

Inside The EU's Overcharge Pass-On Study

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On Oct. 25, 2016, the European Commission released a “Study on the Passing-on of Overcharges” after a year-long evaluation and input process. The study will help judges, regulators and practitioners critically evaluate pass-on claims in European competition cases through both legal and economic lenses. The detailed 315-page report highlights the increasingly important role of pass-on in the EU, and compares EU law concerning pass-on with other jurisdictions, including the United States. This article gives an overview of the study’s results and predicts the effects of increasing pass-on litigation in the EU.

The EU’s new Antitrust Damages Directive (2014/104) provides for full compensation to anyone harmed by anti-competitive conduct, including direct and all levels of indirect purchasers. To determine each claimant’s portion of total damages, European national courts will be required to engage in pass-on analyses when the issue is raised by the parties. Robust and accurate pass-on analysis has many benefits. First, pass-on can help avoid double recovery for claimants and prevent defendants from paying more than total market damages, something that occurs with increased frequency in the United States. Second, it can allow a more accurate quantification of harm and avoid unmerited rejections of claims. And third, it can facilitate indirect purchaser claims which, while permitted under EU law, have been less common than direct actions.



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The Study

The commission’s study is broken down into five main sections: (1) a comparative analysis of the laws governing pass-on; (2) pass-on economic theory; (3) estimating pass-on using quantitative and qualitative analyses; (4) guidance for judges on analyzing complex pass-on evidence; and (5) a checklist that is meant to help judges analyze pass-on issues. The study’s discussion of lost sales as a component of a claimant’s actual damages is outside the scope of this article.

Pass-On Law

The study compares EU law governing pass-on with national court decisions and U.S. law. The study finds that European national law has focused primarily on defensive pass-on, and the underlying analyses have not always been applied in a systematic or sophisticated manner. Out of the 24 cases surveyed where pass-on was determinative, ten resulted in a complete victory for the defendant (court

determined that all overcharges were passed on), 13 resulted in complete victory for the claimant (none of the overcharge was passed on), and only one court found a 50 percent pass-on rate. Jurisprudence in the U.S. typically does not recognize defensive pass-on, but has developed substantial case law and economic studies on offensive pass-on — expertise which may be influential in the EU.

Economic Theory

The study lays out the economic theory underlying pass-on. Many factors can influence the pass-on rate, including:

- Whether the overcharge is industrywide or firm-specific — an overcharge that affects one firm is less likely to be passed on than an industrywide overcharge;
- Cost effects — an overcharge that affects fixed costs is less likely to be passed on than an overcharge that affects variable costs;
- Intensity and nature of competition in the market — imperfect competition and differentiated goods could result in lower pass-on rates for industrywide overcharges;
- Buying power — power buyers may be able to negate pass-on of an overcharge, but this will depend on the circumstances; and
- Entry and exit of competitors — results can be mixed.

The study notes that economic theory is generally not conclusive and a fact-specific quantitative inquiry is often necessary to estimate pass-on with sufficient precision.

Calculating Pass-On

The study describes various approaches to calculating pass-on, their data requirements and data collection mechanisms, and the challenges to estimating pass-on rates. Pass-on can be estimated using quantitative techniques, like multivariate regression analyses, which require cost and price data. If data is limited or not available, experts may rely on other evidence of pass-on, like internal documents, the firm's pricing policy, statements of industry participants, witness testimony, testimony of industry experts, and other pass-on studies. Suffice it to say, calculating pass-on can be a complex endeavor that requires an economic expert to analyze a substantial amount of data.

Guidance for Judges

The study provides guidance to European courts on how to analyze pass-on evidence. The study suggests that courts look holistically at all types of pass-on evidence, including quantitative and qualitative studies, in the full context of the case. The study recognizes that pass-on analysis is a data-heavy endeavor and courts will have to balance the burden of disclosure with a party's need for reliable data. An approach narrower than typical U.S. discovery is proposed, where judges first determine whether pass-on likely occurred, parties submit a disclosure proposal, the scope of disclosure is further limited by sampling and staggered disclosures, and judges actively manage the process throughout.

In terms of weighing expert evidence, judges should understand and critically evaluate the experts'

assumptions and methodologies — a tall order for judges that may have little or no economic training. For cases with complex pass-on issues, judges may want to consider appointing an independent expert, requesting a primer or economic tutorial, or allowing expert cross-examination or “hot tubbing” (experts presenting and critiquing each other’s evidence simultaneously).

Importantly, the study addresses steps courts can take to avoid over- or under-compensating claimants in parallel proceedings pursuant to the Antitrust Damages Directive’s goal to have consistent rulings where there are multiple claims at different levels in the supply chain. It is important to avoid situations where a defendant escapes all liability by arguing that a direct purchaser passed on the entire overcharge in one proceeding, but that an overcharge was not passed on to the indirect purchaser in another proceeding. It is equally important to avoid situations where a defendant pays double (or even triple) damages by losing its defensive and offensive pass-on arguments — e.g., where direct purchasers claim that they absorbed the entire overcharge while indirect purchasers argue complete pass-on. As the study observes, the reality may be somewhere in the middle, and judges must attempt to accurately attribute the overcharge to the various claimants.

Pass-On Checklist

Judges will have to synthesize massive amounts of information to assess pass-on effectively, and will often rely heavily on expert opinions (whether court-appointed or party experts). To that end, the study sets out a 39-point check list for judges summarizing findings on actively managing expert witness evidence, understanding competing quantitative methodologies, and ensuring consistent judicial decisions.

Some Predictions for the Future of Pass-On in the EU

There is no question that pass-on will become increasingly important in Europe given the Antitrust Damages Directive’s goal of fair apportionment of true damages. Indeed, pass-on is already playing an important role in the ongoing MasterCard and Air Cargo litigations.

The directive’s express provision of full compensation to anyone harmed by an anti-competitive act will likely increase the number of cases brought, especially by indirect purchasers. As more (and more complex) cases make their way through European courts, we expect to see increasingly sophisticated and knowledgeable court decisions on pass-on. We would expect there to be less truly binary outcomes — i.e., complete wins for defendants or claimants finding complete or no pass-on, as has been the trend until now — and more nuanced results that reflect the true realities of the markets.

Because the economics of pass-on tends to be highly fact-dependent and complex, judges will have to be creative in the way they trace and apportion damages, which will undoubtedly result in competing decisions. Such conflicts will be reconciled through review by higher courts, as is common in the United States. As more courts grapple with pass-on, better case law will emerge.

The use of economic experts also will increase, as experts will be instrumental in helping judges calculate overcharges and trace those overcharges down potentially complex supply chains. Economic analyses will likely become more advanced and precise as more cases are decided in the EU. Judges will have to understand the data needs of the experts early in the case to effectively manage the disclosure process. We may even see European judges requesting economics tutorials, expert “hot tubbing,” or other methods suggested in the study. Although U.S. judges often have been slow to adopt these techniques, engaging with dense economic material early and often can lead to better understanding of

pass-on.

This study will serve as a guidepost in the development of European pass-on jurisprudence, and it is expected that the European Commission will use the study to help prepare formal guidelines for national courts to use on pass-on issues in the near future.

The study on the passing on of overcharges was co-authored by the commission's external consultants, Paul Hitchings and his team at Cuatrecasas, Goncalves Pereira SLP, and Benoit Durand and Iestyn Williams and their team at RBB Economics LLP, in collaboration with numerous regional lawyers and experts.

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DISCLOSURE: Michael Scarborough and Nadezhda Nikonova provided research and consultation on U.S. antitrust law issues for the study discussed in this article.

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