

Settlements and Private Litigation Policy Considerations from an Economic Perspective



INTERNATIONAL

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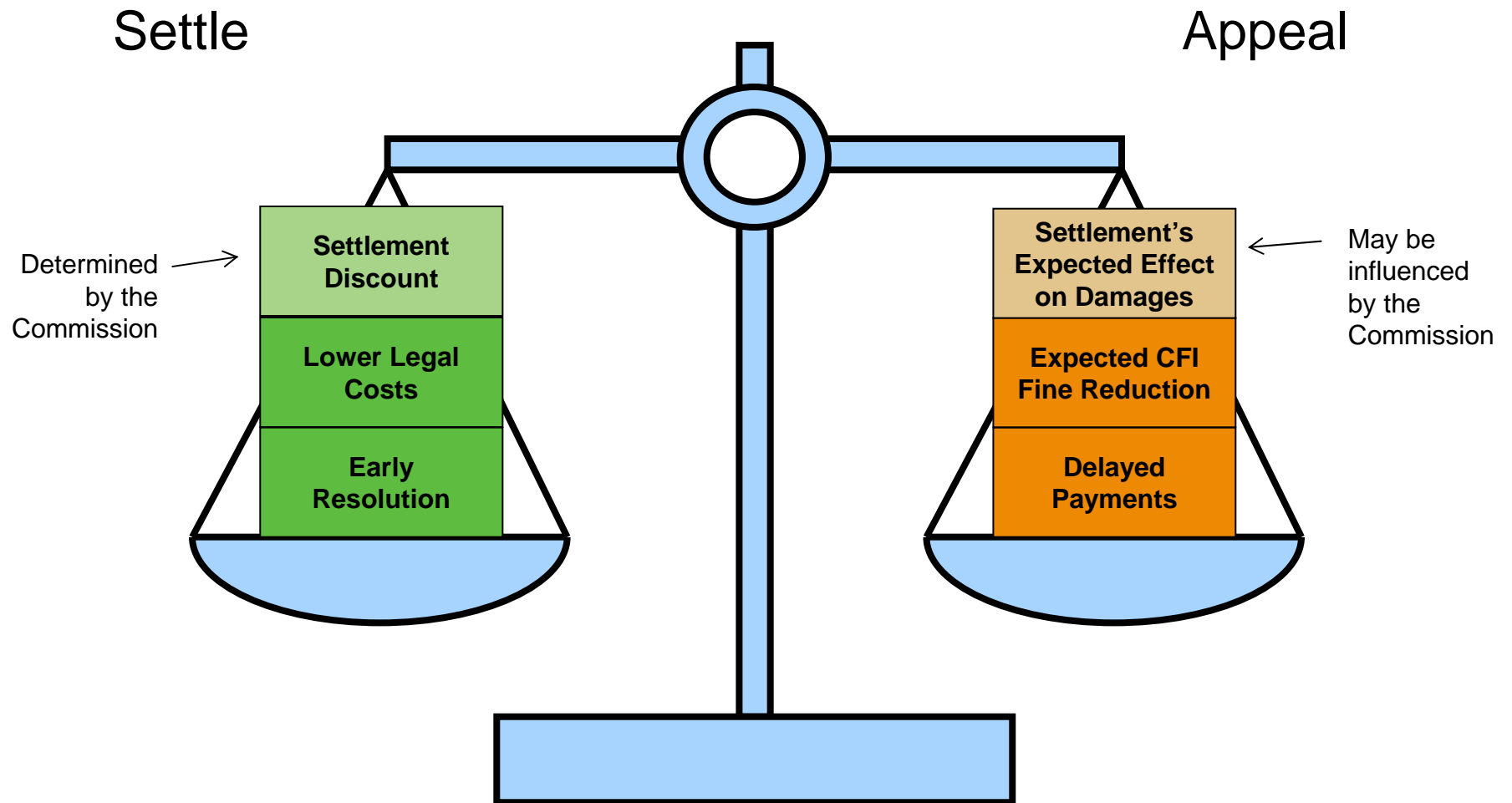
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Interaction between settlements and private litigation

- **Settlements of European Commission's cartel investigations bring forward and crystallize private actions**
- **Settlements may affect the amount of information available to plaintiffs**
 - May create formal and detailed 'admissions' of guilt
 - May reduce the public information created and disseminated by the Commission

Settlement Incentives – the firms' point of view



Settlement Incentives – an economic model

We can write down the expected profit from settling or appealing

Settle $\sigma = F(1 - \delta) + \left(\frac{1}{1+r}\right)^t D^e \left(\frac{1 + C_L + \varepsilon}{1 - \rho}\right)$

Appeal $\phi = F\left(1 - \frac{A^e}{1 + \rho}(1 - C_A)\right) + \left(\frac{1}{1+r}\right)^{T+t} D^e \left(\frac{1 + C_L}{1 - \rho}\right)$

We can then find the value of the settlement discount which would encourage a firm to settle, given its key characteristics (risk aversion, internal discount rate)

$$\delta^* = \underbrace{\frac{A^e(1 - C_A)}{(1 + \rho)}}_{\text{Effect of Expected Increase in Fines in the Commission's Action}} + \underbrace{\frac{D^e}{F(1 - \rho)} \varepsilon}_{\text{Effect of Expected Increase in Damages in Follow-on Private Actions}}$$

Minimum Necessary Settlement Discount

Illustration of the effect of private actions on a firm's incentive to settle

Discount Rate	Effect on Expected Damages	Minimum Required Discount	Effect of Expected Reduction in Fines	Effect of Expected Change in Damages
Impact of Increase in Discount Rate				
0%	0%	13.5%	13.5%	0.0%
3%	0%	29.5%	13.5%	16.0%
7%	0%	43.9%	13.5%	30.4%
Impact of Increase in Expected Damages				
3%	-10%	16.5%	13.5%	3.0%
3%	0%	29.5%	13.5%	16.0%
3%	10%	42.6%	13.5%	29.1%

- The higher the cost of capital to the firm, the higher the minimum required discount
- The higher the increase in damages from settling, the higher the minimum required discount
- Both these effects are driven by the timing of private actions

Conclusions

- **The values of the minimum required discount are calculated so to make the firm indifferent between settling or appealing**
 - This can be interpreted as the minimum required discount that preserve the firms' incentive to settle
 - By construction, the minimum required discount maintains the level of deterrence as that available before the introduction of the settlement process
- **This suggests that even relatively high values of the settlement discount may not necessarily affect deterrence**
- **Within this level of deterrence, by using the two instruments at his disposal (the settlement discount and the amount of information disseminated) the Commission can decide whether to have**
 - Higher fines (lower discounts) and less redress
 - Lower fines (higher discounts) and more redress