Response by Linklaters LLP to the European Commission's consultation on draft guidelines on how to estimate the share of cartel overcharges passed on to indirect purchasers and final consumers

1 Introduction

1.1 Linklaters welcomes the opportunity to comment on the draft guidelines of the Commission on the estimation of the share of cartel overcharges passed on to indirect purchasers and final consumers (the "**Draft Guidelines**"). The Commission is right to address the topic of pass-on in view of the complexity of the issue and the uncertainties to which it gives rise in practice.

1.2 Some national courts have considered the appropriate methods for assessing pass-on and have, understandably, struggled to reach definitive conclusions in this regard. By way of example, this issue received recent judicial consideration by the English Court of Appeal, which concluded that "…*in each case it is a matter for the judge to decide whether, on the evidence before her or him, the defendant can show that there is a sufficiently close causal connection between an overcharge and an increase in the direct purchaser's price. We see no reason why that increase should not be established by a combination of empirical fact and economic opinion evidence. It is not appropriate for us on these appeals to be more specific as to the nature and type of evidence capable of satisfying a trial judge that there is a sufficiently close causal connection.*"[1] While the flexibility of the English Court of Appeal is to be welcomed in view of the fact that the appropriate analysis will to some extent vary in each case, the general guidance proposed by the Commission will be of assistance to the courts of Member States in reducing the scope for disputes between litigants regarding the appropriate methodology.

1.3 In view of the substantial role that economic analysis has in the context of assessing pass-on, Linklaters has worked with Analysis Group in producing this response to the Draft Guidelines. For the avoidance of doubt, there is no institutional or preferential link between Linklaters and Analysis Group, who remain entirely independent of each other.

1.4 For convenience, we have adopted the defined terms used in the Draft Guidelines unless stated otherwise.

2 Theoretical models and empirical assessments

2.1 There is a substantial body of **microeconomic theory** that underlies the pass-on of cartel overcharges. This theory generally predicts that, in cases of perfect competition, most of the overcharge could be passed on to downstream purchasers. In cases of monopoly, theoretical results are not as clear-cut. A monopolist could pass on anywhere between a small proportion and more than 100% of the overcharge. The more the situation differs from these two opposites, the more theory is ambiguous about the level of pass-on.

2.2 Economic theory about pass-on does not do much more than formalise a common sense principle: in the long run, businesses have to cover their costs in order to survive. In the context of perfect competition, where businesses barely cover their cost to generate the

[1] *Sainsbury's Supermarkets Ltd v Mastercard Inc* [2018] EWCA Civ 1536 at §332.

lowest liveable level of profits, any cost increase ultimately has to be passed on - hence the well-known assumption of '100%' pass-on in perfect competition.

2.3 Furthermore, basic economic theory has limited answers to provide when important fixed costs are present. Basic economic models are mostly about *marginal* costs. Yet to survive, businesses have to cover their *total* costs. This reality leads to practical managerial rules that may diverge from economic theory.

2.4 Also, distribution chains are complex and often overlap. Finished goods can end up in the final consumer's hands through many different channels. Figuring out what channel a given good took can be sometimes impossible, making the determination of the exact allocation of the pass-on across the different levels of the distribution chain impossible.

2.5 The Draft Guidelines **underestimate the complexity** of the types of cases we are seeing in front of national courts. The illustration in paragraphs 6 to 8 suggest very simple market structures with simple supply chains from copper manufacturers down to end consumers purchasing personal cars containing automotive parts with wire harnesses made of higher-priced copper. In practice, most cases do not provide such simple structures and require consideration of the issue of pass-on in the context of more complex distribution chains. Although the use of simplified examples is understandable, the guidelines should also stress that market structures can in practice be very different from the illustration. Absent this statement, the guidelines may lead to over-simplifications (e.g. suggesting that pass-on could usually be traced down from the supplier of raw material to the end consumer of the final product) or have only limited impact in practice.

> *It is therefore suggested that Section 1.2 of the Draft Guidelines is supplemented to mention that, in practice, market structures and distribution chains can be much more complex than the illustration and that it can be difficult or impossible to track pass-on through all levels of the distribution chain and to allocate the pass-on properly across the different levels of the distribution chain. That does not, however, mean that pass-on has not occurred and each case will need to be considered on the basis of its facts and the relevant economic analyses.*

2.6 Besides, while microeconomic models provide insightful intuitions and yield accurate results, they rely on a number of **assumptions** regarding demand, supply, and cost functions, among other things, to determine the level of pass-on. All these important elements vary from case to case and may be difficult to measure accurately. This is why theoretical models, which may be helpful to understand the factors at play when estimating the level of pass-on, are often complex to apply in a standardised way in order to reach definitive conclusions, and barely tractable to work with in practice. Unfortunately, the abundant economic literature on the level of pass-on in imperfect competition settings does not provide general principles or results that can immediately be used to get a sense of the level of pass-on in actual case situations.

2.7 The objective should therefore be to apply empirical methods that are (i) scientifically robust, (ii) appropriate to the case in question, and (iii) simple enough to be applied using available data.

> *It is suggested that Section 2.4 of the Draft Guidelines is supplemented to mention that national courts should perform their role to provide a best estimate of the amount or share of pass-on by applying empirical methods that are scientifically robust, appropriate to the case in question and simple enough to be applied using available data.*

2.8 **On the scope of application**, the Draft Guidelines make it clear that they are applicable to cartel overcharges. However, they may also be applicable in other circumstances:

- Umbrella effect, when collusive practices lead to the prices of all substitute products on the market becoming inflated, and not only those of cartel members (paragraph 118);
- Lingering effect, when collusive practices lead to market prices remaining inflated after the end of collusive practices (paragraph 121).

3 Confining the legal presumptions to their proper role

3.1 On the legal regime, paragraphs 11 to 18 of the Draft Guidelines rightly stress that the question of pass-on is one of the issues that must be addressed within the legal framework of the **quantification of harm** caused by cartel infringements. It is one of the various debates that may arise in order to define exactly which harm a person has suffered because of an infringement of EU competition law. Only that harm must be compensated pursuant to the person's right to claim full compensation. The legal regime and the guidelines on pass-on must therefore be coherent with the Damages Directive and the Practical Guide on quantifying harm in competition damages claims. Comments and theories that are specific to pass-on should be kept to a minimum in order to avoid creating inconsistencies within the regime of private enforcement actions.

3.2 Paragraphs 19 to 26 tend to **overestimate the role of legal presumptions** and of rules on the burden of proof. These paragraphs indeed suggest that the presumptions in Article 14 of the Damages Directive should be used as starting points for the analysis of national courts on pass-on, *i.e.* that the courts should first decide whether one of these presumptions applies, and should it be the case, only check whether the party bearing the burden of proof manages to rebut the presumption. This would imply that only one of the parties provides all documents and analysis that are available. Such a regime would not be balanced, would not guarantee a fair application of the principle of full compensation and would not be compatible with how legal presumptions operate in front of national courts.

3.3 The rules on the burden of proof are rather meant to operate as a fall-back position for national courts. They enable the courts to decide when there is no (or not enough) evidence available to form a view on the question of pass-on. In other words, these rules allocate the risk of having all parties submitting no or not enough evidence. Only in a situation where the courts find that the evidence submitted by all parties does not enable them to decide whether (part of) the overcharge was passed on, the courts must apply the legal presumptions and decide accordingly that (some) pass-on occurred (in case of claim by an indirect purchaser) or did not occur (in case of claim by a direct purchaser) according to the applicable presumption.

3.4 The Draft Guidelines also contain very little on how a defendant may actually be able to rebut these legal presumptions, which suggests tipping the scale in favour of claimants if presumptions are excessively relied on. As the legal presumptions in Article 14(1) and 14(2) of the Damages Directive operate in opposite ways depending on whether pass-on is raised as a "shield" against the claim of a direct purchaser or as a "sword" in favour of a claim of an indirect purchaser, there is also a significant risk of conflicting judgments leading to overcompensation if such presumptions are not kept to their proper role of fall-back positions in case of no or insufficient evidence.

3.5 These presumptions are also only effective to decide whether there is pass-on or not; they are of no use to quantify the amount or share of pass-on. On quantification, courts must use their power to estimate as explained in Section 4 below.

> *For these reasons, it is suggested that Sections 2.2 and 2.3 of the Draft Guidelines are supplemented to mention that national courts must examine the evidence submitted by all parties and if necessary request the submission of additional evidence. Only if the courts find that the evidence submitted by all parties does not enable them to decide whether (part of) the overcharge was passed on, must the courts apply the legal presumptions provided by national legislation implementing Article 14 of the Damages Directive. These presumptions are also only effective to decide whether there is pass-on or not; they are of no use to quantify the amount or share of pass-on.*

3.6 Similarly, national courts should also not overestimate the role of general assumptions provided by economic theory. They often oversimplify the complexity of the question of pass-on and do not provide the same conclusive evidence as empirical assessments, as mentioned in Section 2 above.

3.7 As mentioned in paragraphs 62 to 64 of the Draft Guidelines, the **infringement** is the starting point of the analysis on the counterfactual and on the potential overcharge and its pass-on. One should stress that the infringement decisions of the European Commission and the National Competition Authorities often do not include the information that is necessary to estimate potential damages. As an example, where competition authorities sanction bid-rigging cartels because they had the objective of inflating the prices, these infringement decisions do not exclude that such bid-rigging cartel may lead to no overcharge when one non-cartelist candidate can bring the prices down to the competitive level[2].

3.8 In addition, as the Draft Guidelines rightly point out, the actual impact of collusive practices may differ from those suggested by legal evidence. Nonetheless, it is important that, to the extent possible, economists should try to reconcile what they observe empirically with the facts of the case, as reflected in the qualitative evidence at their disposal.

3.9 One may regret that the decisions of the competition authorities have a binding effect only with regard to the infringement period, so that debates may continue on the length of such period within the framework of damages actions (as is recognised by paragraph 120 of the Draft Guidelines). However, this issue is governed by Regulation No. 1/2003 and is therefore beyond the scope of the Draft Guidelines.

4 Choosing between different types of economic analyses

4.1 As already mentioned in Section 2 above, the objective of national courts should be to apply empirical methods that are scientifically robust, appropriate to the case in question and simple enough to be applied using available data. The well-known and widely used methods (e.g., before/after estimators, difference-in-difference, matching or structural models) are the same as those that are used to estimate cartel overcharges.

4.2 These empirical methods are designed to identify causal links (as opposed to correlation) between two variables (such as a cartel period on the one hand and prices on the other hand). This is why they are particularly well adapted to assess damages, which requires

[2] Oxera, *Quantifying antitruct damages – Towards non-binding guidance for courts. Study prepared for the European Commission*, December 2009, page 15.

providing evidence of a causal impact of the infringement. Each of these methods is based on what is called an "**identification assumption**". If this assumption is satisfied, the result obtained when applying the method is the causal impact of the first variable on the second one. For instance, the underlying identification assumption of the during/after estimator, which consists in comparing, in a cartel damages claim, prices during and after the cartel, is that, absent the alleged wrongful behaviour, prices during the cartel would have been equal to or commensurate with what is observed after the end of the cartel. These identification assumptions are of the utmost importance when computing the quantum of pass-on. Indeed, as mentioned above, distribution chains are complex and often overlap. Therefore, many other variables, other than the cartel, may explain price fluctuations all along the vertical chain.

4.3 On the method, we agree that the first step should be for the relevant court to consider whether it is plausible that there is overcharge and pass-on. This first step is relevant not only in the case of a claim by a direct purchaser (where pass-on is raised as a 'shield') but also in a claim by an indirect purchaser (where pass-on is used as a 'sword').

> *It is suggested that paragraph 77 of the Draft Guidelines is supplemented to make it explicit that the plausibility check is relevant in both claims from direct and indirect purchasers. It should also be made clear that judgments cannot rely only on plausibility of pass-on. If pass-on is plausible, courts must check whether the evidence available actually supports the claim that (part of) the overcharge was passed on by the purchasers.*

4.4 As noted in paragraph 70 of the Draft Guidelines, a reasonable and proportionate examination of the available factual evidence prior to undertaking any econometric analysis can have the benefit of guiding the court as to whether such an econometric analysis is reasonable and proportionate in the case in question.

4.5 By way of example, in a highly commoditised business which operates with low margins and prices its goods on a cost-plus-margin basis, a court may take the view that a detailed econometric analysis would be inappropriate and that either the court already has sufficient information to reach a robust decision on pass-on, or that the kind of "indirect" analysis described in section 4.3.2 of the Draft Guidelines may be appropriate.

4.6 As such, we suggest that national courts should be encouraged to exercise their powers to order proportionate disclosure of relevant factual documents prior to the parties undertaking substantial work in assessing pass-on, with a view to determining how that assessment should be undertaken.

4.7 The exercise of such powers is a more straightforward matter regarding questions of down-stream pass-on, where the disclosing party will be the claimant. Regarding questions of up-stream pass-on, national courts would generally need to order disclosure from one or more third parties – this naturally raises further issues regarding proportionality and reasonableness, and may not be within the powers of some national courts.

4.8 As the Draft Guidelines rightly point out at paragraphs 66 and 89, instances where competing experts have adopted different approaches to assessing pass-on can create significant difficulties for national courts. In our experience, encouraging experts to agree the approach they will take in advance of any analysis being undertaken can therefore be of material benefit, both because this limits the scope for the court to be presented with different analyses reaching different conclusions on different bases, and because it reduces the

scope for experts to alter their methodology as their analysis progresses in order to produce a given result (whether consciously or unconsciously).

4.9 We recognise that it will often be difficult to get competing experts to agree on every aspect of their methodology. However, the use of "agree/disagree statements", in which a number of key parameters for the competing analyses are set out and the experts record their respective positions on each parameter, can help in narrowing the scope for future disputes regarding the appropriate methodology.

Analysis of lay evidence vs expert economic evidence

4.10 The Draft Guidelines provide a useful summary of some of the economic concepts applicable to the assessment of pass-on. However, in our view, they would benefit from further discussion regarding the role of lay evidence[3] and, in particular, the relationship between economic analysis and analysis of that lay evidence.

4.11 Over the last few years, national courts have been asked to consider whether an economic analysis of the type discussed in detail in the Draft Guidelines is to be preferred over analysis of the lay evidence[4].

4.12 Different sources of lay evidence can vary significantly in their evidential value. For example, industry reports based on aggregated commercial data are generally of relatively significant evidential value whereas more speculative information such as projections produced for management purposes should be treated with greater scepticism by national courts.

4.13 It may be that the lay evidence available to the relevant national court is sufficient for the court to determine any issues relating to pass-on. This may be an attractive option in circumstances where there are a large number of claimants bringing claims collectively and producing a detailed econometric analysis for each of them would be expensive and cumbersome.

4.14 However, in our view, the temptation to rely solely on such analyses should be resisted unless this is clearly an appropriate approach in the circumstances.

4.15 The problem with reliance solely upon analyses of the lay evidence is that they ignore the actual relationship between a cartel overcharge and the level of pass-on, which may not be reflective of the pricing policies of a given business. For example, while a business may have specific pricing guidelines or may use contracts with customers which provide for prices to be determined on a particular basis, the commercial reality is often more complicated, particularly in markets where buyers have significant power.

4.16 As such, the most robust approach to assessing pass-on is, in our view, to undertake some degree of analysis of the lay evidence in order to provide a hypothesis that can then be tested using economic analysis or statistical techniques such as regression analysis. The lay evidence can also often provide helpful explanatory factors when produced alongside an econometric analysis.

It is suggested that Section 4.2 of the Draft Guidelines is supplemented to further discuss the role of lay evidence and the relationship between economic analysis and

[3] We use "lay evidence" to refer to, for example, (i) relevant contemporaneous documents such as board minutes, contracts with customers, and pricing policies, and (ii) written and/or oral evidence from individuals with personal experience of the matters at issue in the case. This type of evidence is referred to under various names across the EU but, by way of example, is referred to as "factual evidence" in the UK.

[4] See, for example, paragraph 1.2 above.

analysis of that lay evidence. It should be stressed that national courts should not rely solely on lay evidence unless this is clearly an appropriate approach in the circumstances. Relying solely upon analysis of such evidence creates a significant risk that the actual relationship between a cartel overcharge and the consequent change in a claimant's prices is ignored. As best practice, the outcome of any analysis of lay evidence should generally be tested using economic analysis or statistical techniques.

Direct vs indirect economic analyses

4.17 We agree with the position expressed in paragraph 124 of the Draft Guidelines, namely that "*the direct method is preferable when it is feasible and proportionate to implement. This is due to the method's clear advantage of allowing for an estimation of pass-on based on the actual prices set by a direct or indirect purchaser during the infringement period.*"

4.18 As well as having this profound advantage, a comparator-based approach has the advantage of being efficacious at any level of the supply chain, as noted in paragraph 167 of the Practical Guide.

4.19 Comparator-based approaches are already favoured in many national courts precisely because they provide the highest assurance that the results of the analysis will accord with the real position, thereby limiting the risk of overcompensation or undercompensation[5].

4.20 However, the production of a reliable comparator-based analysis is dependent on the availability of a sufficient volume of high quality data. As such, national courts must exercise their powers to order disclosure of relevant data by claimants (and also, where relevant powers are available, by third parties) insofar as it is proportionate and reasonable to do so in a given case, subject to all necessary protection of commercially sensitive data.

4.21 It is often the case that there are gaps in the data available regarding pass-on. In order to conduct a comparator-based approach in respect of periods for which no data is available, methods of estimating the relevant data are often employed. Where possible, experts should endeavour to agree how such gaps are to be dealt with and, in particular, how any estimation should be carried out. In the absence of agreement, national courts should be encouraged to scrutinise the methods used carefully.

4.22 A common criticism of comparator-based analyses is that they are expensive. With regard to the position expressed in paragraph 69 of the Draft Guidelines (namely that "[i]*f the…costs are too high this may render practically impossible or excessively difficult to exercise the right to full compensation*"), we are concerned that national courts which are relatively unfamiliar with competition damages cases and the powers provided to them pursuant to the Damages Directive may unduly impede exercise of the right to full compensation and of the rights of defence as a result of the costs of undertaking robust economic analyses. Such arguments regarding costs should not be allowed to justify breaches of the rights of defence. If the defendant in a direct purchaser claim makes a plausible argument of pass-on, this argument must be investigated even if it leads to higher costs of the proceedings. The most important criteria for assessing the proportionality of the investigation of pass-on are (i) access to the relevant data and (ii) the protection of confidential, commercially sensitive data.

[5] J-F. Laborde, *Cartel damages claims in Europe: How courts have assessed overcharges*, Concurrences No. 1-2007, pp. 36-42.

We therefore respectfully suggest that paragraph 69 of the Draft Guidelines is amended so that national courts are urged to exercise caution in declining a comparator-based approach on grounds of cost.

4.23 If courts apply "safety discounts" as is considered in paragraph 115 of the Draft Guidelines, such discounts should always work in favour of the defendant, in order to take account of the uncertainties of the estimate. In order to avoid the risk of overcompensation, the defendant should never be ordered to pay a higher amount of damages based on such uncertainties. This means that if pass-on to indirect purchasers is uncertain, safety discounts must reduce the share of pass-on in a claim from an indirect purchaser (pass-on used as a 'sword'), but must increase the share of pass-on in a claim from a direct purchaser (pass-on used as a 'shield').

4.24 Courts must also make sure that safety discounts are applied in a coherent way, especially in case of multiple claims from purchasers at the same level of the supply chain. In this situation, different discount rates are possible if they are justified by different facts. In case of claims from purchasers at different levels of the supply chain, cumulative discounts are only possible if they are factually justified.

It is suggested that paragraph 115 of the Draft Guidelines is supplemented to state that safety discounts must always be applied in favour of the defendant and in a coherent way, especially in case of multiple claims from purchasers at the same or at different levels of the supply chain.

5 Volume effects

5.1 Although taking into consideration volume effects is valid in principle, one should note that there is little precedent on quantification of volume effects of pass-on in the context of cartels. Nonetheless, the fact that there are few precedents does not mean that the volume effect is not legitimate. From an economic point of view, it is clear that demand should generally be diminished when prices are artificially inflated, leading to lower sales volumes and potentially lower profit for the intermediate seller.

5.2 Like overcharges and pass-on, volume effects can be estimated using econometric models. The quantification of volume effects requires more analysis and data than the quantification of the overcharge and pass-on. It also requires making additional assumptions and may therefore be more subject to debate. The volume effect should be derived from the estimation of the overcharge and of the pass-on through an empirical model based on the price elasticity of demand and the competitive structure of the downstream market.

5.3 Hence, the estimation of volume effects will face the same challenges as those described for the estimation of the pass-on: multiple layers of intermediaries and potentially overlapping distribution channels.

5.4 Furthermore, the volume effect should take into consideration a number of additional aspects that the Draft Guidelines do not allude to, including most notably:

- Capacity constraints. For example, the intermediate purchaser of a cartelised product may not be in a position to produce additional units of a good that incorporates the product, especially in a growing market. Alternatively, it may have to invest to produce these units, which would cause the net present value of but-for incremental profits to drop.

- Economies or diseconomies of scale. For example, the intermediate purchaser of a cartelised product may benefit from economies (or diseconomies) of scale that would decrease (or increase) the production cost of the good that incorporates the product for each additional unit of the product, resulting in the margin on the additional units being higher (or lower).

It is therefore suggested that Section 4.4 of the Draft Guidelines is completed to note that there is little precedent on quantification of volume effects of pass-on in the context of cartels. The assessment of the volume effect should also take into consideration a number of additional aspects such as capacity constraints and economies or diseconomies of scale.

6 Collective actions

6.1 We note that the Draft Guidelines do not expressly refer to whether or not, and if so to what extent, they are intended to apply in the context of collective actions. In view of the increasing prevalence of collective actions in the context of competition law infringements, we would welcome comments from the Commission on this subject.

6.2 In particular, we note that strict approaches to the assessment of pass-on may make class-certification harder to achieve because purchasers at the same level of the supply chain may nonetheless be in different situations regarding pass-on (for example, because they operate very different business and/or pricing models) and may accordingly require different approaches to assessment.

Linklaters LLP with the assistance of Analysis Group

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