approach seems to be promoted also with the proposed EU Directive by requesting a shift of the burden of proof to the defendant in relation to the passing-on defense.

Despite this apparent harmony in the general approach how damages, passing-on, and the burden of proof are assessed in the cases described and recommended by the EU Directive significant leeway for differences remain.

How easy it will be for national courts to shift the burden of proof to the claimant in a passing-on defense will strongly influence the effectiveness of this clause in a particular jurisdiction and remains—to a large extent non-harmonized by the EU Directive—at the discretion of national courts. To illustrate, see the German example given above which imposes rather narrow boundaries for the claimant to disclose evidence on that matter and which stays in contrast to, for example, the U.K. system which allows a rather broad disclosure in general.

Whether the disclosure rules proposed by the EU Directive narrows this gap (see Article 5) remains to be seen. The acceptance of alternative procedures for the compensation of indirect purchasers (see the example of the Arnhem Court Decision given above) is another example of a potential national divergence in the application of law. Both will have strong implications on the incentives to sue in a specific jurisdiction.

B. Quantifying Damages—Calculating the Appropriate Interest

A second issue is the question of how much interest should be applied to historic damages. With regard to interest payments, Article 2 of the proposed EU Directive proclaims:

> Full compensation shall place anyone who has suffered harm in the position in which that person would have been had the infringement not been committed. It shall therefore include compensation for actual loss and for loss of profit, and payment of interest from the time the harm occurred until the compensation in respect of that harm has actually been paid.

Some additional guidance is given in the accompanying, non-binding Practical Guide on how to quantify damages. In paragraph 20 it states:

> Addition of interest will also need to be considered. The award of interest is an essential component of compensation. As the Court of Justice has emphasised, full compensation for the harm suffered must include the reparation of the adverse effects resulting from the lapse of time since the occurrence of the harm caused by the infringement. These effects are monetary devaluation and the lost opportunity for the injured party to have the capital at its disposal. National law may account

> for these effects in the form of statutory interest or other forms of interest, as long as they are in accordance with the above-mentioned principles of effectiveness and equivalence. [Footnotes deleted]

The EU Directive provides guidance on two accounts. First, that interest has to be applied and, second, that this interest applies from the point in time when the historical damages were incurred. It still leaves significant leeway with respect to the specifics of its implementation.

Consider, for example, a case where annual historical damages of EUR 10 million were incurred over the period from 2000 to 2007, i.e. over a time period of eight years. In sum, historic damages of EUR 80 million are estimated. The court proceedings were initiated in 2010 and the damages awarded at the end of 2012.

Based on these stylized facts, one can calculate the interest under various assumptions. First, interest can be calculated under the assumption that interest payments start from the date when the damages were incurred vs. the date when the claim was brought to the court. Second, different interest rates can be assumed. Depending on whether statutory interest has been defined or whether firm-specific damages are allowed (i.e. based on the actual cost of capital of the individual claimants), interest may differ significantly. In our example, we consider an annual interest rate of 4 percent and of 8 percent. Second, different jurisdictions may use different practices of whether simple interest or compound interest is accepted.

Table 2 shows the resulting interest under the different assumptions in the example. Scenario A describes a situation where interest payments are only incurred from the point in time when the claim was brought to court; scenario 2 describes the situation under the procedure proposed by the EU Directive, that is, from the point in time when the damages were incurred. As one can see, the decision for the latter scenario has significant implications for the amount of the damages awarded, resulting in three to four times higher interest rate payments than under scenario A.

Hence, the EU Directive contributes significantly to the objective of harmonization. Still, one can observe significant differences that are feasible within the boundaries of the EU Directive. Depending on the interest and whether compound interest is assumed, the historical damages are increased by 38 percent (under the assumption of a 4 percent single interest rate) or by a factor of 111 percent (under the assumption of 8 percent compound interest). In other words—for the example at hand—interest payments can depend on national court practice that can vary by a factor of three within the boundaries of the EU Directive.

Table 2: Interest payments under various conditions:

		Annual interest 4%				Annual interest 8%			
		Simple interest		Compound interest		Simple interest		Compound interest	
Scenario	Historic damages	Absolute	Relative	Absolute	Relative	Absolute	Relative	Absolute	Relative
A	80	10	12%	10	12%	19	24%	20	25%
B	80	30	38%	37	46%	61	76%	89	111%

Source: Own research. Absolute values in million Euro.

V. CONCLUSION

One of the two main objectives of the proposed EU Directive is to ensure effective compensation for the victims of infringements of EU competition rules. Besides the overall level of damages awarded ("Effectiveness Objective"), this aims towards a harmonized legal practice throughout Europe ("Harmonisation Objective"). Focusing on the central topic of the quantification of damages (and here, the topic of a passing-on defense and interest payments), we illustrate our claim that—despite important harmonization steps established through the proposed EU Directive—significant strategic options remain unspecified.

In addition to the examples discussed here, there are further areas which offer additional leeway—such as, for instance, the acceptance or non-acceptance of lingering and umbrella effects, the depth and scope of empirical methods accepted in front of courts, the treatment of currency risks, etc.

Some leeway is required though. Empirical methods have to be applied within the economic and legal context of a specific case. Hence, a certain degree of flexibility is needed. The contrasting history of the various legal systems may also justify national differences to some extent. Still, it should be noted that the room to maneuver is—despite the partial success in harmonization through the proposed EU Directive—large and, hence, it depends on national practice. If full harmonization is the goal, there is still a way to go.

To the extent that the decision of where to bring a case has implications on i) which cases are brought, ii) which firms are sued, and iii) which customer are compensated, partial harmonization will have an impact on the regional distribution of damages awarded and the regional location of firms paying the damages. The implications of this will only be seen in the future. The damages lie in the details.