

ABA Antitrust Section | Global Private Litigation Committee

Global Private Litigation Bulletin



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Unpacking “pass-on” for EU’s national courts?

As our attention continues to focus on Europe’s emerging private litigation regimes, we watch as the national courts grapple with a host of challenging issues in the wake of the EC’s Damages Directive. One particularly important and complex issue is “pass-on.” The Damages Directive requires courts to estimate what share of an overcharge has been passed on to indirect purchasers, and yet—as U.S. practitioners know from decades of heated litigation on this topic—proving and refuting “pass-on” are no easy tasks and a “pass-on” finding can shape the outcome of a case.

We devote this issue to the EC’s first major step towards providing the national courts with some practical guidance on “pass-on.” The EC’s recently commissioned “*Study on the passing-on of overcharges*,” co-authored by RBB Economics and Cuatrecasas, Gonçalves Pereira, will help inform the EC as it prepares guidelines for the national courts on the topic of pass-on (which it plans to release in 2017-2018).

From their separate perspectives as a global economic group and an international law firm, the co-authors each describe the background and significant findings of the study, as well as thoughts for the future. Following their articles are six intriguing commentaries from leaders in all aspects of the competition law arena.

We hope you enjoy this issue as you head into the holidays. We also encourage you to reach out to us at any time if you have ideas or topics that you propose we explore in our upcoming Global Private Litigation Bulletins.

Sincerely yours,

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Paul Hitchings, Partner, Cuatrecasas, Gonçalves Pereira¹

Introduction

On 25 October 2016, the European Commission published the “*Study on the passing-on of overcharges*” co-authored by RBB Economics and Cuatrecasas, Gonçalves Pereira (the “Study”).² The Study, commissioned by the Commission in 2015, is intended to assist the European regulator in preparing guidelines for national courts on how to estimate the share of an overcharge which has been passed on to indirect purchasers,³ as required by Article 16 of Directive 2014/104/EU (the “Damages Directive”).⁴ It is expected that those guidelines will be published during the course of 2017 or 2018. Prior to their publication, the Commission is planning to carry out a series of workshops with judges, economists and legal practitioners and can be expected then to publish draft guidelines for consultation.

The Study includes an extensive analysis of current thinking on the topic of pass-on, a full review of national and EU case-law (as well as experience from the US), and an in-depth analysis of economic theory. The Study also sets out and evaluates alternative approaches to quantifying the impact of pass-on on damages claims. It concludes with “*39 Steps*”: a checklist providing practical recommendations for national courts, including on how to navigate and manage expert evidence and quantification methods, how to utilize new disclosure mechanisms introduced by the Damages Directive and how to avoid inconsistent decisions. It is thought that the Study will provide a key and useful touchstone for the forthcoming discussion on the Commission’s guidelines, as well as providing practical guidance that will be of particular help to judges as they develop the practice and doctrine in this nascent area.

Relevance of pass-on

It is a basic principle of EU law on civil damages for breach of competition law that any person who has suffered harm caused by a competition infringement may claim for that harm.⁵ This places the question of entitlement to sue and quantification of harm firmly in the sphere of the law of causation.⁶ Within this sphere, pass-on plays a crucial role.

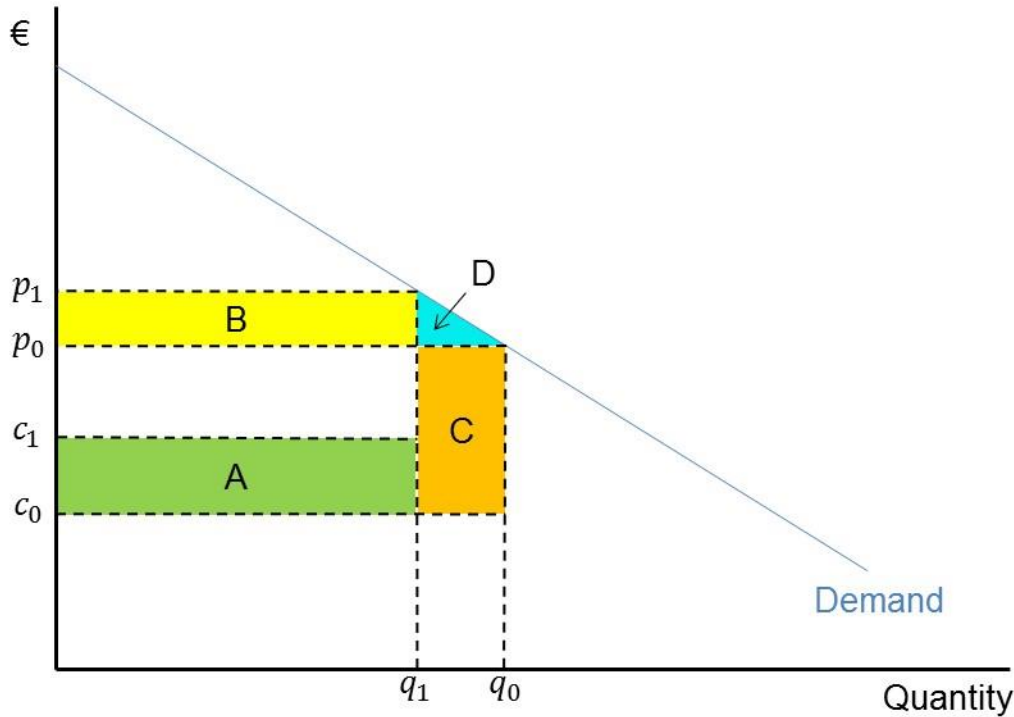
Pass-on may be invoked by an indirect purchaser in order to claim harm, which has allegedly been suffered as a result of overcharges on the purchases of products or services made by it from direct customers of the infringer or from companies which have incorporated goods affected by the infringement to their own products or services: pass-on as a “sword”. Alternatively, pass-on may be raised as a defence to claims for damages on the ground that the claimant has incorporated overcharges, or part of them, in its downstream prices of products or services, thus reducing its actual harm: pass-on as a “shield”.

Accordingly, the elements of the calculation of a damages claims in the EU where pass-on has occurred are three:

- A. First, there is an overcharge in products purchased by the claimant which have been affected by an infringement, such overcharge being either directly suffered by a direct purchaser or indirectly suffered by an indirect purchaser to whom the overcharge, or part of it, has been passed on.
- B. Second, the impact of the overcharge may have been reduced by the claimant passing on part or all of that overcharge in the prices it charges downstream.

- C. Third, the passing-on of the overcharge may have reduced sales by the claimant and therefore caused it a loss of profit.

These three elements are represented graphically below:⁷



Impact of an overcharge with two layers of downstream purchasers

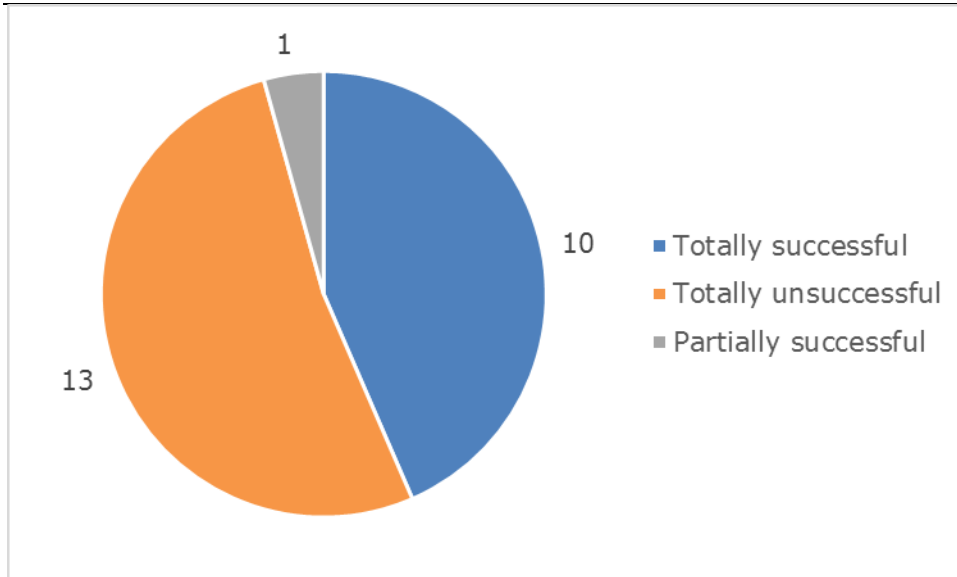
It is worth noting that it was the difficulty of determining the effects of pass-on in terms of increased prices (Area B) and loss of sales (Area C) which led the US Federal Court to reject the defence in its seminal judgment in *Hanover Shoe Inc v United Shoe Machinery Corporation*.⁸

Practice of EU national courts

Pass-on is frequently raised in antitrust damages claims in the EU and can potentially be key to the quantification of damages (or even to a party’s standing to claim). Nevertheless, it has not to date been determinative of many case outcomes and has seldom been subject to any detailed expert quantification.

In the majority of cases where the issue has been determinative of the outcome of the case, it has been raised as a defence. In more than half of those, the court rejected the pass-on defence entirely whereas in about 40% of the cases the court determined that the claimant had passed on the overcharge entirely.⁹ In one, 50% pass-on was held to have occurred (reducing the overcharge harm by half) and loss of profits was also quantified and awarded.¹⁰ We provide an overview of decided cases below:

Statistics on the success level of pass-on arguments



In the recent judgment of the Competition Appeal Tribunal in London in the Sainsbury's claim against MasterCard in relation to interchange fees, pass-on was a key element of the defence raised by the card platform.¹¹ The defence was, however, rejected by the court because MasterCard had, to its mind, been unable adequately to demonstrate the causal relationship between interchange fees and an increase in Sainsbury's product pricing (such that indirect purchaser actions further down the chain would be entitled to claim that harm):

485. It follows that MasterCard's pass-on defence must fail. No identifiable increase in retail price has been established, still less one that is causally connected with the UK MIF. Nor can MasterCard identify any purchaser or class of purchasers of Sainsbury's to whom the overcharge has been passed who would be in a position to claim damages.¹²

Interestingly, a huge collective consumer action has been launched before the same court which alleges, conversely, that card transaction overcharges have, in fact, ultimately been passed on to them in retail prices by retailers (such as Sainsbury's) to UK consumers.¹³ This is, accordingly, a clear case where pass-on will be critical to whether or not indirect purchaser actions will succeed and, if so, to what extent.

Pass-on has been raised in a number of further important cartel damages claims around the EU in recent years. These include the Spanish *Sugar Cartel* case which reached the Spanish Supreme Court in 2013. There, the highest Spanish court, adopting the approach of the Court of Justice of the European Union in its case-law on the reimbursement of unlawful taxes,¹⁴ rejected the defence *inter alia* because the defendants had been unable to show that the claimants would not have suffered some kind of harm (in particular, in the form of lost profits) even if pass-on had occurred.¹⁵ The German Supreme Court followed a similar approach in the *Carbonless Paper Cartel* case in Germany in 2011.¹⁶ France has tended to adopt a more favourable position to the pass-on defence by requiring plaintiffs to demonstrate that they did not pass-on the overcharge in order to make good their claim.¹⁷

Pass-on is also an important defence raised by the defendants in the *Gas Insulated Switchgear Cartel* claims currently being heard in the Netherlands, initially rejected at first instance,¹⁸ and since the subject of a number of rulings all the way up to the Dutch Supreme Court about the correct legal approach to pass-on under Dutch law.¹⁹ Finally, in the ongoing *Air Cargo Cartel* litigation in the UK the approach to disclosure in the context of

pass-on has met with some skepticism from the court. Specifically, Justice Rose has aired considerable concern about the potential cost and time that could be involved in carrying out the quantitative analysis of pass-on contemplated by the experts, as opposed to relying on other “factual” or “qualitative” evidence (such as testimony from price setters).²⁰

The Study’s in-depth description of legal practice, economic theory and economic quantification methods will no doubt be of use to practitioners and courts in future cases. At the same time, the Study sheds light on some important procedural issues and concepts related to managing and assessing economic and other types of evidence in the determination of pass-on and addressing the key question of causation under national law. These types of recommendations and guidance for judges are likely to become of increasing importance over the coming year as Member States implement the new Damages Directive and, *inter alia*, new *inter partes* disclosure rules.

Conclusion

The potential complexity of the determination of pass-on and the need for sensible and qualified scientific and legal analysis are almost certainly some of the key drivers behind the Commission’s wish to seek professional advice through the Study as well as to open up the forthcoming consultation process. It will be fascinating to see how the ensuing debate and court practice develops over the coming years in light, *inter alia*, of this work.

¹ Paul Hitchings led the team at Cuatrecasas, Gonçalves Pereira which co-authored the Study with RBB Economics and heads the firm’s Antitrust Damages Practice. The views set out in this article are, however, his own.

² http://ec.europa.eu/competition/publications/reports_en.html.

³ Indirect purchasers are defined in the Damages Directive as any person “*who acquired, not directly from an infringer, but from a direct purchaser or a subsequent purchaser, products or services that were the object of an infringement of competition law, or products or services containing them or derived therefrom*” (art. 2(24)).

⁴ <http://eur-lex.europa.eu/eli/dir/2014/104/oj>.

⁵ See to this effect judgments of the Court of Justice of the European Union in *Courage and Crehan*, C-453/99, EU:C:2001:465 and judgment in *Manfredi*, C-295/04, EU:C:2006:461. See also Article 3(1) of the Directive

⁶ It is national Member State law in the EU which, subject to principles of effectiveness of EU law, determines the rules of causation (and, indeed, standard of proof).

⁷ Reproduced with the kind permission of RBB Economics. Area D represents the deadweight loss, which refers to the reduction in consumption brought about by the passing-on of the overcharge causing an additional welfare loss for end customers.

⁸ 392 U.S. 481 (1968).

⁹ Note that, of the 10 cases in which pass-on was totally successful, 3 were cases of the French courts in which pass-on was raised as a defence and where the burden of proof was on the claimant to show that they had not passed on the overcharge (i.e. there was a reversal of the burden proposed by the Directive).

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- ¹⁰ Danish Maritime and Commercial Court, Case no. U-4-07, *Cheminova A/S v. Akzo Nobel Functional Chemicals BV and Akzo Nobel Base Chemicals AB*, judgment of 15 January 2015.
- ¹¹ http://www.catribunal.org.uk/files/1241T_Judgment_140716.pdf.
- ¹² MasterCard is seeking permission to appeal this judgment.
- ¹³ <http://www.catribunal.org.uk/237-9391/1266-7-7-16--Walter-Hugh-Merricks-CBE-.html>.
- ¹⁴ See *inter alia* judgment in *Ireks-Arkady v. Council and Commission*, C-238/78, EU:C:1979:226; judgment in *Just*, C-68/79, EU:C:1980:57; judgment in *Amministrazione delle finanze dello Stato v. San Giorgio*, C-199/82, EU:C:1983:318; judgment in *Bianco and Girard v. Directeur général des douanes and droits indirects*, C-331/85, EU:C:1988:97; judgment in *Comateb and Others v. Directeur général des douanes and droits indirects*, C-192/95, EU:C:1997:12; judgment in *Dilexport*, C-343/96, EU:C:1999:59; judgment in *Michailidis*, C-441/98, EU:C:2000:479; judgment in *Lady & Kid and Others*, C-398/09, EU:C:2011:540.
- ¹⁵ Spanish Supreme Court, Case No. 5819/2013, *Nestlé and ors v. Ebro Puleva*, judgment of 7 November 2013.
- ¹⁶ Federal Court of Justice, KZR 75/10, *German Carbonless Paper*, judgment of 28 June 2011.
- ¹⁷ Judgment of 16 February 2011 of the Appeals Court of Paris, Case No. 08/08727, *Le Gouessant v. Ajinomoto & CEVA*.
- ¹⁸ District Court of Gelderland, *TenneT v. Alstom*, judgment of 10 June 2015 (ECLI:NL:RBGEL:2015:3713).
- ¹⁹ Dutch Supreme Court, *TenneT v. ABB*, judgment of 8 July 2016 (ECLI:NL:HR:2016:1483).
- ²⁰ High Court of England & Wales, *Emerald Supplies v. British Airways Plc*, HC-2008-000002. Case Management Conference, hearing of 13 October 2015.

THE PASSING-ON OF OVERCHARGES: AN ECONOMIC PERSPECTIVE

*Benoît Durand and Iestyn Williams, Partners, RBB Economics*¹

Introduction

The *Study on the Passing-On of Overcharges* recently published by the European Commission is intended to provide judges, and other practitioners who are not economists, with practical guidance on obtaining and assessing economic evidence in relation to pass-on claims arising from competition law infringements.

The adverse impact of an infringement which increases a firm's costs may be reduced if that firm can pass on some or all of this overcharge to its own customers, by means of a price increase. Significantly, however, this "passing-on" effect will almost invariably cause the firm to lose sales volumes, together with the profit margins earned on those sales. Such passing-on will also lead to harm being transmitted further down the supply chain.

The overall harm suffered by a claimant can, therefore, be broken down into three elements: the overcharge, the passing-on effect, and the volume effect. The remainder of this article offers an overview of the economics of passing-on and the practical methods that can be used to quantify the passing-on and volume effects.

The economics of passing-on

Passing-on and the associated volume effects arise because of the incentives that a firm may have to respond to an increase in its costs with price increases of its own. Economics indicates that the strength of those incentives will depend on the type of costs that are affected, as well as on the market environment in which the affected firm operates. The more information that is available on the essential facts of the case at hand, therefore, the more accurate the guidance that economics can offer to courts on the magnitude of these effects.

Relevant cost effects

Economics suggests that it is only overcharges affecting a firm's avoidable costs which would normally be expected to influence its pricing decisions.² The extent to which costs are avoidable will tend to increase with the scale of any volume response to an increase in prices, as well as the timeframe involved.

To illustrate: suppose that the costs of leasing the machines needed to manufacture widgets are subject to an overcharge. This overcharge is not predicted to influence the manufacturer's pricing of widgets, however, unless it encourages a price increase/output reduction that is sufficient to allow a reduction in the number of machines used. Even then, the machine costs will only become avoidable when the existing leasing commitment expires.

At the same time, very small cost changes may have no impact on an affected firm's prices – at least not immediately. This could be because the firm in question would incur "menu" costs – i.e. adjustment expenses – whenever price is changed that would make a small price change unprofitable. Similar rigidities affecting output adjustments could also discourage small price changes, as could a desire to maintain €xx.99 price points, for example.³

The effects of competition

Economics also predicts that a firm's ability and incentive to pass on a cost-raising overcharge will depend on the intensity of the competition that it faces, and on whether its competitors are affected by the overcharge. Under textbook conditions of perfect competition and elastic supply (i.e. supply that is highly sensitive to even very small changes in price), 100% pass-on is predicted when an overcharge is 'industry-wide' and all competitors are similarly affected.⁴ Conversely, there will be no scope for any passing-on of overcharges that are specific to an individual firm in these conditions.

In practice, few markets, if any, are likely to conform to the economist's textbook notion of "perfect" competition, however. Where competition is imperfect, predicted pass-on for industry-wide overcharges can range from over 100% to substantially less than 100%, depending on the precise context. (Even a monopolist, may choose to absorb some part of an overcharge, implying a pass-on rate of less than 100%.) Economics also predicts that even if only one of a number of competitors is affected by the overcharge, i.e. it is firm-specific, that firm will (be able to) pass on at least part of it when competition is imperfect. However, the extent of this passing-on will typically be less than for industry-wide overcharges of the same magnitude.

In imperfectly competitive markets, one of the key factors that is predicted to determine the magnitude of the pass-on effect is whether customers' demands become more or less price sensitive as prices increase, i.e. the so-called curvature of demand. Significantly, this is typically not known in practice, so alternative empirical strategies (see below) will usually be required to estimate pass-on with any precision.

The implications of buyer power

In some market settings, buyer power acts as a constraint on the pricing behaviour of suppliers. It might be supposed, therefore, that this would automatically enable strong buyers on the downstream market to resist the passing-on of overcharges too. However, this does not follow.

Instead, economics predicts that outcomes will depend on how – exactly – the overcharge changes the parameters of the negotiations between the affected firm A and its customers. For example, if customers are so strong that negotiations result in prices which are anchored to firm A's costs, then substantial pass-on of any overcharges affecting those costs may be expected. On the other hand, suppose the price that a buyer secures from firm A is fixed by the option which that buyer has to purchase from firm B instead. In that case, the extent to which an overcharge that is specific to firm A is passed-on may be limited, as the option of switching to firm B is unaffected.

The expert economist can offer valuable insight into the likely extent of passing-on in practice by examining carefully the precise circumstances of the case at hand - notably the source of buyer power.

The relationship between passing-on and volume effects

The passing-on and volume effects will have opposing influences on the overall harm suffered by a claimant. Whilst the former will reduce damages, the latter will increase them. When the affected purchaser is a monopolist on the downstream market, economic analysis indicates that the volume effect will exceed the passing-on effect. A damages estimate based on a measure of the overcharge alone will then understate the harm caused. Put differently, invoking the passing-on defence will increase rather than decrease the estimated magnitude of the damages claim in this case.

Outside monopoly, however, the balance of the passing-on and volume effects in imperfectly competitive settings will also depend on the strategic interactions between competitors and can, in general, affect overall damages positively or negatively. The expert economist will have to evaluate this on a case-by-case basis, therefore, when estimating the overall effects of passing-on.

Quantifying the impact of pass-on

Economic methods provide a practical toolkit of ways to quantify the passing-on and volume effects. The reliability of the damages estimates obtained will depend primarily on the quality of the information (or data) that is available and the robustness of the assumptions made to obtain a particular estimate. The Study presents a number of approaches, focusing in particular on the quantitative techniques that are most likely to yield robust damages estimates.⁵ However, the costs and benefits of adopting more or less sophisticated approaches should always be considered, in particular when data are limited or when undertaking more sophisticated analyses could be disproportionate. In any event, sound economic analysis will take into account all available evidence, including documents and statements on how firms set prices, for example.

The Study focuses on methods for estimating the passing-on and volume effects separately. Experts may also calculate total damages in an integrated way, accounting simultaneously for the passing-on and the volume

effects. These holistic approaches may reduce data requirements, but typically at the expense of substantial additional assumptions, notably about the nature of competition.

Passing-on effects

The main challenge in quantifying the pass-on effect is to obtain an estimate of the price increase on the downstream market caused by the infringement. Doing so requires a measure of the counterfactual price that would have prevailed 'but for' the infringement. Where suitable data are available, comparator-based techniques – such as those familiar from the estimation of overcharges – can be deployed to estimate this price effect of passing-on directly. Candidate measures include the prices of the affected product before or after the infringement period (the “before/during/after” approach) and of the same or similar products in different geographies, that were not subject to the infringement (a “benchmarking” approach).⁶

The reliability of these methods depends in large part on the extent to which the effects of the infringement on price can be isolated from other influences. If sufficient data are available, regression analysis can be employed to control for confounding influences, which may otherwise distort the estimates of the passing-on effect obtained.

An estimate of the price increase arising from passing-on can also be obtained by multiplying the relevant overcharge (i.e. usually that affecting avoidable costs – see above) by a measure of the pass-on rate. This is the rate at which changes in costs are translated into changes in prices. A pass-on rate can be estimated where cost and price data are observable, including using multi-variable regression techniques. Evidence in respect of firm's pricing policies will also offer relevant insight.

Often the expert may have to rely on estimates of the pass-on rate obtained in a different set of circumstances. In this case, an important practical consideration is whether such estimates can provide an appropriate measure of the pass-on rate that is relevant to the case at hand. For example, pass-on rates might differ according to the scale of the cost changes concerned or according to the input that is affected. Particular issues arise when such pass-on rates are used to estimate the effects of (very small) overcharges that cannot be identified directly.

Volume effects

An estimate of the volume effect can be computed by multiplying the volume loss that results from passing on of the overcharge by the margin the purchaser would have earned on those sales 'but for' the infringement (i.e. the counterfactual margin).

If the expert already has an estimate of the pass-on effect on price, this can be combined with a measure of the elasticity (or price sensitivity) of demand for the product or service in question to obtain an estimate of the resulting volume loss.⁷

It is important to utilise an appropriate elasticity measure for this, however. When all firms in a market are affected similarly by an overcharge, economics suggests that a measure of the sensitivity (elasticity) of aggregate market demand to market-wide price changes is most likely to provide the best measure of the proportionate impact of the resulting passing-on on any one firm's sales. On the other hand, if the overcharge is firm-specific, a measure of the firm's own-price elasticity of demand, i.e. by how much its sales would fall if only its own price were to be increased, may provide a better starting point. In this case, however, the resulting estimate of the volume loss will not take account of the impact of competitors' reactions. Further adjustment may be warranted to allow for this. At the very least, the potential biases in the measure of the volume effect obtained in this case should be recognised.

Conclusions

Taking account of the passing-on and volume effects that result from an overcharge can have a material impact on the estimate of damages. Since these effects pull in opposite directions, the net effect may be to increase or to decrease the damages estimate. Economics offers useful insight into the factors which shape the magnitudes of those effects. It also provides a range of techniques to quantify their contribution to damages. To deliver reasonably precise damages estimates, careful consideration of the specific facts of a case is needed.

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- ¹ Benoît Durand is partner in Brussels and Paris, Iestyn Williams is partner in London. They are both co-authors of the European Commission Study on the Passing-on of Overcharges, together with a team of lawyers from Cuatrecasas, Gonçalves Pereira.
 - ² The trade-off between securing fewer sales at a higher price (and margin) and greater sales at a lower price will resolve itself in favour of higher prices/fewer sales when avoidable costs are increased.
 - ³ A firm is unlikely to find it attractive to raise prices from €5.99 to €6.99, say, in response to a unit cost increase of only a few cents.
 - ⁴ More generally, the extent of passing-on in the textbook perfectly competitive environment is predicted to depend on the relative price sensitivities (elasticities) of supply and demand, and can be less than 100%.
 - ⁵ For example, where detailed data analysis has been conducted, statistical measures of the potential margins of error associated with the estimated parameters of interest can be obtained.
 - ⁶ A combination of these two techniques (a so-called “difference-in-differences” approach) may yield more robust results.
 - ⁷ Alternatively, comparator-based techniques can be deployed to obtain direct estimates of the volume loss.

PASS-ON: TOGETHER ECONOMISTS AND LAWYERS REALLY DO HAVE THE ANSWERS

Robin Noble and Gunnar Niels, Partners, Oxera

The RBB and Cuatrecasas study provides a thorough review of the economics of passing-on of overcharges and the related issue of volume effects.¹ This study adds to the existing guidance from the Commission on antitrust damages, published in 2014, which followed a report by Oxera and an international team of lawyers.²

These publications show that, working together, legal practitioners and economists have the potential to provide answers to the key questions arising when quantifying damages. The new study makes plain that pass-on is usually a matter of degree: in many real world situations pass-on is unlikely to occur completely (100% pass-on) or not at all (0% pass-on), and instead lies part-way between the two. This matters, because in some debates pass-on has been regarded as something that either did or did not happen, which can lead one to focus on these two extreme outcomes.

The RBB and Cuatrecasas study addresses most of the elements that one needs to consider when analysing passing-on in a case. It starts with the core economic foundations: did the overcharge affect all rivals in an industry? (If it did, then pass-on is more likely, as all firms factor it into their pricing.) How competitive is the industry? (The more competitive, the more likely there is pass-on, since prices have been driven down close to costs already.) The next step after the theory is usually the analysis of data, perhaps a statistical analysis of input costs and output prices. The study guides readers through the options available (though it could perhaps have said more about what to make of factual and business information on how prices are set in practice). Finally, the study addresses practical ways to synthesise background information, witness testimony, and economic analysis, into a coherent final view on the available information.

In seeking to provide this practical guidance, the study makes an oblique reference to a famous novel by John Buchan, 'The Thirty-Nine Steps' (1915). There are some parallels. The book is focused on tensions between the UK and Germany, and is a roller-coaster ride with thrills and spills along the way. The study, while perhaps not having the pace of the novel and having 2.5 times more pages, lures in the reader with an accessible summary and introduction to the basics. As its many examples highlight, there are sometimes tensions between the precedents in different jurisdictions, including the UK and Germany, and others such as France and Spain. For example, in France a claimant is often required to demonstrate that it did not pass on the overcharge, while courts in Spain and Germany place more burden on the defendant.

Buchan's 'The Thirty-Nine Steps' was the start of a five-book series. The RBB and Cuatrecasas study is certainly an exciting next instalment in a series of publications that should give courts and practitioners greater clarity in damages claims. If the instalment after this one is going to be the Commission's own guidance on pass-on, one might prefer a checklist that has fewer than 39 steps in it. Perhaps one inspired by book four in Buchan's series: 'The Three Hostages'?

¹ RBB and Cuatrecasas (2016), 'Study on the passing-on of overcharges', prepared for the European Commission, October.

² European Commission (2013), 'Commission Staff Working Document: Practical Guide; Quantifying Harm in Actions for Damages Based on Breaches of Article 101 or 102 of TFEU', June. Oxera and a multijurisdictional team of lawyers led by Dr Assimakis Komninos (2009), 'Quantifying antitrust damages: Towards non-binding guidance for courts', report for the European Commission, December.

REFLECTIONS ON THE EU PASS-ON STUDY

Jon Lawrence, Partner, Freshfields Brukhaus Deringer LLP

I congratulate the authors of this extensive and comprehensive study. It is, in my view, a valuable introduction to the law and economics of pass-on, particularly for those who are not already familiar with the area.

As such, I would recommend the study as a guide to anyone in the profession seeking to obtain a working understanding of the core concepts and technical terminology that they will encounter in advising in connection with antitrust damages claims involving pass-on issues. The study addresses – and seeks to explain in simple terms – some of the basic concepts and some concepts that are intuitively less obvious, such as the impact of downstream buyer power on the assessment of likely pass-on levels, the relationship between pass-on and volume effect claims, and the advantages and disadvantages of various economic and econometric

methods of estimating pass-on. These matters are explained clearly and aptly and, in a number of cases, in a relatively novel fashion that should help to focus future discussion and debate.

The authors of the study should also be commended for avoiding the temptation to reach conclusions about the 'best' method for estimating pass-on or to give a 'rule of thumb' for the likely level of pass-on in particular cases. Instead, the study explores in a neutral fashion the various arguments and methods that judges may encounter in practice and recognises that pass-on must be estimated on a case-by-case basis depending on the facts of each case. This approach is sensible and welcomed.

Without wishing to be critical, it could be said that the study emphasises, perhaps unduly, the role of economic analysis, and does not provide enough guidance on the types of factual issues and evidence that are necessary to an understanding of the level of pass-on in any given case. Indeed, while the study acknowledges that precedent and factual evidence (as well as economic evidence) are all potential sources, the weight of the analysis and focus of the study is on the various economic approaches. In practice, it is documentary evidence that most often drives the assessment of pass-on, because such evidence is required properly to understand the market and dynamics at play at different levels of the supply chain. Economic evidence is, and should be, used to test the credibility of the factual pass-on evidence and the inferences drawn – but it is sometimes no more than a cross-check. The study should not be understood as endorsing any view that the economic analysis can be a substitute for a detailed analysis of the facts.

The real value and impact of the study will turn on its application in practice. It will have to be looked at in conjunction with the pass-on Guidance to be produced by the Commission. It will be particularly interesting to see the interaction of the study and Guidance with Member States' implementation of the Damages Directive's provisions relating to pass-on. It will also be informative to see whether any Member States seek to find a way of avoiding over-compensation at different levels of the supply chain and in judgments in more than one Member State. This is one area relating to pass-on that is not addressed in detail in the study – perhaps understandably. It would have been inventive for the study to try to resolve what appears to be an insuperable practical problem for the national legislatures in Europe – but it perhaps wisely stayed away!

THE RBB/CUATRECASAS STUDY ON PASSING-ON OF OVERCHARGES

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The report provides a useful and comprehensive explanation of the relevant principles for competition litigators and the judiciary to consider when approaching the issue of pass-on. As the Report highlights, the question of pass-on is a complex question and may involve a combination of factual evidence, economic principles and empirical analysis. Key in each case will be to find an appropriate approach based on the data which is available and the proportionality of the exercise in order to reach a sufficiently reliable way for the court to estimate the damage. The following issues identified in the Report are, we believe, likely to be key, based on our practical experience.

1. The court's task is to find an approach by which it can reach a sufficient view on which to estimate the damage.
2. Economic theory can provide a helpful starting point to any analysis, but must be overlaid by an understanding of the industry context, buyer power and facts of the particular case, as to whether economic assumptions are consistent. Experience shows that the discussion between economist and

client witness on economic theory -v- commercial reality can produce some diametrically differing views.

3. Qualitative evidence may be helpful in understanding how prices were set, particularly where empirical data is not available or may be considered disproportionate and/or unlikely to provide meaningful results. This is subject to 2 caveats:
 - (a) the extent to which whether such pricing policy documents exist; and
 - (b) whether in practice policies were in fact followed. As the Report acknowledges existence of policy does not mean mechanical application in practice, and witness evidence is likely also to be key;
4. The Report describes the various empirical techniques which can be used to analyse pass-on. As noted, key to their utility will be 3 factors:
 - (a) the availability of sufficient data to perform a meaningful analysis – as the Report acknowledges even large/sophisticated clients will often not retain the historic sales records needed for such analysis (and particularly in circumstances where they were not, of course, aware of the cartel/future claim and later need for this data);
 - (b) the proportionality and utility of such data analysis in terms of the collection of data, analysis and reliability of results. Appropriate use of sampling, targeted disclosure and early liaison between economic experts is key to ensuring data requests and subsequent analysis are appropriately targeted and useful. The staged approach recommended in paragraphs 462 to 467 of the Report may often be sensible; and
 - (c) the relevance of the results to the period affected by the cartel and other factors which might affect the price – as the Report notes, apparent correlation of cost and prices does not automatically support evidence of pass-on, where other factors might explain the causal link, which need to be excluded.
5. The Report also notes the relatively limited claims which have been pursued to date for volume effects. The clear acknowledgement of the relationship between pass-on and volume effects in the Report should help strengthen the position of claimants pursuing volume effect claims, which we might expect to see increase.

A question of law, fact or economics?

The Report understandably focuses in considerable detail on the economic principles on pass-on and the empirical analysis which it may be possible to carry out, where appropriate data is available.

Key however is to consider how the relevant test will be approached by the court. Is pass-on to be approached from a legal, factual or economic standpoint – all of which may lead to differing results. The Report notes the approach taken on this issue by the European Courts, approaching pass-on as *“a question of fact to be determined by the national court on the basis of a free assessment of the evidence adduced before it following an economic analysis in which all the relevant circumstances are taken into account”*.

As the Report concludes at paragraph 469, however, it is ultimately a question for the court as a matter of its national legal framework and rules on causation to determine whether there is pass-on as a matter of law, which may differ from the economist’s view.

This is aptly illustrated by the recent Judgment by the UK Competition Appeal Tribunal in July 2016 in the claim by Sainsbury’s against Mastercard, which was awaited at the time of writing of the Report. In paragraph 484(4) of the Judgment, the CAT noted that the notion of pass-on *“simply reflects the need to ensure that a claimant is sufficiently compensated, and not over-compensated, by a defendant.”* It then went on to note that whilst the notion of passing-on of a cost is a very familiar one to an economist, an economist is

concerned with how an enterprise recovers its costs, where a lawyer is concerned with whether a specific claim is not well-founded. The Tribunal found that the legal definition of a pass-on cost differed from that of an economist in two respects:

- (a) That whilst an economist might well define pass-on more widely (i.e. to include cost savings and reduced expenditure), the pass-on defence is only concerned with identifiable increases in prices by a firm to its customers; and
- (b) The increase in price must be causally connected with the overcharge and demonstrably so.

At the time of writing, there is a pending request for permission to appeal the Judgment. However, it usefully illustrates the importance of considering how a court will approach pass-on as a matter of law and ensuring that the factual and economic evidence is targeted to that test, and the potential this leaves for variation in approaches at national level.

Management of multiple actions at different points in the supply chain

Finally, the Report notes the requirement of courts under the Damages Directive to consider the consistency of judgments where there are multiple claims by claimants at different levels of the supply chain, and consider the potential co-ordination of parallel actions. This is likely to prove a challenge as the directive aims to encourage and facilitate claims being brought in all EU members states, in particular in avoiding undue delays to proceedings where claims may be brought at different stage throughout a 5 year limitation period.

PASSING-ON STUDY

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The question of whether or not an overcharge caused by a cartel infringement has been passed on to the indirect customers of the cartel(s) is one of the current “hottest topics” in cartel damage litigation in many Member States. This is, in particular, true for Germany, where the Supreme Court ruled in 2011 on the indirect customers’ possibility to claim for damages (“pass-on as a sword”) and on the admissibility of the passing-on defence (“pass-on as a shield”). Thus the passing-on question is already one of the most crucial practical issues in cartel damage litigation and arguably among the most complex questions, from a legal as well as from an economic point of view.

In light of Chapter IV of the Antitrust Damages Directive 2014/104/EU, one can expect the passing-on issue to become even more significant in the future. Similar to the German Supreme Court ruling referenced above, the Directive states, on the one hand, that compensation of harm can be claimed by anyone who has suffered it, irrespective of whether they purchased directly or indirectly from an infringer. The burden of proving the existence and scope of such a passing-on shall rest with the claimant, who may reasonably require disclosure from the defendant or from third parties. In this context the directive establishes a legal presumption of passing-on for indirect purchasers (provided certain conditions are met). The Directive further provides that national courts should be able to estimate the share of the overcharge that has been passed on. On the other hand, the Directive establishes the passing-on defence and thus allows as a defence against a claim for damages the fact that the claimant passed on the whole or part of the overcharge resulting from the infringement of competition law. The burden of proving that the overcharge was passed on shall be on the

defendant, who may reasonably require disclosure from the claimant or from third parties. Regarding the passing-on defence, the Directive does not establish a presumption comparable to that described above.

The “Study on the Passing-on of Overcharges” published by the European Commission and co-authored by Cuatrecasas, Gonçalves Pereira and RBB Economics is an excellent starting point for dealing with the difficult passing-on questions, especially regarding obtaining and assessing economic evidence re passing-on. Thus, the study will certainly provide a useful touchstone for the upcoming discussion on the Commission’s guidelines. Since national courts have, to date, had only limited or - in some Member States - no experience at all with passing-on questions, it is of utmost importance to concentrate on the main points of the already complex passing-on issue. To live up to the “mission” expressed in Article 16 of the Antitrust Damages Directive of issuing guidelines for national courts, it seems advisable, if not necessary, to focus the comprehensive 315-page study and the “39-step” checklist for the judges on the most important issues in order to make a practical guideline available for the judges and other third parties who usually are not economic experts. If the level of complexity of the Study cannot be further reduced, it will run the risk of not being used very widely and intensively by judges, who will only be able to devote a limited amount of time so such questions in light of their workload. Also, one might lament that the Study does not develop solutions for the numerous (conflicting (?)) presumptions provided for in this context by the Antitrust Damages Directive which may prove hard to handle in practice. But it must be conceded that this was not the intention of the Study in the first place.

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COMMENT ON THE STUDY ON THE PASSING-ON OF OVERCHARGES

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Contrary to the situation at US federal level, the right of indirect purchasers to claim for damages and the availability of the passing-on defence have been key issues of Private Enforcement in the EU and are explicitly recognised in the Antitrust Damages Directive 2014/104/EU (the ‘Directive’). The Directive is due to be implemented by the Member States by 27 December 2016. Against this backdrop the recently published ‘Study on the Passing-on of Overcharges’ (‘the Study’) provides for a welcomed comprehensive compilation of the legal and economic fundamentals of this complex topic. The Study complements an earlier study on the quantification of antitrust damages published in 2009.

While the Study is an important first step, there still remains a long way for the development of a consistent approach by courts to the question of passing-on in Europe. In this respect the summary of the existing case law of the CJEU in the Study is of particular importance. Even if not applied in the context of antitrust damage claims, the CJEU has developed key principles which provide guidance for national courts on the assessment of passing-on such as the need for a direct causal connection between the infringement and the price increase in the downstream market, the need to assess whether any pass-on of overcharges is offset by countervailing volume effects, and the absence of a general pass-on presumption. Given that the Directive is aimed at guaranteeing the fundamental right of effective compensation provided by Art. 101 and 102, this part of the Study seems a good starting point for the development of a consistent EU-wide case law in this field.

It is also clear from the Study that it will be difficult to converge the economic and legal approach to the question of pass-on. This is evident from the careful collection and description of the national case law and confirmed by the recent judgment of the UK Competition Appeal Tribunal in *Sainsbury's v Mastercard* which unfortunately could not anymore be included in the Study. In line with the approach of other courts such as the German Federal Court of Justice (*ORWI*) and the Dutch Supreme Court (*TenneT v ABB*), the CAT made a distinction between the 'economic' and the 'legal' concept of pass-on. While the former is based on economic theory applied to the relevant markets in the case at hand, the latter is a less technical approach which is based on the requirements of causality and reasonableness. In this respect, the disincentive to bring damage claims from more remote levels in the supply chain and thus the lack of a risk of multiple liability, can be weighed against the risk of foregone liability of the infringer. This approach is mirrored in Art. 12 of the Damages Directive leaving judges with discretion to take decisions which take account of the overall effects of an infringement and make sure that the pass-on defence does not result in the unjust enrichment of the infringer. Inadvertently, laying out the economic mechanics of passing on in such detail – culminating in a 39-step 'practical guide' for judges – the Study may foster the emergence of such more pragmatic decisions based on legal principles. While it remains uncertain, whether direct purchasers will successfully employ a holistic approach to obtain full compensation, defending claims with a sequential passing on analysis will certainly put significant strain on national courts' often limited personnel, technical and financial resources.

One aspect that would have deserved some more attention is the application of the pass-on analysis in the context of collective actions and parallel actions brought across various supply chain levels. An example how courts may deal with such situations is the judgment of the Supreme Court of Canada in *Pro-Sys Consultants v Microsoft* which recognised that direct and indirect purchasers can all form part of the same class, while excluding the passing-on defence under reference to the Roman law principle of *nullus commodum capere potest de injuria sua propria* (no advantage may be gained from one's own wrong). Given the multi-jurisdictional environment of the EU, the establishment of central registers for all damage actions relating to infringements of Art. 101 or 102 TFEU at national and EU-level would be a welcomed first step to assist national judges avoid the risk of multiple liability by parallel actions across different market levels.

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THE EU PASSING-ON STUDY: SOME COMMENTS

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The study on the *Passing-on of overcharges in the context of damages claims for the infringement of competition law* provides an in depth analysis and a stimulating synthesis of the economic and legal questions raised by the difficult task of evaluating the passing on of overcharges, in particular in the context of a passing on defence. Article 14(2) of the EU Damages Directive puts in place a rebuttable presumption of causality exclusively for the benefit of indirect purchasers, but does not provide for an equivalent presumption when passing-on is used as a shield by a defendant in order to mitigate the damages claim brought by a direct purchaser. Harm is also defined narrowly as only referring to the higher prices paid as a result of the anticompetitive conduct (the overcharge), without the Directive making any reference to other types of harm that may result from an anticompetitive exercise of market power, such as a reduction of consumer choice or reduction of innovation or quality, which do not benefit from equivalent causal presumptions as Article 14(2) for indirect purchasers¹. Either used as a sword by indirect purchasers, or a shield by a defendant, passing on

aims to ensure that a claimant is sufficiently compensated, and not over-compensated, by a defendant and that the defendant is not forced to pay more than compensatory damages, this principle being justified by the corrective justice approach taken by the EU Damages Directive.

As it is highlighted in the Study, passing on claims may stumble in the legal requirement of causation, the UK Competition Appeal Tribunal remarking in its recent *Sainsbury's* judgment that in complex business selling multiple product lines in a competitive environment it is “impossible” to say what proportion of the cost incurred because of the overcharge was passed on “(i) in the form of higher prices to the indirect consumers or (ii) paid out of cost-savings or (iii) paid for by reducing expenditure and so service levels”². This is an important issue as the law is only interested in the first type of passing on, the overcharge. Analysing these claims often involves the consideration of complex economic and other technical evidence, because of the fundamental uncertainty in view of the complexity of the commercial environment and the multiple factors influencing markets. As the CAT highlighted in *Sainsbury's* when discussing the possibility of a passing on defence, “(i)n order to be relevant as a benefit to be taken into account in the assessment of damages, that benefit must bear some relation to the damage suffered by the claimant as a result of the breach [...] (u)nless that relationship exists, the benefit is a collateral one”³. Although the Study does not examine in depth the issue of causation, which, with the exception of the causal presumptions put in place for indirect purchasers, is not directly covered by the Directive and is essentially a matter of national law, it provides a critical discussion of the challenges judges usually face with regard to establishment of the causal link.

As the authors of the Study explain, a lot of evidence on which such claims will rely upon are predictions on the basis of economic theory (and economic models) establishing a “credible range” of passing on and the impact that it has on the damages resulting from the overcharge. The way judges in Europe will engage with this economic evidence is a matter of speculation. There are various judicial traditions in Europe with regard to the admissibility and assessment of economic expertise and the organisation of the experts’ evidence submission process⁴. The concepts and tests for causation in use by the different tort law systems of the EU Member States also vary, some jurisdictions relying on individualizing theories of causation, such as equivalence of conditions and NESS, while others are inspired by generalizing theories of causation, such as the theory of adequate cause or systems of causal proportional liability, such as loss of a chance or ‘loss of opportunity’⁵. New ways to assess economic expert evidence, such as the hot tub or concurrent evidence are also making their way into the European courtrooms and rules on civil procedure⁶. All in all, the brave new world of the EU Damages Directive is full of challenges and exciting developments, an important aspect of which is the passing on of overcharges. The authors of the recently published study on passing on should be commended for a concise and illuminating presentation of the various issues raised by these developments.

¹ Damages Directive, recitals 39, 43.

² *Sainsbury's Supermarkets Ltd & Mastercard Inc. and others*, [2016] CAT 11, para. 465.

³ *Sainsbury's Supermarkets Ltd & Mastercard Inc. and others*, [2016] CAT 11, para.475.

⁴ For a detailed analysis, see I. Lianos, ‘Judging economists’: Economic Expertise in Competition Law Litigation: A European View, in I. Lianos & I. Kokkoris, *The Reform of EC Competition Law: New Challenges* (Kluwer, 2010), Chapter 10.

⁵ For a discussion in depth of legal causation and the various approaches used in different Member States, see I. Lianos, *Causal Uncertainty and Damages Claims for the Infringement of Competition Law in Europe*, *Yearbook of European Law*, (2015), pp. 1–62; I. Lianos, P. Davis & P. Nebbia, *Damages Claims for the Infringement of EU Competition Law* (OUP, 2015), Chapters 4 & 5.

⁶ See, Practise Direction 35 (para 11.1), following the Jackson review, supplementing the UK Civil Procedure rules.

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