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ARTICLES

# A Comparison of Damage Theories in Price-Fixing Cases in the United States, Canada, and the European Union

By Pierre Crémieux, Marissa Ginn, and Marc Van Audenrode – January 31, 2017

**Safeguarding the Benefits of Competition**
Competition is a good thing. As the U.S. Federal Trade Commission (FTC) notes, "[f]ree and open markets are the foundation of a vibrant economy. Aggressive competition among sellers in an open marketplace gives consumers—both individuals and businesses—the benefits of lower prices, higher quality products and services, more choices, and greater innovation." Thus, the FTC concludes, the FTC's "competition mission is to enforce the rules of the competitive marketplace—the antitrust laws." FTC, *Guide to Antitrust Laws*. These antitrust laws have been introduced to protect consumers from a host of anticompetitive abuses, among them price-fixing and collusion.

The United States is not alone in recognizing the importance of competition. According to analysis conducted by the authors, in 2014 more than 95 percent of world gross domestic product was produced in the more than 100 countries that had antitrust laws, compared with just 63 percent in the 37 countries with such laws in 1990.

To enforce antitrust laws, governments typically rely on both public and private actions. In public actions, government agencies such as the FTC may impose fines on sellers that have engaged in anticompetitive behavior. But private actions play an important role as well, in the form of lawsuits awarding damages to plaintiffs claiming they have been harmed by anticompetitive behavior.

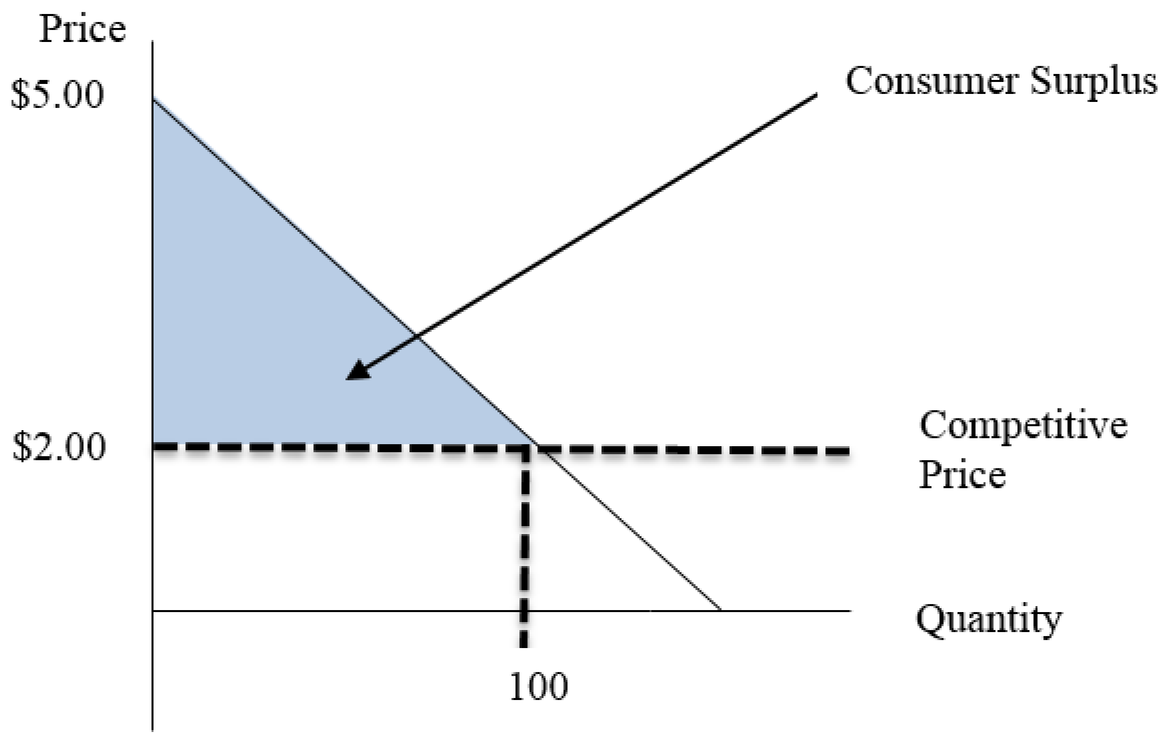
In private actions to help enforce antitrust laws, the question is whether laws governing private antitrust actions are designed to compensate parties for their losses or act as deterrents—or both. This article focuses on the different views on this question that have come about in the United States, Canada, and the European Union, in the context of damage awards in price-fixing cases. In each jurisdiction, the regimes governing who can sue in private actions for damages, and what claims are allowed, differ.

**The Economic Underpinnings of Price-Fixing Awards**
Price-fixing occurs when competitors agree to set their prices for a product at the same level. Such actions can result in higher prices being charged in the marketplace, and the parties buying the products may suffer harm. Buyers can sue to recover damages from the colluding companies.

The kind of damages that can be claimed in price-fixing litigation depends on two things: who you are and where the suit is filed. Regardless, in price-fixing cases, regulation and case law have been developed to address the economic impact in the marketplace. A simplified example of street vendors of hotdogs in a typical city illustrates the concept.

Figure 1 represents the market for hotdogs sold by street vendors in a competitive market. The downward sloping line on the figure (the demand curve) shows that, on any given day, some people are willing to pay up to $5.00 for a hotdog, but most are not. As the price of a hotdog goes down, the number of hotdogs sold goes up.

**Figure 1: Market for Hotdogs**




Assuming a prevailing price for hotdogs of $2.00 and sales of 100, every single buyer except for the last one (the hundredth buyer) would have been willing to pay more than $2.00 to buy a hotdog. As shown by the demand curve, each buyer therefore is better off after purchasing the hotdog for $2.00 (because the value of the hotdog to the consumer is greater than its $2.00 price). The difference between the price paid by customers and what they would be willing to pay is referred to by economists as consumer surplus, the blue triangle in Figure 1.

Now assume that the hotdog producers collude to artificially raise prices for the vendors—that is, the producers' direct purchasers—to $2.50. This raises a few additional questions. First, who is harmed by the action and by how much? In deciding how to answer this question, antitrust courts and regulators have taken different tacks in their consideration of the actions that the direct buyers take in response to the higher price they pay. Second, what would it take to deter hotdog producers from colluding again?

**Figure 2: Market for Hotdogs under Collusion**

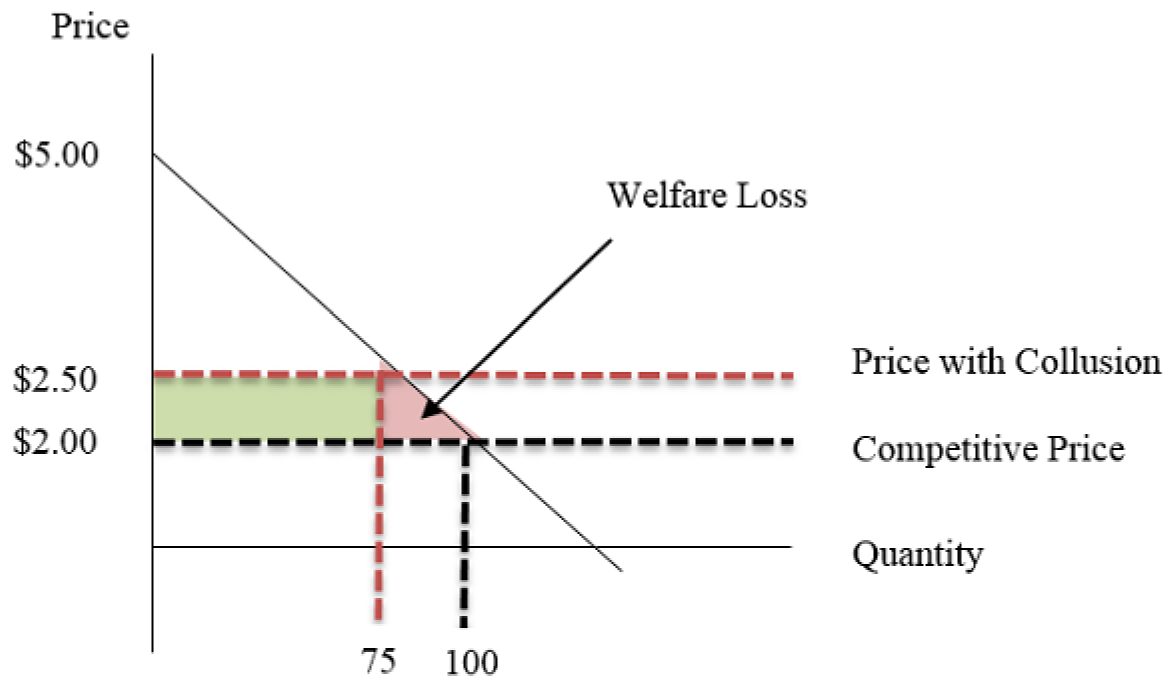



Figure 2 illustrates the potential impact of the collusive price on the different participants in the market. If the vendor fully absorbs the increase in cost that results from the collusion, the market for hotdogs will continue to look like Figure 1, despite the producers' collusion. The impact of the collusion will not reach the final consumer—who is the indirect purchaser, in this case—and 100 hotdogs will still be sold. The consumer is left unharmed.

Instead, the street vendor will suffer a drop in profits equal to the overcharge it absorbs. For example, if the cost of hotdogs increased by $0.50 each, the vendor's total profits would decrease by $50.00 (i.e., $0.50 × 100). In this scenario, the direct purchaser (the vendor) absorbs all the damage from the overcharge. For this to occur, the street vendor must have at least $0.50 per hotdog in profits to give up and therefore cannot have been in perfect competition prior to the collusion because there would then be no profits available and no ability to absorb the overcharge.

On the other hand, if the vendor passes the overcharge on to the final consumer by increasing its price by the same amount ($0.50 here), the outcome will be similar to that shown by the line for the collusive price in Figure 2.

If the overcharge is fully passed on, the consumer (the indirect purchaser) is the one who experiences direct harm in the form of a $0.50 price increase—the consumer will pay more for each hotdog, and the overall consumer surplus is reduced. Nevertheless, every customer purchasing a hotdog in this scenario is, by definition, better off after the purchase. Despite the higher price, all of these consumers freely decided to purchase the hotdog rather than keep the money. However, the consumers are not as well off as they were before the collusion, and they will purchase fewer hotdogs. Some former customers (25, in our example) prefer to keep the $2.50 rather than purchase the hotdog. In our example, this means that 75 hotdogs are sold, instead of 100.

In this instance, even though the vendor is not harmed directly by the overcharge on the hotdogs that are sold, it may be harmed by the loss of profits on sales that are lost because customers are unwilling to pay the higher price. In economic terms, the collusive price results in an overall loss of welfare (the pink triangle in Figure 2), in the form of the value of the hotdogs that were not sold as a result of the higher price.

It is because this welfare loss does not occur in the competitive setting that economists have had such a love affair with competition. It is also at the heart of the differences in the frameworks developed in the United States, Canada, and the European Union to address antitrust enforcement.

**Key Differences in Antitrust Private Actions Across Jurisdictions**

As mentioned earlier, the question of what it would take to deter hotdog producers from colluding is another important consideration. In the United States, the focus of enforcement is primarily on deterring anticompetitive behavior to maintain the overall competitiveness of the marketplace rather than engaging in a complicated process to allocate harm and associated compensation along the supply chain. The U.S. system of private action in antitrust cases is well known and long established, dating back to the Sherman Act of 1890 and the Clayton Act of 1914. More recently, decisions such as *Hanover Shoe Inc. v. United Shoe Machinery Corp.*, 392 U.S. 481 (1968), and *Illinois Brick Co. v. Illinois*, 431 U.S. 720 (1977), have defined which parties have standing to recover damages.

At the federal level, only direct purchasers—in our example, the hotdog vendors buying from the hotdog producers—can sue for damages from overcharges that result from collusion. From the federal courts' point of view, it is immaterial whether the direct purchaser then passes on any or all of the price increase to its own customers. No pass-on defense is allowed, and a defendant may not argue that the plaintiff suffered no harm because it passed on the overcharge. To be consistent, the direct purchasers therefore may sue for 100 percent of the damages from the overcharge. In our example, the hotdog vendors could sue the producers for the full amount of the overcharge, which would be $0.50 times the number of hotdogs they bought at the collusive price. Under U.S. federal law, this amount would then be trebled, thereby serving an explicit punitive and deterrent purpose.

Indirect purchasers—those buying from the direct purchaser—can have their day in court only at the state level. Largely in reaction to the Supreme Court's ruling in *Illinois Brick*, 27 states, and the District of Columbia and Puerto Rico, have passed legislation explicitly to allow indirect purchasers to sue for damages in antitrust cases. In parallel with federal direct purchaser actions, indirect purchasers may also claim damages at the state level.

Thus, if damages are trebled in federal court and separate suits at the state level are successful, a defendant found guilty of price-fixing could face total damage awards that are several times the amount of the actual overcharge. This has punitive and deterrent effects. However, missing from the equation are lost profits from lost sales. In our example, these are the profits that the vendor could have made from the 25 additional hotdogs it could have sold at the lower price. These typically are not considered in price-fixing cases under U.S. antitrust law, as case law has indicated that overcharge is a more appropriate measure of damages. (Lost profits from lost sales are more often considered for anticompetitive actions that are not the product of collusion, such as exclusionary conduct.)

The situations are different in Canada and the European Union, where the antitrust landscapes have begun to be reshaped in recent years. There, the focus is more on making plaintiffs whole while ensuring that compensation flows appropriately to all parties along the supply chain, in proportion to the harm suffered by each party. At the awards stage of a case, the emphasis is more likely to be on appropriately distributing compensation to the different parties rather than on the scope and deterrent effect of the penalty.

A recent trilogy of decisions by the Supreme Court of Canada has cleared the way for damages awarded to indirect purchasers in price-fixing cases, but only as joint plaintiffs with direct purchasers. *See Sun-Rype Prods. Ltd. v. Archer Daniels Midland Co.* (2013); *Pro-Sys Consultants Ltd. v. Microsoft Corp.* (2013); *Infineon Techs. AG v. Option consommateurs* (2013). Still, the Canadian courts remain wary of the risk of overcompensation, and so to date, damages are calculated based on the actual amount of the overcharge. The compensation then must be divided among the direct and indirect purchasers in proportion to the harm each party suffers. Although the authors are not aware of any Canadian cases in which lost profits on lost sales were claimed by plaintiffs in alleged cartel cases, we also are not aware of an explicit preclusion of such claims.

In the European Union, a directive issued in 2014 (Directive 2014/I04/EU) delineated a new framework governing private actions for antitrust damages in member countries. First, the directive allows damage awards to indirect purchasers as long as the overcharge or any portion of it is passed along by direct purchasers. The actions by direct and indirect purchasers are separate but should be coordinated so that the amount of damages sought by direct purchasers is reduced proportionately to the amount passed on down the supply chain. This is intended to avoid overcompensation to any one party.

Second, the directive explicitly calls for direct purchasers to seek damages for lost profits on lost sales, in addition to direct damages from overcharges. In this regard, the European Union framework stands apart from the other two. This provision attempts to explicitly address the total economic impact of the alleged behavior on markets, in the form of loss of value in the marketplace that results from consumers having made fewer purchases due to the higher (collusive) prices.

**Summary**

The standing of indirect purchasers and the admissibility of a pass-on defense can shape the nature of private antitrust damages actions. In federal court in the United States, no pass-on defense is allowed, damage awards are trebled as a punitive measure, and indirect purchasers are excluded from seeking damages. Thus, the full effect of the anticompetitive action is focused on the direct purchaser alone. It is left to the individual states to determine whether to allow compensation for indirect purchasers, potentially allowing the punitive effect of damage awards to be compounded.

In Canada, the Supreme Court has ruled in recent years that both direct and indirect purchasers could sue for damages, but their claims should be combined into a single action. Multiple and duplicative suits are to be avoided. These rulings rendered the issue of pass-on defense moot but opened the door to issues of allocation of harm and conflicts within the class because of potential disagreement over the allocation of damages.

Perhaps because it started from a blank slate, the European Union directive has opted for an approach that allows for compensation arising from the combination of the overcharge and lost profits due to lower sales as a result of the higher price. Damages from the overcharge should be apportioned among direct purchasers and indirect purchasers to the degree that each class is harmed, while damages from lost profits on lost sales may also be awarded.

These recent developments in case law in both Canada and the European Union are in their early stages. Implementation as well as upcoming precedents may yet determine what the different frameworks imply for actual compensation levels.

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