Competition Law Enforcement: The "Free-Riding" Plaintiff and Incentives for the Revelation of Private Information

June 2006

Competition Law Enforcement

CCP Policy Briefing

INTRODUCTION

- In December 2005, the EC Commission published a Green Paper on *Damages actions for breach of the EC antitrust rules* (Com (2005) 672 Final). The document lauds the potential benefits of an increase in the private enforcement for EC competition law. Launching the paper, Competition Commissioner, Neelie Kroes, argued that those suffering losses as a result of anti-competitive activities, such as cartels, have the right to compensation but it "is all too often theoretical because of obstacles to exercising this right in practice" (IP/05/1634). The puzzle is that while these rights have clearly been enforceable for some time, there has been an extremely low incidence of private competition cases across Europe. It appears that the 2001 judgment of the European Court of Justice in *Courage v Crehan* (Case C-453/99) has done little to fortify would-be litigants, despite the fact that the court was clearly giving its imprimatur to private actions (paragraphs 26 to 27). The Green Paper lays out a range of "options" for how private enforcement might be facilitated, including: the altering of cost rules and rules over discovery in order to provide would-be litigants with more incentives and information to sue; how damages ought to be quantified; the appropriate rules of standing; and whether a "passing-on" defence ought to be permitted.
- In their paper, Morten Hviid and Michael Harker have examined the issue of private enforcement to determine what might incentivise private parties to use it to deal with competition issues directly. They argue that while public enforcement has a number of comparative advantages, private enforcement may have an informational advantage as those in close commercial relations are more likely to observe competition law infringements.
- The focus is on the types of case which are more likely to reveal information that otherwise would not come to light, as well as augmenting public resources and, therefore, increasing the overall level of enforcement of competition law. Providing there are appropriate safeguards in place, this should lead to a higher level of deterrence against anti-competitive behaviour.

BACKGROUND

- Not all types of private action cases are likely to lead to the same degree of revelation of crucial and valuable information. Cases can be divided into two categories – *de novo* cases and *follow on cases*.

De Novo cases

- A plaintiff initiates a private action based on an alleged breach of competition law. It must provide all the evidence to secure the infringement decision but faces the risk of having to pay at least its own costs, and possibly the costs of the defendant should it lose. Because the firm is in the market, it is likely to have better information than a competition authority. It has, therefore, the evidence necessary to construct a realistic case without recourse to public resources.

Follow-on cases

- A plaintiff only initiates a case after the infringement has been established by the competition authority. This is generally less expensive to the private plaintiff than a de novo case since the violation will have been established already. The competition authority case may have been initiated on the basis of information supplied by a firm. In this way some information may have been revealed, but this information is supplied by an interested party and hence requires more scrutiny. These cases do not augment resources for detection and enforcement directly. They are a (costly) way to increase the level of punishment.

METHODOLOGY

- The paper develops a simple model to highlight the incentives or otherwise of de novo private action. It is assumed that the plaintiff has information pointing to a breach of competition law which has harmed it. The plaintiff can use the information in three different ways – it can choose to ignore it, it can initiate a de novo case or it can pass on the information to the competition authorities with a view to pursue a follow on case – choosing the one that will give it the greatest monetary benefit. If the case goes to court there are two possible outcomes – the case is found in

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favour of the plaintiff (in which case the plaintiff receives damages, the defendant pays them plus costs) or in favour of the defendant (the plaintiff pays all or a proportion of costs). Finally, it is assumed that an infringement finding by a Competition Authority is conclusive evidence of a violation in a private follow-on case and likewise a non-infringement decision would bar a follow-on case.

- The model takes into account the time taken for a decision to be reached in the case, the probability - assessed at the time of starting the de novo case - of the court finding in favour of the plaintiff, and the probability - assessed at the time at which the competition authority is informed by the future plaintiff - of the competition authority finding a violation. The model also allows firms to settle their case, avoiding the costs of a court case.

RESULTS

- The key to getting more de novo cases is that they must get to a conclusion quicker than follow-on cases. Success in a follow-on case is a relative certainty for a plaintiff, whereas a de novo case involves a greater risk of losing (and having to pay costs). Should it take the same time (or less) for a plaintiff to get compensation in a follow on case, it will obviously be more attractive than a de novo case.
- Other parameters play a role. Interestingly, the effect of lower costs of de novo cases is ambiguous. On the one hand, they lead to a smaller payout for the plaintiff where it loses. On the other hand, the incentive to sue in the first place is reduced because the lower costs of a de novo case will lead to less generous settlements by defendants.

POLICY ISSUES

- De novo cases can benefit society by providing a more efficient enforcement mechanism both in terms of better information and more resources. Follow-on cases, while they have the capacity to reveal information, involve free-riding on public resources. The results demonstrate how plaintiffs can be persuaded to pursue a de novo cases instead, sparing the resources of competition authorities to pursue other perhaps more urgent cases.
- De novo cases are more likely to be initiated for some violations than others. For example, for restricted practices, competition authorities have no obvious advantages over a private litigant when it comes to presenting the case. For such violations, de novo cases can be encouraged through speedier resolutions. On the other hand, de novo collusion cases are less likely to be encouraged through speedier resolutions. Once aware of a violation, the Competition Authority has two clear advantages over a private litigant in a de novo case: powers of investigation including dawn raids, and leniency programmes to obtain admissions of violations.

What Next?

- The paper illustrates the importance of recognising explicitly the incentives of potential litigants in designing procedures and remedies for the enforcement of competition law. It also underlines the importance of considering the public and private aspects of enforcement together and not in isolation from one another.

FOR MORE INFORMATION:

The full working paper (**CCP Working Paper 06-9, Harker, M and Hviid, M (2006) "Competition Law Enforcement: the "Free-Riding" Plaintiff and Incentives for the Revelation of Private Information"**) and more information about CCP and its research is available from our website: www.ccp.uea.ac.uk

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