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PERSPECTIVES

JUST PASSING THROUGH? CARTEL DAMAGES UNDER THE NEW EU DIRECTIVE

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Many cartels arise in intermediate goods industries that feed into a chain of buyers before reaching the final consumer. Direct buyers of the cartelised product pay the overcharge (i.e., the difference between the higher price charged by the cartel members and the lower price that would prevail in the absence of the cartel). But the

buyers will pass through 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 (i.e., the customers of the direct buyers) may also be able to pass through 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 along each successive link in the supply chain.

The new EU Antitrust Damages Directive allows infringers to defend themselves against a damage claim by invoking a ‘passing-through defence’ – that an overcharge levied on a direct buyer was passed through, at least in part, to an indirect buyer (i.e., that the direct purchaser did not absorb the full overcharge). The passing-through presumption affords infringers the opportunity to limit claims provided they can demonstrate that cartel overcharges were passed along a chain of buyers. Defendants will need to prove that cartel overcharges (or underpayments in the case of a buyers’ cartel) were (partially) passed through by the claimants to their own customers. At the same time, however, the passing-through 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. An indirect buyer will need to prove the extent of the overcharge that was passed through and the loss suffered.

The extent of the loss to indirect purchasers, however, 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 through all or a substantial portion of the amount of the cartel overcharge. 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

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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.

Economists have developed an approach to estimate the distribution of cartel damages through a chain of direct and indirect buyers. 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 through the full cartel overcharge to their customers. If all markets in the supply chain are competitive, then the overcharge is passed through 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 through to their customers only a portion of the overcharge. To illustrate the issue, consider the simplified 'Cournot model' of competition, outlined by Antoine Augustin Cournot in 1838. A simple version of this model suggests that the proportion of the overcharge passed through increases with the number of firms in the market, approaching near complete pass-through if there are a large number of buyers at each stage.



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 or changing their production technology, then irrespective of the competitiveness of direct purchasers' markets only a portion of the increase would be passed through. More precisely, the portion passed through 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-through 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 through might well change over the lifetime of the cartel. An understanding of these market-specific effects is fundamental to determining pass-through and will

have a direct bearing on quantifying the overcharge and incidence of damages.

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 through inclusive of such a markup may be greater for a time than the proportion of the overcharge it bears.

The impact of pass-through may be significant, as suggested by the outcome of a cartel case in the United States in 2013 (*In re: TFT-LCD (Flat Panel) Antitrust Litigation*). A federal jury in California found HannStar Display Corp. participated in an Asia-based conspiracy to fix prices on liquid crystal display panels but co-defendant Toshiba Corp. did not.

Two damage experts for Best Buy estimated that the two LCD manufacturers owed the electronics retailer up to \$770m for selling it products that contained the price-fixed panels, which it then resold to customers, they testified during the trial. The jury awarded Best Buy Co. \$7.5m in damages at the close of a six-week trial. Although the jury found that Best Buy had been harmed by the conspiracy, its damage award conformed much closer to the amount calculated by the defence's experts, which had assumed that Best Buy passed 93 percent of the added costs along to its customers.

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-through and its distribution amongst direct and indirect buyers.

Estimating the pass-through will involve detailed analysis of market structure, competitiveness, mark-ups, and demand and supply elasticities in all the affected downstream markets. 