

ESTIMATING PASS-ON

Response to the consultation on the EC's draft guidelines

Economic Insight | October 2018



Economic Insight is pleased to respond to the EC's draft guidelines for national courts on how to estimate the share of overcharge passed on to indirect purchasers and final consumers (the "Draft Pass-on Guidelines") published on 5 July 2018.¹

We welcome the publication of the *Draft Pass-on Guidelines*, which provide a comprehensive and practical guide to estimating the damages to indirect purchasers and final consumers arising from the passing-on of overcharges in the context of Article 101 infringements.² Of the issues that the *Draft Pass-on Guidelines* raise, we consider the following to be especially important:

- the detail provided on a range of available techniques, as it is important that courts are aware of their advantages and disadvantages in particular circumstances;
- the clarifications provided with respect to the use of qualitative evidence, especially as this can very effectively complement quantitative techniques;
- the consideration given to the nature of costs (for example whether they are fixed or variable) when assessing pass-on; and
- the Commission's advice on the use of experts and the need to ensure proportionality.

In addition, we think that it would be helpful for the Commission to provide more detail on the following topics:

- how courts should decide between techniques for the estimation of pass-on that accord better with economic theory, and those that are a better match for available data;
- what 'holistic' approaches to the estimation of pass-on look like in practice, and when they should be used;
- the relationship between economic theory and empirical evidence, and the circumstances in which it is appropriate to lean more on one than the other;

¹ [Guidelines for national courts on how to estimate the share of overcharge which was passed on to the indirect purchaser](#). European Commission (2018).

² While the *Practical Guide on quantifying harm in actions for damages based on breaches of Article 101 or 102 TFEU (the "Practical Guide")* briefly deals with passing-on, this topic is sufficiently important that it merits the more detailed discussion set out in the *Draft Pass-on Guidelines*. ([Staff Working Document – Practical Guide on Quantifying Harm in Actions for damages based on breaches of Article 101 or 102 of the Treaty of the Functioning of the European Union](#). European Commission (2013), paragraphs 161-171.)

- how qualitative and quantitative evidence can complement one another;
- the rationale for the use of safety discounts, especially in view of the need to avoid both under- and over-compensation;
- the relationship between fixed costs and the extent and timing of any pass-on; and
- illustrative examples of successful and proportionate disclosure from third parties, in order to better inform the court of the costs and benefits of this possibility.

1. Techniques for the estimation of pass-on

We welcome the consideration given in the *Draft Pass-on Guidelines* to a wide range of techniques for the estimation of pass-on, in addition to exposition of their advantages and disadvantages. This is of benefit to courts in understanding the options for estimating pass-on, and the circumstances in which particular techniques are most appropriate, including accounting for practical considerations regarding data availability.

An issue that courts are likely to encounter is that, in some circumstances, some of the available techniques will accord better with economic theory, while others will be a better match with available data. In such circumstances, courts will need to weigh up the relative importance of the theoretical and practical benefits of different techniques. It would be helpful for the guidelines to include additional detail on how courts should weigh up techniques' advantages and disadvantages of in such circumstances.

In our view, the technique used to assess pass-on should be driven by the available data. As such, we would tend to favour techniques that accorded better with available data, rather than use a technique that was theoretically more appropriate but did not actually fit with the circumstances at hand. Where there would be significant gains in precision from using the more theoretically appropriate technique, this could suggest that it would be proportionate to require more data to be collected.

2. Holistic approaches to pass-on estimation

While they are treated separately for the most part, the *Draft Pass-on Guidelines* raise the possibility of using a 'holistic approach' to assessing pass-on price and volume effects. **We think that it would be helpful to provide more detail as to how holistic approaches would work in practice, their advantages and disadvantages, and when it would be appropriate to use them in place of a sequential approach to damages estimation.**

One possible holistic approach to estimate pass-on price and volume effects would involve the simultaneous assessment of the firm's optimal price and quantity choices. This could be, for example, through an econometric approach that accounted for supply and demand systems, such as three-stage least squares. Such an approach would provide theoretical rigour, but would place strong demands on the data, and would therefore, only be appropriate when a rigorous dataset could feasibly be assembled without prohibitive cost. In our experience, however, the demands such analysis place on the data generally mean that it is not feasible.

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IN OUR EXPERIENCE, HOLISTIC APPROACHES TO PASS-ON AND VOLUME EFFECTS ARE UNLIKELY TO BE FEASIBLE.

3. Balance of theory and empirical evidence

It would be helpful for the Commission to set out more guidance on the appropriate balance between economic theory and empirical evidence. In many circumstances, there is a tension between what theory suggests and what empirical evidence shows. In other situations, there may be question as to the extent to which one can rely on theory without significant empirical backing, in order to avoid expensive disclosure requirements.

‘To invoke economic theory ... it is important to provide empirical backing to show that the underlying assumptions are sound ...’

This is, in our view, a complex matter. Economic models rest on a range of simplifying assumptions, which may or may not be appropriate to particular situations. To invoke economic theory, we consider that it is important to provide empirical backing to show both that the underlying assumptions are sound, and that the economic model in question does not omit any important features of the relevant market.

4. Use of qualitative evidence

We welcome the clarifications provided in the *Draft Pass-on Guidelines* with respect to the use of qualitative evidence to support analysis of pass-on. This includes the statement that “*internal documents or other documents of a qualitative nature produced by the direct or indirect purchaser regarding the relationship between the overcharge and changes its own price*” may be used as evidence on pass-on.³ It also includes the examples of cases in which national courts have taken qualitative evidence into consideration when assessing pass-on.⁴

QUALITATIVE EVIDENCE SHOULD BE USED TO SHAPE QUANTITATIVE ANALYSIS.

In addition, **we suggest that the Commission should provide additional detail as to how qualitative and quantitative evidence should be used together to develop the most robust possible estimate of damages.** In our experience, it is imperative to use qualitative evidence to shape quantitative analysis so that it is grounded in business realities. In addition, we also consider that internal documents should be used to confirm the findings of any quantitative analysis. We strongly encourage the use of both qualitative and quantitative evidence *in combination* in all circumstances when estimating damages.

5. Nature of costs

The *Draft Pass-on Guidelines* helpfully emphasise that, as per economic theory, one important determinant of whether an input cost increase will be passed on is the nature of the cost, i.e. whether the cost itself is variable or not.⁵ By ‘variable’ we mean that the cost increases with the firm’s output, and therefore has an impact on the firm’s pricing decisions in the short run (because the firm needs to spend more to produce more). In view of this, the *Draft Pass-on Guidelines* note that fixed costs will probably not be passed on in the short run.⁶

We think that there is value in providing a more developed discussion of the relationship between the nature of costs and both the extent and timing of pass-on. This would involve discussion of the following points.

First, it would set out that the distinction between variable and fixed costs is often a matter of degree – for example, when costs are ‘lumpy’ and only change with

³ [Draft Pass-on Guidelines, paragraph 70.](#)

⁴ [Draft Pass-on Guidelines, paragraph 114, boxes 6 and 7.](#)

⁵ [Draft Pass-on Guidelines, paragraph 45.](#)

⁶ [Draft Pass-on Guidelines, paragraph 46.](#)

sufficiently large changes in the firm's output. In such circumstances, care will need to be taken to characterise the relevant cost correctly to establish how much was, in fact, passed on.

FIXED COSTS CAN AFFECT PRICING DECISIONS IN THE LONG RUN.

Secondly, as the *Draft Pass-on Guidelines* note, fixed costs can affect pricing decisions in the long run. This is because all costs will be taken into account when firms make strategic decisions about factors such as production capacity, which then also affect pricing decisions.⁷ It would be helpful for the guidelines to bring out that the implication of this is that, when assessing damages over a longer timeframe, it is necessary to consider whether fixed as well as variable costs were passed on. For example, where an overcharge took place over a long timeframe, it may be appropriate to assume some degree of pass-on of fixed costs later in the period.

6. Use of safety discounts

The *Draft Pass-on Guidelines* note that courts have sometimes applied 'safety discounts' when estimating overcharges, to take account of uncertainty when using comparator-based methods.⁸ **We think that it would be beneficial to provide more detail on the rationale for safety discounts, and the circumstances in which it would be appropriate to apply them.**

The stated aim of safety discounts is to 'take account of uncertainties in the estimate'. Discounting overcharge estimates suggests that the concern is that the estimate is too high. In principle, however, uncertainty applies in both directions around an estimate. When applying safety discounts, therefore, one should take account of the risks of both over- and under-compensation. As such, safety discounts would only appear to be appropriate where there are good reasons to expect that the overcharge had been *overestimated* and where this cannot be corrected by changes in methodology.

Further, courts will often be presented with two estimates, one from the claimant and one from the defendant. In these circumstances, it is unclear which estimate safety discounts should be applied to, if at all. We therefore think that it is difficult to envisage circumstances in which it would be appropriate to apply safety discounts.

7. Proportionality and the use of experts

We welcome that the guidelines highlight the importance of proportionality when considering which techniques to use in damages estimation. Trade-offs between the robustness of any analysis and its cost are inherent, and the practical guide will motivate courts to achieve the right balance between the two.

In this context, we also welcome the Commission's advice on the use and engagement of different experts, especially as this is an important way to arrive at estimates in the most proportionate manner. The examples in which economic experts enter into early discussions to narrow down areas of agreement and disagreement on relevant issues, and of courts appointing their own experts, show how expert advice can be used to achieve proportionate outcomes.

In addition, it is likely that there will continue to be areas of disagreement between experts as to whether or not it is proportionate to undertake particular types of analysis. It would be helpful for the Commission to set out the issues that courts

'It is difficult to envisage circumstances in which it would be appropriate to apply safety discounts to damages estimates.'

⁷ *Draft Pass-on Guidelines*, footnote 44.

⁸ *Draft Pass-on Guidelines*, paragraph 115.

should consider when deciding between conflicting expert evidence. In our experience, relevant considerations include the extent to which certain techniques rely on very specific data, the collection of which has the potential to be more complicated than first expected, and the level of uncertainty around the gain in precision from using a more complicated technique.

8. Disclosure from third parties

We are pleased that the *Draft Pass-on Guidelines* consider the need for and availability of disclosure arrangements from third parties. This is especially pertinent in claims from indirect suppliers, which may have to rely largely on data on business practices of interim suppliers (i.e. the infringer's direct customers).

In this context, it would be useful if the Commission could include illustrative examples of successful and proportionate disclosure from third parties in the *Draft Pass-on Guidelines*. For instance, it would be helpful to understand the practicalities of the processes (i.e., things to consider in requesting the disclosure, experts to be included in the confidentiality rings, etc.) as well as data that was in fact, made available (understandably, this will depend on the case but some indication of what can be largely expected would be helpful). This could help courts more helpfully identify situations in which requesting such disclosure could be beneficial to the case. In fact, identifying some instances where it wasn't the case is also helpful.

9. Concluding remarks

Economic Insight welcomes the EC's consultation on the *Draft Pass-on Guidelines* and we hope that this note provides helpful comments on these.

We look forward to contributing further in the future.

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