

Time for Collective Action? Redressing the Damaging Effects of Cartels on Small Businesses

Ingrid Gubbay and Anthony Maton

Summary

- Individuals and small to medium sized businesses continue to suffer losses resulting from unlawful cartel activities. Research conducted by the OFT in 2005 found that one in three SMEs are aware of anticompetitive actions, and one in five has been the victim of anticompetitive behaviour.
- Whilst the damaging consequences of cartels have been the subject of much debate, small businesses have been relatively quiet when it comes to redressing any wrongdoings. In 2005, the European Commission found that cartel damages had only been awarded for breach of EC or national competition laws in eight out of the 25 member states.
- Despite the often daunting prospect of seeking damages from large corporations, there are cost effective ways of funding solutions for both consumers and small businesses such as entering into a conditional fee agreement or after the event insurance.
- Recent changes to the Financial Services and Markets Act mean that the FSA now has the power to make and enforce rules requiring firms to operate a consumer redress scheme when it appears that firms may have been involved in widespread or regular failure to comply and when consumers have suffered loss as a result.
- Financial services firms will look to insurers to cover the costs of investigations and ultimately payments made under the redress scheme.

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CII Introduction: Unable to match the spending power of large corporations, it can be a daunting prospect for a small firm to make a claim against a larger counterpart. However, unlike individual consumers, small businesses have been largely forgotten in the debate about cartels. This paper, by Ingrid Gubbay and Anthony Maton of Hausfeld & Co LLP, examines the damaging effects of cartels on small businesses. It also highlights the affordable options open to SMEs for collective redress, and the opportunities for insurance firms to become the underwriters of claims.

Private enforcement of “collective redress” – that is civil claims relating to unlawful cartels and financial services – is growing. Why does this matter to insurers?

- Claims in respect of these areas can be anticipated.
- Insurers need to consider how to approach these claims and how to adapt policies.
- Cartel involvement defined as fraud: what view will insurers take to combat it?

In recent years there have been innumerable court based collective actions and proposals for sectoral consumer redress schemes. Activity within the UK has been mirrored at the European level with rounds of consultations, government meetings with stakeholders, and final reports and recommendations.

Collective action typically refers to court based vehicles designed to give greater access to remedies for those perceived to be ‘shut out’ due to lack of an effective procedural model, expense of legal action, and lack of awareness that such mechanisms might exist. Originally these initiatives were spearheaded by consumer groups, which precipitated the ‘Wolf reforms’ in 1993, bringing in the Group Litigation Order (“GLO”) process, and a new funding arrangement called Conditional Fee Agreements or (“CFA”) effectively, regulated ‘no win no fee’ agreements. Alternatively, consumer redress schemes are a proposed new adjunct to regulatory powers which provide sectoral regulators with wider powers to order redress from firms where there is evidence of widespread market failure.

Alongside these developments, a similar recognition about businesses and consumers losing billions due to unlawful cartel activities has become the subject of many conferences. It has polarised academic debate on the purpose and best means of, bringing private enforcement action to recover massive financial losses due chiefly to price fixing.

The fear of adopting ‘US style class actions’ into the EU with its perceived excesses has been a constant if now tired refrain by defence lobbyists. Claimant lawyers by contrast, particularly those familiar with the US and EU legal systems, will minimise these

fears and talk about the lack of access to justice in the English and Welsh courts.

More recently, following the succession of banks and insurance companies which fell on their swords during the height of the recession, the UK Treasury drafted a Financial Services Bill, which included a number of procedural features which would have allowed shareholders and others to more easily and effectively challenge large financial institutions for their losses. The Bill however lost those particular features during its parliamentary passage to becoming an Act on April 8 2010.

In this article we will briefly set out the current state of play in two areas of collective action, private enforcement and financial services; comment on the fundamental differences between the US and EU collective action systems; and discuss some of the risks and opportunities for insurers in what is undoubtedly an evolving area of litigation.

1. Private enforcement of cartel claims: risks and opportunities for business

The amounts lost due to cartel activity are very significant, with cartel profits (and therefore, correspondingly, losses) estimated to be billions of pounds. In the very same year that the EU study published its findings the OFT reported¹ that nearly a quarter of small and medium sized businesses across Britain believed they are harmed by unfair practices such as cartel price fixing and collusion to set tender prices. The OFT’s research found that one in three SME’s say they are aware of anti-competitive activities in their industries and one in five (22%) feel they have been the victim of anti-competitive behaviour.

The gritty reality is that whilst it is just a minority of businesses that engage in cartel activity, it is the vast majority of businesses as well as consumers who suffer losses as a result.

The cost to Business: There is no doubt that cartels are bad for consumers who suffer loss as a result of them and that reform is required if consumers are to have a realistic chance of enforcing their rights to recover losses suffered from cartels. In addition, there is no doubt that certain businesses are involved in cartels and, accordingly, will have to make restitution to consumers if these changes are pushed through. However, this rather simplistic picture veils the gritty reality that whilst it is just a minority of businesses that engage in cartel activity, it is the vast majority of businesses as well as consumers who suffer losses as a result. In addition, it is typically large businesses and not small businesses that engage in cartel activity and accordingly small businesses which suffer as a result of cartels.

¹ OFT Press Release : OFT urges SME’S to report anti-competitive practices: 129/05 21 July 21, 2005

Despite the adverse impact of cartels on small businesses, small firms have been relatively quiet when it comes to redressing any wrongdoings. The evidence in this context is telling. The European Commission's study in 2005² found that cartel damages had only been awarded for breach of EC or national competition laws in eight out of the then 25 member states which included the UK's solitary (and now overturned) award in *Courage* and *Crehan*³.

The report set out three reasons why private actions are so 'underdeveloped' in the sixty years since Competition regulation was introduced:

- A lack of awareness about the opportunities to recover losses.
- A lack of robustness on the part of public enforcers to bring prosecutions in the past.
- The difficulties of uncovering secret cartel activity.

The last five years has seen those involved in the development of private damages enforcement in the competition field in the EU and UK, participating in innumerable national and international debates, consultations and conferences aimed at defining a distinctively EU private enforcement procedure for consumers and businesses who have suffered significant losses as a result of long periods of cartel activity. In conducting this programme for reform the interests of consumers and of business have been treated largely as separate entities, warranting differing approaches to proposed new recovery mechanisms, with consumers viewed as requiring a greater degree of legal protection.

Businesses are perceived as commercially savvy and better able to access the courts and legal counsel

Businesses are perceived as commercially savvy and better able to access the courts and legal counsel. In this article we argue that while there do exist fundamental differences between the two groups, there are also significant similarities, and that small and medium sized businesses (SMEs) are losing out on significant recovery awards because their interests are being caught beneath the cross fire between the consumer and business lobbies.

The discussions convened by the European Commission (EC) and the Office of Fair Trading (OFT) have primarily focused on reforms that will allow consumers who have suffered loss as a result of cartel claims to effectively bring claims before the courts. In contrast, any such proposed reforms have been attacked by the Confederation of British

Industry (CBI) as dangerous and unwelcome. For example, the CBI's⁴ stated position in its response to the OFT on private actions was that any proposed reform to the existing system would herald the 'importation of US style class actions', and would lead to 'speculative claims and additional costs to business'. In contrast, most well informed commentators now accept and understand that the US model is far from catching on in Europe and that a particularly European model of collective redress is proposed, not one of US class actions.

The approach to business claims: According to the OFT report⁵ 'despite the high level of awareness of harm to individual businesses and the high reward offered by the OFT to anyone who has useful information which will assist their cartel investigations, the small firm owner's reaction to suffering harm as a result of a cartel is to soldier on without turning to the authorities for assistance'. This reaction is, we suggest, not because of any indifference to recovery but because of the hurdles that have traditionally existed in the way of that recovery.

Against this background, and recent changes that have emerged over the last 12 months, we believe SME owners may require more support and advice with respect to seizing the opportunities available to them, and more discussion of perceived risks in bringing restitution actions.

The BA/Virgin case & business: Many will have read about the BA/Virgin fuel surcharges cartel in which Hausfeld & Co. reached a settlement⁶, benefiting those who bought tickets in the United Kingdom (5.6million) to the tune of £73.5 million through the route of actual proceedings in the US, and threatened proceedings in England and Wales. What is most widely known about that settlement is that it allowed thousands of consumers who were overcharged for flights on BA and Virgin between April 2004 and September 2006 to claim a return of that overcharge. What is not widely understood is that the settlement has also been taken up by many thousands of businesses which have suffered loss as a result of BA and Virgin's illegal activities.

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Pausing for thought for a moment, it comes as no surprise that a succession of law firms, banks, accountants and other city institutions flew many of their staff to and from the US during the period of the cartel. More surprising is the influx of other organisations, ranging from charities to candlestick

² European Commission D-G Competition: Ashursts Study on the conditions of claims for damages in case of infringement of EC competition rules August 2004 at www.ec.europa.eu

³ *Courage and Crehan* [2006] UKHL 38

⁴ CBI; official response to the OFT's Discussion paper on Private Actions in competition law: effective redress for consumers and business July 2007 at www.cbi.org.uk

⁵ See note 1

⁶ See website of law firm Hausfeld & Co at www.hausfeldllp.com for further details and to make Air Passenger refund applications online.

makers, who also flew employees in the same period. A variety of businesses suffered loss as a result of the overcharge levied by BA and Virgin – and each of those businesses is able to claim restitution for that loss. These claims vary from the smallest of businesses that have a handful of journeys to claim for, to the largest corporate claimant who has a claim in respect of some 400,000 journeys.

The Passenger case illustrates perfectly, a cartel that is perceived as a ‘consumer’ cartel, and yet affects all, bringing together the interests of both business and consumers in defeating cartels.

The Air Cargo cartel case & business: A further case example is the other airline cartel, the Air Cargo cartel. This cartel was much broader involving up to thirty airlines during a six year period, from early 2000 to late 2006. Already thirteen airlines have pleaded guilty to involvement in the cartel in the United States Department of Justice investigation and paid millions of dollars in fines whilst investigation by regulators around the globe – in the EU, the USA, Korea, Australia and Canada continues. Any business that purchased airfreight from one of the cartelists during the cartel period has been overcharged for the price of their airfreight. As such, any business in that position has suffered losses to which it is entitled to make a claim for restitution. This cartel – given its length and scope – has caused overcharges to tens of thousands – if not hundreds of thousands - of businesses in every corner of the globe. In this type of cartel, cartelists often say two things to businesses seeking restitution of the overcharge.

The effect of this form of defence is not to deny the existence of the cartel but rather to say that it was so ineffectively run that it made no difference to the overall market price

The first is to assert that the cartel was ineffective and that there was no overcharge. This is BA’s stated public position in relation to the air cargo cartel. The effect of this form of defence is not to deny the existence of the cartel but rather to say that it was so ineffectively run that it made no difference to the overall market price. One is simply left to rather cynically wonder at the great extent of ineffective cartels being run by large and sophisticated businesses at great risk to those involved.

Second, it is asserted that businesses in a typical cartel pass on any overcharge down the contractual chain to the ultimate consumer. This is to exist in an economic fairyland. In that fairyland, every business can pass every cost down the supply chain until it reaches the ultimate consumer. In the economic real world of course businesses are forced to absorb all or the majority of costs, and are simply unable to pass all of that cost down their supply chain.

Funding cartel claims: One of the major impediments for the vast majority of businesses who

have suffered loss from cartels has been their inability to effectively bring claims to recover those losses. The sad truth is that the vast majority of individuals and businesses in this country have not been able to afford to use the court system, or stomach taking on large corporations with the capacity to afford expensive lawyers. In reality, until recently, litigation funding has only allowed access to a minority of large businesses. This issue of obtaining effective access to the court system has been as pertinent for the vast majority of businesses as it has been for consumers. There are however, now innovative and secure funding solutions for both consumers and businesses in this position.

There is also a practical solution to the risk – albeit, in a cartel case, a small risk - of paying fees to the other side if you lose the action.

With respect to your own solicitor’s costs, the solution is to enter into a conditional fee agreement (“CFA”) with your solicitor – an agreement where the solicitors will only charge you where they succeed for you. There was some criticism of these arrangements in the context of the vibration white finger and chronic lung disease coal miner cases but these were exceptional circumstances involving a statutory scheme which funded the actions. The CFA arrangements have generally worked very well for claimants who would not otherwise be able to afford to fund their actions.

The core message is that a professional firm of solicitors acting under the tight regulation and rules of the Solicitors Regulation Authority, ensures that CFA’s are the best way for a small business to recover its losses.

There is also a practical solution to the risk – albeit, in a cartel case, a small risk - of paying fees to the other side if you lose the action. The answer is after the event insurance (“ATE”) with a premium payable on a deferred, success only basis. What this means in practice is that if you lose the case the insurer pays the costs and the premium is not payable, yet, if you win the case then the premium is payable but should be recoverable in whole from the losing defendants, leaving the recovery of the over-charge intact.

This combination of CFAs and ATE insurance now allows both consumers and businesses to effectively bring claims to recover losses suffered as a result of cartel action. It is also a highly effective tool for businesses which can, nevertheless, afford to litigate as it is simply an approach to shifting the risk to the defendant, whilst alleviating cash flow without compromising the right to restitution.

What should small businesses do? How do they know if they have suffered a loss as a result of a cartel?: The European Commission keeps a list of those sectors where it has investigated and found cartels – both price fixing and big rigging cartels. By accessing the European Commission website you can discover those sectors and whether you think

your business is likely to have been affected by that cartel. The reality is that if you purchased goods or services that were subject to cartel then you are likely to have suffered a loss – the amount will depend on the cartel but, as an indication, is typically 10%. If you suspect that you have suffered loss as a result of a cartel you could consult a claimant law firm which specialises in cartel recovery actions, to advise on best recovery strategies including reaching out of court agreements.

One significant avenue, often overlooked for many types of businesses, is to look to cartel activity in their individual sector for opportunities to recover restitution of loss.

So, to answer the question posed at the head of this article, cartel claims and possible reforms in the area of cartel claims represent only business risk for those who are involved in cartel activity. Increasingly financial advisors and insurers are looking to find creative ways to assist foundering businesses to increase profit margins. One significant avenue, often overlooked for many types of businesses, is to look to cartel activity in their individual sector for opportunities to recover restitution of loss.

US v EU models-why the EU model poses low risk to insurers

Who's afraid of Virginia class actions?: The reform process for claimants has been impeded by opponents of the 'opt out' model class action vehicle. Their mantra is that introducing an 'opt out' vehicle to give claimants greater access to recovery awards will bring in all the excesses of the US system. The 'opt out' system is one where an action can be bought on behalf of an unidentified group of claimants, for example the 5.2 million UK ticket holders who flew between the US and UK during the BA/Virgin price fixed fuel surcharge cartel period. Currently most recovery vehicles in the EU are 'opt in' systems where everyone in the group must be gathered together prior to the commencement of the action and individually named - a process which has hamstrung claimants from effectively bringing private actions, and is out of step with the modern world of mass production.

Having said that, there were excesses in the US class action system to such a degree that the US Federal Government intervened and introduced the 'Fairness in Class Actions Act of 2005' giving the courts greater control of lawyers fees, litigation costs, and state jurisdiction, all of which are now tightly controlled. Notably, the excesses were not caused by the much maligned 'opt out' system, it was the lawyers' fee model which caused the excesses.

The reasons why US style class actions will not be adopted into the EU are:

Triple damages

We don't need triple damages in the EU for two very good reasons. First the EU system of private enforcement is not aimed at enforcing public policy as it is in the US. Second, and more importantly, there is no entitlement to interest in the US in the way there is in the EU so there is no need for triple damages. Interest added to damages awards, or settlements in cartels, recognises the real monetary value loss to the claimant of being out of their money for often lengthy periods of time.

Judges not juries

No-one in the EU is advocating the introduction of juries into civil actions: cases will continue to be heard by judges.

Costs rules

Other than proposals about cost capping and protective costs orders to assist claimants, there has been no push to abolish or change the current adverse costs, or costs follow the event rules. Indeed, the techniques designed to run cases through CFAs and with ATE insurance policies make the adverse cost rules very attractive for claimants.

Contingency fees for lawyers

In the US, litigation by claimants' lawyers is routinely bought on a contingency fee basis where fees come out of the award to the plaintiffs. Note however that in the BA/Virgin case fees were settled with the defendants and court approved on top of, and not out of, the settlement sum. This has been an area open to abuse and therefore justly criticised. In the EU, contingency fees have not been permitted, however efforts to find ways to fund litigation on behalf of claimants in the UK, has seen some preliminary public approval from the bench of tightly capped and judicially controlled contingency fees in certain cases.

Traditionally under the EU model, greater reliance is placed on public enforcers, not private litigators, to bring prosecutions against companies for alleged anti-competitive practices.

This means that in most cases private enforcement in the EU will typically be 'follow on' only (once a conviction has been secured) which greatly reduces the costs and risk burden to claimants.

European collective redress will look, smell, and feel nothing like Virginia, so there is no need for Europeans to fear that US style class actions are at their backdoor.

Changes to UK Financial Services Regulation:

Following the high profile bank and pension fund failures in the recent past, the previous Government published the Financial Services Bill which for the first time in regulatory history provided a scheme whereby consumers acting collectively could issue proceedings for 'financial services claims' against any FSA regulated person, investment firms, credit institutions, insurers and other financial services firms.

The Bill was the response to the UK Ministry of Justice's 2009 report on collective actions. In a trade off to powerful lobbyists, this report moved away from accepting generic 'opt out' collective actions which had been recommended by the Civil Justice Council, toward a piecemeal individual sector 'consumer redress' approach.

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While the far reaching 'opt out' provisions were 'watered down' during the passage of the Bill the Treasury have indicated that more detailed proposals may be added in due course and therefore insurers should watch for any developments closely.

In short, Section 14 of the new Financial Services Act amends the Financial Services and Markets Act 2000 (FSMA) which provided that the FSA must seek authority from the Treasury before requiring firms to conduct a review of past business and to pay compensation to affected customers. The FSA can dispense with this underused process as it now has the power to make and enforce rules requiring firms to operate a consumer redress scheme where it appears that there may have been a 'widespread or regular failure' by a firm to comply with requirements applicable to the carrying out of any activity, and it appears that consumers have suffered loss or damage as a result of the failure.

Under a consumer redress scheme a firm may be required to undertake one or more of the following:

- Investigate whether it has failed to comply with the requirements applicable to the carrying on by it of the activity.
- Determine whether the failure has caused loss or damage to consumers.
- Where the firm determines that the failure has caused loss or damage, it must determine what redress is to be paid and then make the redress to the consumers.
- If a consumer is not satisfied with the determination made by the firm under a consumer redress scheme, she can make a complaint to the Ombudsman.

Payment protection insurance (PPI) mis-selling which has been so widespread could be a prime example, typical of the type of failure targeted by these provisions.

Evidence that the FSA is taking its new powers seriously came through in the announcement this month that it intends to spell out to firms what is expected of them in handling payment protection complaints, which it said are too often going to the Ombudsman where three out of every four are being paid out.

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Significantly for insurers, KPMG responded to the FSA announcement⁷ by warning that the cost of compensation, estimated to be £2billion, could force smaller lenders into bankruptcy – forcing the Financial Compensation Scheme to pay. Dan Thomas, head of remediation at KPMG, said that the whole industry will have to share the pain. The FSA action however has come after 24 investigations, three thematic reviews, issued warnings, the halting of selling single premium PPI with unsecured loans, visits to over 200 firms, and fines so far totalling £13million: a fairly strong indication to insurers that there has been a problem for some time.

It will be the task of the FSA to determine when to require a firm to undertake a redress scheme. Since it is not necessary for the FSA to establish actual evidence of a failure, the powers may lead to a wider application and may affect more than just mis-selling cases.

Commentators have expressed concerns that the ACT has given too much unilateral power to the FSA, without sufficient opportunity for a firm to present its case, and without reference to the court process. The FSA may effectively determine an insured's liability outside the judicial process and act as judge and determine the final decision. Consumers unhappy with the FSA determination can make a complaint to the Ombudsman, who will determine in their view, what redress ought to have been given under the redress scheme.

Legal specialists have raised questions for insurers including how much control should, or can, insurers seek to impose on redress payments by insured's

All are agreed that this new piece of legislation will present new challenges to the insurance industry. Financial services firms will look to insurers to cover the costs of investigations and ultimately the payments made under the redress scheme. Legal specialists have raised questions for insurers including how much control should, or can, insurers seek to impose on redress payments by insured's. Insurers may be left liable with no ability to challenge the insured's liability to consumers.

These however, are not new issues for the insurance industry and no doubt there will be a regular path beaten to the door of the FSA as and when they investigate market failures that will be within striking range of the new powers.

⁷ 'Three million in the queue for compensation over PPI mis-selling', Guardian article by Patrick Collinson August 10, at www.guardian.co.uk/money

The specific redress scheme set up under the FSA 2010 may be only the first example of what may become typical further down the line in other areas, such as the environmental damage, pharmaceutical, and product liability sectors. Financial advisors and insurers would do well to look at these developments closely.

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