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The passing on defence and the future direction of UK private proceedings

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Actions for damages

Compensation and deterrence? The passing on defence and the future direction of UK private proceedings

By Greg Olsen, Jones Day*

The passing on defence allows a defendant to argue that a claimant’s loss has been reduced or negated by the claimant having passed on to his customer (the indirect purchaser) all, or a proportion of, any overcharge resulting from the defendant’s actions.

The availability of the passing on defence in private proceedings has yet to be established in the UK and there is little precedent elsewhere in Europe. As discussed in this article, the inevitable determination of this issue, and the associated ability of indirect purchasers to initiate proceedings – the offensive use of passing on – will have a significant effect on the nature of private competition law litigation in Europe.

The state of private enforcement

In Europe there has been much talk of the need to stimulate private competition law proceedings as an enforcement tool. This led to the European Commission’s 2004 study on the conditions for damages claims for EC competition law infringements which found “total underdevelopment” of such actions in the EU member states (CLI 23 November 2004, p.3).

In addition, the European Court of Justice in Courage v Crehan (Case C-453/99 [2001] ECR I-6297) championed the importance of private rights of enforcement noting that it “...strengthens the working of the Community competition rules and discourages agreements or practices, which are frequently covert, which are liable to restrict or distort competition. From that point of view, actions for damages before the national courts can make a significant contribution to the maintenance of effective competition in the Community.”

The European Commission has now announced that it intends to publish a green paper by the end of this year setting out options for improving the current system of private enforcement (Neelie Kroes, IBA/European Commission Conference, 10 March 2005). It remains to be seen exactly what is proposed in terms of the appropriate direction of private proceedings and whether it will specifically address issues such as the passing on defence.

Subject to the outcome of such further consideration, any determination by the UK courts on the availability of the passing on defence may have resonance in Europe. This is particularly the case since the UK may emerge as the forum of choice for private competition law proceedings.

UK litigants enjoy a number of advantages when compared with their counterparts in many other member states, such as comparatively wide discovery rules, adversarially based proceedings and the availability of the specialist Competition

Appeal Tribunal. Plaintiffs also benefit from the fact that decisions by the European Commission and the UK Office of Fair Trading (“OFT”) establishing a breach of competition law are binding in damages proceedings before the Tribunal.

Moreover, the English High Court has shown that it is willing to hear claims based on EC competition law notwithstanding a fairly limited connection with the jurisdiction (Provimi Ltd v Aventis SA et al [2003] EWHC 961(Comm)).

The Tribunal has already noted the significance of the existence or exclusion of the passing on defence to future private enforcement proceedings. In a recent interlocutory application (BCL Old Co Limited & Ors v Aventis & Ors, Case No 1028/5/7/04), Sir Christopher Bellamy noted that:

Whether or not the passing on defence is available to defendants will in future be an important consideration to potential claimants when they are considering whether or not to issue proceedings.

US exclusion of the passing on defence and actions by indirect purchasers

In the US, defendants are effectively prevented from invoking the passing on defence in respect of sales to direct purchasers due to the 1968 Supreme Court decision in Hanover Shoe (Hanover Shoe & Co v United Shoe Machinery Corporation, 392 US 481 (1968)).

As a result of that decision, US direct purchasers are able to recover damages calculated by reference to the entire amount of any overcharge rather than their actual loss. In taking this step, the Supreme Court sought to incentivise direct purchaser litigation by avoiding the complexity and uncertainty that it was considered would be engendered by allowing the passing on defence.

In particular, Mr Justice White referred to the “normally ... insurmountable” task that would arise in making a convincing showing of “virtually unascertainable” figures concerning the historic impact of the relevant overcharge on pricing, total sales, costs and profits.

The Court also considered that direct purchasers would provide more effective litigants than indirect purchasers, who may have less motivation to bring proceedings given their greater number and correspondingly smaller share of the loss resulting from the total overcharge.

Any concerns about direct purchasers obtaining a windfall as a result of the Supreme Court’s approach were seemingly outweighed by the policy objective of deterring anticompetitive behaviour. Mr Justice White noted that, if the defence

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were allowed, “treble damages, the importance of which the court has many times emphasised, would be substantially reduced in effectiveness.”

This underscores the fact that the US exclusion of the passing on defence must be assessed in the context of US policy on the role of private enforcement action. The exclusion of the passing on defence needs to be understood as part of a system that provides for punitive treble damages and where private antitrust proceedings make up around 90% of all US antitrust cases.

A consideration that is inextricably linked to the assessment of the passing on defence is whether indirect purchasers should have standing to recover damages from the defendant based on the proportion of the overcharge that has been passed on by the direct purchaser.

In the US Supreme Court decision in Illinois Brick Co v Illinois (431 US 720 (1977)) it was held that indirect purchasers did not have standing. This development was intended to avoid undue complexity and to protect defendants from the possibility of duplicative recoveries given that direct purchasers were entitled, by virtue of Hanover Shoe, to recover the full amount of any overcharge by the defendant. However, it should be noted that this objective has been significantly undermined by the actions of a number of US states that have sought to avoid the Illinois Brick ruling by passing legislation allowing indirect purchaser claims.

The Supreme Court’s decision was intended to provide something of a trade-off between the interests of direct purchasers and indirect purchasers. In determining that the maximisation of effective private enforcement action was achieved through incentivising direct purchasers to litigate, the Court necessarily sacrificed the interests of indirect purchasers.

This was also explained on the basis that indirect purchasers are typically a disparate group who will be less inclined than direct purchasers to initiate proceedings given that they would only recover damages based on the smaller amount of overcharge passed on to them.

Indirect purchaser actions and the passing on defence in the UK

UK experience of private competition law enforcement action is very limited. The first award of damages has only recently been made (Bernard Crehan v Inntrepreneur Pub Company CPC [2004] EWCA 637). A number of fundamental issues remain to be addressed as to the nature and scope of damages that may be awarded.

However, it is expected that a UK court would not follow Illinois Brick so as to deny standing to indirect purchasers. In particular, such action would be incompatible with EC law since it would be contrary to the principle of direct effect. As made clear by the European Court in Courage v Crehan: ... The full effectiveness of article [81] of the Treaty and, in particular, the practical effect of the prohibition laid down in article [81(1)] would be put at risk if it were not open to any individual to claim damages for loss caused to him by a contract or by conduct liable to restrict or distort competition (emphasis added).

Based on the above assessment alone, it could be argued that the UK courts should not exclude the application of the passing on defence. As explained in Illinois Brick, it would be wrong to allow indirect purchaser actions while excluding the passing on defence since this would give rise to the spectre of duplicative recoveries. On this basis, the two measures should necessarily stand together.

The above analysis assumes that indirect purchaser actions are a realistic proposition in UK litigation such that effectively banning them would be a necessary corollary of excluding the passing on defence. It may be observed that indirect purchasers will inevitably face difficulties in sustaining proceedings for damages due, in particular, to issues of causation and remoteness. Moreover, while there have been some procedural steps towards the development of “class action”-styled litigation in the UK, this area remains underdeveloped.

On balance, it is very difficult to predict the future prevalence and effectiveness of indirect purchaser actions. However, the possibility of such proceedings expanding in importance and giving rise to the risk of duplicative recoveries presents an impediment to the exclusion of the passing on defence.

In addition, exclusion of the passing on defence would not sit comfortably with the fundamental principles applied by the UK courts in making damages awards.

If we proceed from first principles, it is clear that the primary object of an award of damages in the UK courts is to compensate the claimant for harm done to him. At the same time, the claimant is under a duty to mitigate his loss if he is reasonably able to do so. If the passing on defence were to be excluded in the UK, as it has been in the US, it would contradict these principles by over-compensating the direct purchaser. It would therefore represent a significant exception to the traditional stance of the UK courts.

Aside from the advantage granted to the direct purchaser, the exclusion of the passing on defence in circumstances where there remained at least the possibility of indirect purchaser actions, and therefore duplicative recovery, would effectively manipulate the process to the disadvantage of the defendant and thereby introduce a punitive element in UK proceedings.

While exemplary or punitive damages are not unknown, the UK courts have only introduced a punitive element in exceptional circumstances. This step, it is submitted, should not be taken without careful consideration. This is particularly the case given the availability of other means for the imposition of pecuniary penalties, the payment of which will not result in the over-compensation of a claimant (Rookes v Barnard [1964] AC 1129; R v Secretary of State for Transport, ex p Factortame [1997] Eu LR 475, QBD; Kuddus v Chief Constable of Leicestershire Constabulary [2001] UKHL 29).
Would the passing on defence lead to unacceptable complexity?

Taking the above issues into account, the question becomes whether the UK courts should modify the usual approach to damages awarded so as to take account of the concerns raised in Hanover Shoe. The overarching consideration is whether the exclusion is necessary in the interests of enhancing the effectiveness of private enforcement as a means of deterring anti-competitive conduct.

Perhaps the major issue is whether recognition of the passing on defence would lead to the unworkable complexity envisaged by Mr Justice White and thereby constitute a significant impediment to private enforcement. The second justification advanced effectively involved the promotion of direct purchasers at the expense of indirect purchasers, leading to the ban on indirect purchaser actions. As already discussed, this would not be acceptable as a matter of EC law.

While recognition of the passing on defence would undoubtedly involve a measure of complexity, there is considerable doubt that it would lead to insurmountable difficulties in the handling of private proceedings. It must, of course, be remembered that Hanover Shoe was decided in 1968, at a time when the current tools of sophisticated economic analysis were not available to litigants.

For example, it is now the case that, while difficult, it would not be genuinely impossible to obtain necessary data in most industries on production costs and demand behaviour. This could be obtained from econometric analysis of market or survey data.

Once such data has been gathered, it should be possible to construct a hypothetical model to show how much the plaintiff should have passed on were it a monopolist, or subject to constructive a monopoly. This would be contrary to EC law and inconsistent with the Conseil’s opinion leaves this matter open.

In addition, many of the perceived concerns as to the operation of the defence are likely to be ameliorated by imposing on the defendant the burden of proving the defence. An alternative would be to impose a presumption of passing on that would be rebuttable by the direct purchaser on the basis of clearly defined criteria.

It should also be noted that there are likely to be instances in which direct purchasers will seek damages even if they have passed on the overcharge. For example, where only some of the competitors in a market are subject to the overcharge, then those competitors may seek to argue that they have suffered additional loss either due to their inability to pass on the overcharge or lost sales where they have passed it on, depending on the relative levels of competition and demand in the market. Thus, even where the defendant is successful in invoking the passing on defence, it may still face claims from direct purchasers.

Conclusion

Applying the law as it currently stands, the UK courts are likely to recognise the passing on defence. Exclusion of the defence would conflict with established principles of compensation on which damages are usually awarded in the UK.

Moreover, exclusion would most likely necessitate the denial of standing to indirect purchasers, as is the case in the US, in order to avoid the prospect of multiple proceedings and duplicative damages awards.

This would be contrary to EC law and inconsistent with the ECJ’s ruling in Courage v Crehan that full effectiveness requires that it should be open to anyone to claim damages for a breach of article 81, EC Treaty.

French actors gain flexibility

On 26 April, the French Conseil de la concurrence closed a case against the Société des auteurs et compositeurs dramatiques – SACD. This body manages the IP rights of actors and artists collectively, mainly in the audiovisual field.

The Conseil persuaded SACD to drop a condition that complicated actors and others to surrender the management of all their rights – dramatic as well as audiovisual – to the SACD if they wanted to use its services at all.

By tying its captive audience for audiovisual rights management to it for all their performance rights needs, the SACD was exploiting its dominance in the audiovisual market to create monopoly power, in the Conseil’s view.

SACD has agreed to amend its statutes with effect from 1 January 2006. These will then define three categories of work – dramatic, audiovisual and pictorial. The right of withdrawal will not be arbitrary, since the SACD has to survive in the commercial world. Time limits are therefore imposed on withdrawal, and a member may not withdraw rights more than three times in the course of membership.

While the courts have recognised in such cases that the defence is not an easy one because there are a large number of variables, it has not been suggested that the level of complexity is such as to warrant the denial of the defence (Marks & Spencer v Customs & Excise [2000] CA, CGNU [2001] VADT and GIL Insuance [2002] VADT. See also Mark Brealey QC, “Adopt Perma Life, but follow Hanover Shoe to Illinois? – Who can sue for damages for breach of EC competition law?” [2002] Competition Law Journal 127).

No cross-border issues were raised by rights-holders or the SACD, and no evidence emerged that this was a relevant consideration. Given the sensitivity of EU law to market fragmentation, the Conseil’s opinion leaves this matter open.

Allowing the dramatic, theatrical and pictorial elements to be divided between different managing societies raised no problems for the market from the producers’ or agents’ point of view either.

Décision no 05-D-16 du 26 avril 2005 http://www.conseil-concurrence.fr/user/ avis.php?avis=05-D-16