FREE Policy Brief Series

On Leniency, Damages and Deterrence

Catarina Marvão and Giancarlo Spagnolo, SITE
February 2015

On November 26th of 2014, an EU Directive on antitrust damage actions was signed into law. The Directive is to praise as it does a lot to facilitate private antitrust actions in the EU. However, the Directive also tries to address a possible conflict between public and private antitrust law enforcement due to the central role played by Leniency Programs in cartel detection and prosecution. This conflict has long been at focus of legal debate. Private damage actions may reduce the attractiveness of Leniency Programs for cartel participants if their cooperation with the competition authority increases the chance that the cartel's victims will bring a successful suit. The Directive strikes a compromise between public and private enforcement by preventing the use of leniency statements in subsequent actions for damages and limiting the liability of the immunity recipient to its direct and indirect purchasers. A new paper by Buccirossi, Marvão and Spagnolo (2014) shows that damage actions will actually improve the effectiveness of such programs, through a legal regime in which the civil liability of the immunity recipient is minimized and full access to all evidence collected by the competition authority, including leniency statements, is granted to claimants, a legal regime already implemented in Hungary since 2011.

The Need to Improve Antitrust Enforcement Against Cartels and the Directive 2014/104/EU

Cartels remain widespread and constitute a major problem for society. In the past 5 years, only 20 cartels have been discovered in the EU and the US (information available on the EU Commission and DOJ websites), which suggests that antitrust enforcement has limited deterrence effects. The available evidence, on the other hand, indicates that, among the range of available competition policy tools, anti-cartel enforcement is by far the most important in terms of the effects on a country's productivity growth (Buccirossi et al., 2013). The Directive 2014/104/EU aims at improving the cartel deterrence effects of EU antitrust law by trying to facilitate private damage claims by cartel victims, which will add to antitrust fines in terms of expected sanctions for cartel participants.

One aspect of the Directive, which may not help improve antitrust enforcement, is that damages are limited to the harm caused, thus not allowing compensation for the evident low probability of cartel detection behind the limited deterrent effect of the current enforcement system. The second, on which this piece focuses, is more subtle and has to do with the interaction between private damages and Leniency programs.

The Current Conflict Between Private and Public Antitrust Enforcement Against Cartels

While public and private enforcement may be highly complementary in terms of deterring cartel formation (Buccirossi et al., 2004), it is in the case of anti-cartel enforcement that the current state of the legislation may engender some conflicts between the two. This is due to the central role of Leniency Programs (LPs) in the public action against cartels, which provide a fine reduction (up to immunity) to cartel members in exchange for the reporting of the cartel and substantial cooperation with an investigation. The existing LP in the EU does not protect leniency applicants from the civil law consequences of their participation in the cartel. Furthermore, the general rules of the tort law of all EU Member States provide that when several parties are responsible for the same damage, as in the case of a cartel, they are jointly and severally liable for it. This means that each victim is entitled to claim their entire loss from each liable party, including the leniency applicants, who may afterwards claim from the other co-cartelists a sum corresponding to their share in the liability.

Private action for damages may jeopardize LPs, since a leniency application increases the risk of a successful damage claim by the cartel's victims. First, the evidence provided by the leniency applicant may be used by the claimants in the damage action, to prove the existence of the infringement and its effects. Second, leniency applicants, and especially immunity recipients, do not challenge in court the infringement decision adopted by the competition authority, at least as far as the existence of the cartel is concerned, while the other cartel members typically do it, considerably allocating the possibility of successful damage actions against themselves. Since the cartelists are joint and severally liable towards all the cartel's victims, the leniency applicant becomes the preferred target of the damage action for the entire harm caused by the cartel. Hence, the incentive stemming from the avoidance of the fine may be counterbalanced by the disincentive of being condemned to pay damages.

Two issues are particularly important to this conflict between public and private enforcement. The first issue is whether leniency applicants (and in particular the immunity recipient) should have the same level and type of liability as all other cartel members. The second issue is whether access to the leniency statements and related documents should be granted to the claimants in the damage action. The directive has tried to tackle the current conflict between LPs and private actions by partially limiting immunity recipients' liability to damages, and by completely eliminating victims' access to leniency (and settlement!) statements for the sake of private damage actions. We argue below that this solution is highly problematic and likely to harm the effectiveness of EU antitrust enforcement.

The Legal Debate Culminated in the Directive

Before the adoption of the Directive, the two conflicts mentioned above were dealt with by applying some general legal principles. The first relevant principle, as stated by the European Court of Justice (ECJ) in the *Manfredi* (13/7/2006, Cases C-295/04 to C-298/04) and *Courage* (20/9/2001, Case C-453/99) judgements, is that the victims of an antitrust infringement have the right to be fully compensated for the harm they suffered. As for the access to the leniency statements, in a judgement on a reference from the district court of Bonn in Germany (*Pfleiderer* case, 14/6/2011, Case C-360/09.) the ECJ ruled that EU law does not prohibit a third party, who has been adversely affected by a breach of competition law, from having access to a

leniency application by the infringer and held that it is for the national judge to determine the conditions under which access to leniency material can be granted to someone seeking to obtain damages. According to the ECJ, the national judge would need to take into account and weigh all the interests protected by EU law, namely the need to ensure the effectiveness of LPs and to support antitrust damage actions. This position has been confirmed in the more recent *Donau Chemie* judgement (Case C-536/11).

The position of the ECJ has the merit of clarifying that actions for damages initiated by the victims of an antitrust infringement may increase the level of deterrence. In this respect, public and private enforcement do not conflict with each other. However, as far as hard-core cartels are concerned, the public interest has been pursued in many jurisdictions through the adoption of LPs. The legal debate has then correctly focused on the risk that, under the current laws, an increase in damage actions could undermine the incentive to apply to these programs. However, the legal debate has (incorrectly, as we will see) taken for granted that an inherent conflict must exist between the proper functioning of a LP and private damage claims, so that any proper legislation necessarily has to compromise between the interest of the public enforcement system and the interest of private cartel victims to be fully compensated.

The recently adopted EU Directive on damage actions follows this path and it intervenes on the two issues described above. As for the rule on the liability, the Directive provides that "*an immunity recipient is jointly and severally liable as follows: (a) to its direct or indirect purchasers or providers; and (b) to other injured parties only where full compensation cannot be obtained from the other undertakings that were involved in the same infringement of competition law*" (Art. 11(4)). As for the access to the documents submitted by a leniency applicant (not only the immunity recipient), the Directive provides that "*national courts cannot at any time order a party or a third party to disclose any of the following categories of evidence: (a) leniency statement; and (b) settlement submissions"* (Art. 6(6)). Moreover, Article 7(1) provides that "*Member States shall ensure that evidence in the categories listed in Article 6(6) which is obtained by a natural or legal person solely through access to the file of a competition authority is either deemed to be inadmissible in actions for damages or is otherwise protected under the applicable national rules*".

The Study by Buccirossi, Marvão and Spagnolo (2014)

The aim of Buccirossi, Marvão and Spagnolo (2014) is to examine rigorously the interaction between private damage actions and LPs, and understand whether the solutions adopted by the EU legislator are the most appropriate ones, taking into consideration both the objective of preserving (or improving) the effectiveness of the LP and the objective of guaranteeing the right to compensation of the cartel's victims. The authors investigate whether pursuing the primary goal of the public enforcement system, that is achieving an optimal level of deterrence of anticompetitive conducts, necessarily requires to sacrifice the amount of damages that claimants can expect to recover, or whether, to what extent and how these two objectives can be pursued in a consistent and complementary way.

In Spagnolo's (2004) analysis of optimal LPs, it was already shown that in order to maximize deterrence in the presence of a LP, it is optimal to minimize (eliminate) the amount of damages paid by the first (and only the first) reporting firm (see also Spagnolo, 2008). This proposal was also supported by some legally oriented commentators (e.g. Green and McCall, 2009). However, how much information from the leniency report has to be

disclosed in the civil action and the right of victims to be compensated were not taken into account in these studies.

Buccirossi, Marvão and Spagnolo (2014) focus precisely on these two aspects. In their model, firms may choose to enter a collusive agreement to maintain a high price and escape the poor competitive outcome. If they do, and respect the agreement, each of them earns collusive profits in each period. If a cartel is convicted because of an independent investigation by the competition authority, each member must pay a fine. If a cartel is convicted because one of the firms reported information within the LP, the reporting firm pays no fines while the other pays the full fine. If both parties self-report, each of them pays half of the fine.

In addition to fines, cartel members are liable for compensation of buyers. The fraction of the maximum total damages of the cartel that each convicted firm will have to pay depends on the liability rules defined by the legislation in the various situations. The amount of damages that convicted firms expect to pay will also depend on the amount of information available to victims after the conviction. The authors determine the optimal combination of damage liability of the reporting firm and of the amount of information, which should be accessible to the claimants, including leniency statements, both in terms of deterrence and of the ability of victims to be compensated.

Buccirossi, Marvão and Spagnolo's Results

The results of the analysis show that there is no conflict between the objectives of maximizing deterrence and allowing full compensation to victims, or by public antitrust enforcement through LPs and private actions for damages, as presumed by the legal debate which led to the Directive. The analysis suggests that a legal regime in which the immunity recipient's liability is reduced as much as possible (even eliminated) and that grants victims full access to all files of the competition authority including leniency statements, maximizes both the effectiveness of public antitrust enforcement and the ability of victims to obtain compensation for damages (treble damages for non-applicants would have further improved the outcome).

The authors find that the possibility of victims to obtain compensation for harm is also maximized, provided that competitors are able to jointly cover the private damages caused by the leniency applicant. Claimants are worse-off with the Directive, in comparison with both the previous legal system and one that would result from the optimal solutions proposed by the authors.

The authors then extend their analysis to also take into account the additional deterrence channel induced by the presence of a LP (the "risk of been turned in by a cartel partner"; see Spagnolo, 2004, and Bigoni et al, forthcoming) and the cost of being the preferred target of the damage action, under different legal regimes. These extensions show that, taking into account these additional factors, both the loss of deterrence and of compensating damages obtained by victims implied by the new directive, increase when compared to the optimal policy discussed.

Conclusions

To wrap up, the new study by Buccirossi, Marvão and Spagnolo (2014) shows that a compromise between private and public antitrust enforcement – or between the objective of cartel deterrence and the right of cartel victims' to be compensated, was never actually needed. We need not limit cartel victims' ability to recover their loss by hindering the access to leniency statements to preserve the effectiveness of a LP. We can do that by further limiting leniency recipients'

liability. Once we go in that direction, damage actions will obviously improve the effectiveness of such programs by increasing the cost of not applying for leniency. In the proposed optimal legal regime, public and private enforcement are perfectly complementary instruments. Their alleged conflict appears to be the result of the existing rules rather than a consequence of their inherent features and goals. Moreover, the optimal regime characterized in Buccirossi, Marvão and Spagnolo (2014) cannot be claimed to be "legally unfeasible" with the usual smoky arguments linked to "conflicts with the founding principles of our legal system": it is practically the same regime that has been valid in Hungary since 2011, where an immunity recipient is only liable to pay his (direct only) damages in the very unlikely event that all other cartel members went bankrupt. We leave to the EU the burden of explaining why Hungary has to change their excellent system.

▪

References

Bigoni, M., Fridolfsson, S.-O., Le Coq, C., Spagnolo, G. Trust, Leniency and deterrence. CEPR Discussion Paper 9002, forthcoming in the Journal of Law, Economics and Organization.

Buccirossi, P. Ciari, T. Duso, C. Vitale, and G. Spagnolo, 2014. Deterrence in Competition Law. Ch. 15 in Analysis of Competition Policy and Sectoral Regulation, M. Peitz and Y. Spiegel eds., Now Publishers Inc., Boston-Delft.

Buccirossi, P., Ciari, L., Duso, T., Spagnolo, G., Vitale, C., 2013. Competition policy and productivity growth: An empirical assessment. Review of Economics and Statistics (95).

Buccirossi, P., Marvão, C., Spagnolo, G., 2014. Leniency and Damages. Working paper.

European Commission, 2014. Directive of the European parliament and of the council on certain rules governing actions for damages under national law for infringements of the competition law provisions of the member states and of the European Union. Official Journal of the European Union, Ch. PE-CONS 80/14; RC 8, 2013/0185 (COD).

Green, J., McCall, I., 2009. Leniency and civil claims. Competition Law Insight, 3–5.

Marvão, C., Spagnolo, G., forthcoming March 2015. What do we know about the effectiveness of leniency policies? A survey of the empirical and experimental evidence. Ch. in The Leniency Religion: Anti-Cartel Enforcement in a Contemporary Age. Available here: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2511613

Spagnolo, G., 2004. Divide et impera: Optimal leniency programs. CEPR Discussion Papers 4840, Center for Economic Policy Research, London.

Spagnolo, G., 2008. Leniency and Whistleblowers in Antitrust. Ch. 12 of P. Buccirossi (Ed.) Handbook of Antitrust Economics, 2008, M.I.T. Press.

Catarina Marvão

Stockholm Institute of
Transition Economics (SITE)
and Trinity College Dublin
marvaoc@tcd.ie
http://sites.google.com/site/catarinamarvao

Catarina Marvão is a Post-Doctoral Fellow at SITE since October 2013. Her main research interests are industrial organization and international trade, with particular focus on antitrust issues, such as detection and regulation of cartels. She holds a Ph.D. from Trinity College Dublin, where she also lectured.

Giancarlo Spagnolo

Stockholm Institute of
Transition Economics (SITE)
Giancarlo.Spagnolo@hhs.se
http://www.hhs.se/SITE

Giancarlo Spagnolo (M.Phil. Cambridge; Ph.D., Stockholm School of Economics) is Senior Research Fellow at SITE - Stockholm School of Economics and Professor of Economics (on leave) at University of Rome II. He is also research affiliate of CEPR, EIEF and ENCORE.

Spagnolo's main competences and interests are in Antitrust and Anti-corruption Policies, Banking and Corporate Governance, Game and Contract Theory, Industrial Organization, eCommerce and Procurement Design and Management. He has published widely quoted scientific articles in these fields and co-edited Cambridge University Press's Handbook of Procurement (under translation in Russian). He has also been consulting for many national and international institutions (including the World Bank, the EU Parliament and the EC DG Comp and EcFin) on antitrust, procurement and corruption issues, and for several private corporations on the design and management of procurement and reputational mechanisms.