United Kingdom

Leniency, Pfleiderer and the impossibility of balance

Mick Smith and **Christina Petra Grigoriadou** of Calunius Capital look at the options open to whistle-blowers in the light of the ECJ's Pfleiderer decision. Is there a better way, they ask

The October *GCR* Live: Litigation conference in London featured an excellent presentation by Mark Hoskins QC on the incompatibility at the heart of the European Court of Justice's *Pfleiderer AG v Bundeskartellamt* decision. He analysed the difficulties now faced by local courts in applying the *Pfleiderer* principles: whether or not to grant disclosure of documents (submitted by leniency applicants) to claimants bringing follow-on cartel damages claims. At that same conference, the authors proposed a (slightly provocative) solution to this incompatibility. We explore that argument further here.

The Pfleiderer problem – a doomed balancing act?

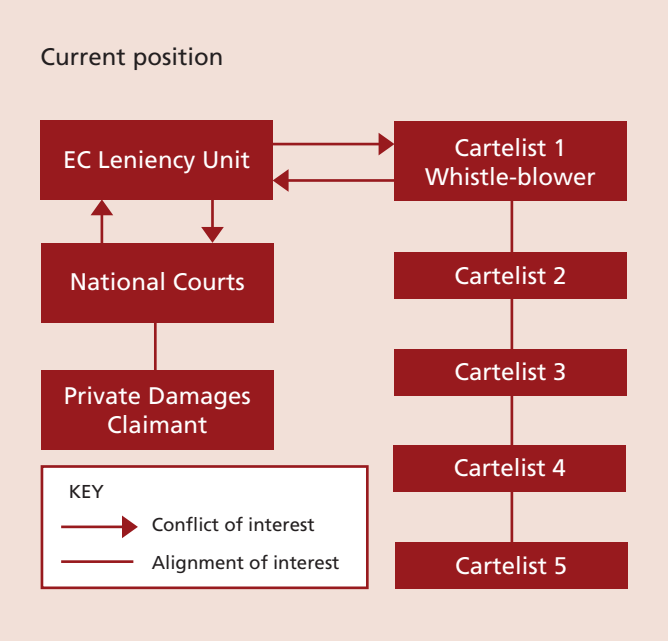
After the uncertainty over the availability of document disclosure in cartel follow-on damage claims, the ECJ ruled in *Pfleiderer* that access to leniency documents is not prohibited by EC law. However, the ECJ left it to the national courts to balance their national law with the interests protected by EC policy, on a case-by-case basis. As no specific criteria were set out, the ECJ decision is no more than a statement of principle, and much uncertainty remains.

Meanwhile, the *Pfleiderer* balancing exercise as approached by the English High Court in *In National Grid Electricity Transmission v ABB Ltd* consists of two principles: Legitimate expectations and proportionality. This means assessing whether ordering disclosure would increase the exposure to liability of the leniency applicants, compared to the liability of the non-cooperating parties; and whether disclosure is proportionate, by taking into account the difficulty of obtaining information from other sources and the relevance of the leniency material.

In short, courts must decide how far to protect the information involved in the leniency application. From a leniency applicant's perspective, the more incriminating the documents, the better the chances of the applicant receiving full leniency and a fine reduced to zero. But the more incriminating the document (if disclosure is subsequently ordered) the more likely the applicant is the subject of a successful private damages claim.

What about a court's perspective? Can a national court carry out this balancing exercise in practice? The answer seems to be no. As things currently stand, the claimant's interest cannot be reconciled with the interest of the cartelist whistle-blower, and the court will always have to make a choice. Likewise, the court cannot reconcile the whistle-blower's interests with those of EC leniency policy. Moreover, a court is asked to make these decisions without any mechanism to compensate for any future prejudice to the losing party in the application.

The position can best be shown by the following diagram, where we see the two deep conflicts, and also the continuing unity of purpose of the cartelists:



A whistle-blower's perspective

In "game theory" terms, the leniency programme aims to create a prisoners' dilemma for the cartel members. To explore the theory further, let's put some simple numbers around the above scenario and work out whether it is worth Cartelist 1 ("C1") blowing the whistle.

Suppose C1 estimates that if the cartel is uncovered a fine of €500 million is likely, which would be shared equally between the five participants who have roughly equal market share. And suppose further that private damages claims (if brought) would likely be for the benefit of the cartel to date estimated at €500 million over five years (ie, €100 million each and €20 million per cartelist per annum).

For C1 to carry out a rough cost-benefit analysis of the impact of blowing the whistle (or not) it must make an assumption as to the likelihood of the cartel being uncovered. After some head scratching C1 decides this probability is 50 per cent. By extension, C1 therefore estimates that the probability that the cartel remains undisclosed is also 50 per cent. C1 guesses that the economic consequence of non-revelation would be a further five years of cartel profits (ie, another €100 million for each cartelist).

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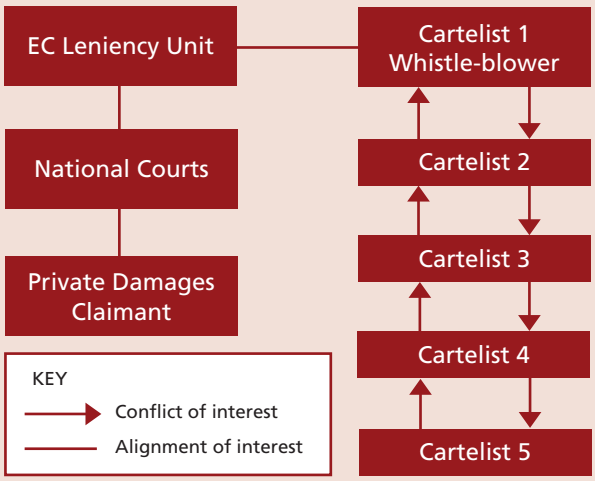
Table 1

Cash amount	No whistle	Whistle
€100m continuing cartel profits for 5 years	+€50m Subject to 50% probability	€0m
Damages of €100m	-€50m Subject to 50% probability	-€100m
Fine of €100m	-€50m Subject to 50% probability	€0m
Net effect	-€50m	-€100m

Proposition



The back of the envelope cost-benefit analysis then looks like Table 1.

To work out the net effect on C1, we simply add up the three rows in Table 1. From this analysis, it can be seen that C1 expects to be €50 million out of pocket if it does not blow the whistle. But if it does, C1 expects a net loss of €100 million. So the correct economic decision is to keep quiet. This disincentive to blow the whistle across the cartel applies equally to all the cartelists given equivalent market share. In other words, the "prisoners" are aligned and they do not really face a "dilemma" at all.

Of course this analysis would vary where there is a dominant player in the relevant market. And it goes without saying that the above analysis is a gross simplification of many factors including the likelihood of a victim bringing a successful damages claim. But the observation holds from C1's perspective – why bother applying for leniency?

All the above difficulties lead us to ask, is there a better way?

A possible solution?

The forthcoming EC legislation promises to change the landscape, but how will it approach the leniency and disclosure issue? We saw above how the current situation continues to align the cartelists' interests, while generating conflict between institutions and participants that should be aligned if justice is to function. In addition, it can be seen that the economic attractions of whistle-blowing are far from obvious.

The proposition put forward here is this: why not provide the successful leniency applicant with a full indemnity from civil damages, to be paid by the other cartelists?

If legislation granted the leniency cartelists an indemnity (subject to certain procedural requirements) from civil damages in addition to the total immunity from (or a significant reduction of) the fine, it could ensure that more cartels were detected. The whistle-blower would need to participate fully in the follow-on damages claims from private claimants, but the other cartelists would have to pay the damages of the whistle-blower (jointly and severally) together with their own amount of damages, if these actions were successful. This procedural mechanism transfers the conflicts to the cartelists who would have to resolve the dispute with each other, and removes the conflicts between the EC, national courts, claimants and leniency applicants. Revisiting the previous diagram, we can now see that the proposition establishes a true "prisoners' dilemma" between cartelists, whose interests are no longer aligned.

Specifically, in relation to the disclosure of prejudicial documents (supplied in leniency), the proposition ensures that the problem disappears. In fact, the more incriminating the disclosure, the better the position is for the whistle-blower, as this would enhance its chance of emerging with zero loss. Of course, as the other cartelists would have to pay their fines and damages and also the damages of the whistle-blower, their burden increases. But this is a risk they should take if they choose to participate in illegal cartels.

Now let us consider how the proposition would work in practice. If C1 assumes the probability of uncovering the cartel remains at 50 per cent, we can see that there is a clear benefit to blowing the whistle – avoiding a loss of €50 million (Table 2).

The position becomes even clearer if we assume that the change in leniency law means that the chance of a cartel being uncovered is 75 per cent (and thus the chance it remains uncovered is 25 per cent).

Armed with the analysis in Table 3, the cost-benefit analysis

Table 2

Cash amount	No whistle	Whistle
€100m continuing cartel profits for 5 years	+€50m Subject to 50% probability	€0m
Damages of €100m	-€50m Subject to 50% probability	€0m
Fine of €100m	-€50m Subject to 50% probability	€0m
Net effect	-€50m	€0m

Table 3

Cash amount	No whistle	Whistle
€100m continuing cartel profits for 5 years	+€25m Subject to 25% probability	€0m
Damages of €100m	-€75m Subject to 75% probability	€0m
Fine of €100m	-€75m Subject to 75% probability	€0m
Net effect	-€125m	€0m

to C1 is clear – a full and frank application for leniency would avoid a €125 million loss. So, on these assumptions, the incentive to blow the whistle is huge.

Concluding thoughts

EC policy aims to prevent violations of antitrust law, through deterrence by way of fines (public law policy) and by supporting claims for compensation by the cartel's victims (private enforcement).

From the above analysis we conclude that the current position creates uncertainty; can deter applicants from cooperating with enforcement authorities; makes it impossible for the EC to reconcile the principle articulated in *Pfleiderer* with its leniency regime; and therefore undermines the effectiveness of the leniency programme.

By contrast, legislation to give an indemnity from civil damages to the successful leniency applicant would create strong economic incentives for leniency applicants. It would also remove the conflicts between public and private law – and eradicate the lingering alignment of interests among the cartelists.

Some observers might find the possibility of a cartelist "getting off free" raises policy objections. The counterargument to this is straightforward.

In practical terms, to see the indemnity principle through to its logical conclusion would need the whistle-blower to participate fully in the civil damages procedure, anchoring jurisdiction in its home jurisdiction, providing full disclosure and ensuring joinder of the other cartelists. So the whistle-blower becomes an active agent of policy and in this extended way must "sing for his supper".

In terms of enhancing the policy of deterrence, we simply highlight the increased attractiveness of whistle-blowing that would be generated by adopting the proposition herein – compare the net effect of Table 1 with Table 3.

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Lastly, we point out the increased probability of victims recovering civil damages because cartels are more likely to be uncovered. The strength of the "all for one" collective nature of the cartel is turned against itself, via collective (joint) responsibility for the damages applicable to the whistle-blower. Moreover, the compulsory involvement of the whistle-blower as anchor defendant should serve to remove the existing gamesmanship on jurisdiction and similar delay tactics adopted by cartelists. The bottom line being that the victims will not care who pays the damages, so long as they are recovered.

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