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Private damages claims: questions relating to the passing-on defence

Recent developments in European and national competition law are leading to a clarification of the circumstances under which damages can be claimed. A particularly important question is whether defendants can argue that the damages involved had already been passed on by the claimants to consumers. Mario Siragusa, Partner at Cleary Gottlieb Steen & Hamilton LLP, Rome, examines the current situation

The passing-on defence and effective private enforcement

One of the European Commission's main concerns in recent years has been to bolster the development, within the European legal systems, of actions for damages caused by antitrust infringements. A number of initiatives have been taken, with the purpose of identifying the obstacles to a more efficient system of damages claims in the EU, and to propose different options to overcome such obstacles. Note, in particular, the 2005 Green Paper,[1] followed by the 2008 White Paper[2] and, in March 2009, a proposal (then retired) for an EU Directive, as well as the publication of a comprehensive study on the methods of damages calculation, aimed expressly at establishing a guidance tool for national courts in assessing antitrust damages.[3]

In this general framework, the 'passing-on defence' (POD) represents a key issue, insofar as it allows defendants, while being held responsible for the infringement, to rebut the claims of the direct purchasers. At the same time, passing-on can represent a legitimate circumstance for arguing for an indirect purchaser's standing in antitrust actions for damages. Authors refer to these two guises of the POD, stressing its *offensive* use—ie, as an argument enabling indirect purchasers to claim damages—and its *defensive* use—ie, as an argument allowing defendants to limit the amount of the damages that can be claimed.

POD and indirect purchaser standing: definition and issues

As is well known, the POD is strictly based on a simple observation of market dynamics: in multi-stage distribution chains, firms having to pay supra-competitive prices resulting from an antitrust infringement may be able to pass overcharges downstream to indirect purchasers. These can be producers deploying the cartelised component in their manufacturing process, distributors, and/or end-consumers. The phenomenon typically arises in a price-fixing setting, which represents the reference point of the debate, although it can also be discussed in the case of an (especially exploitative) abuse of dominant position, and, to a lesser extent, in the field of vertical restraint (given that the producer's interest is usually aligned with the consumer's, aiming at squeezing the distributor's margin).

Therefore, in the presence of the passing-on phenomenon, the question arises as to whether the passing-on of the anti-competitive charges has any relevance within the context of adjudicating antitrust claims, and, if so, to what extent the burden of proving the passing-on of the anti-competitive overcharge has to be allocated. Unfortunately, there is no best solution to this problem. The approaches proposed in legal scholarship and those followed in national litigation systems tend to be different, ranging between two extreme positions, each inspired by a particular enforcement philosophy.

On one side, we find the 'zero option', which consists of recognising in full both the POD and indirect standing. This approach is strictly compensatory in nature, insofar as it is a possible remedy for the multi-liability of the defendants, and ensures that direct purchasers do not obtain compensation greater than the harm actually incurred. It is an approach common to most European Member States.

On the other side, we find the opposite approach, which denies both POD and indirect standing. This scenario relies heavily on direct customers as the

leading force in antitrust private enforcement, given their closer ties with the infringers and their greater knowledge of market dynamics. At the same time, denying POD strongly incentivises direct customers to claim damages, and may lead to substantial over-deterrence and excess of litigation. (In this regard, the literature refers to direct purchasers as the 'most efficient enforcers' or 'better detectors'.[4])

The latter approach was the one originally adopted by the US system. In *Hanover Shoe* (1968), the court rejected the POD argument raised by the defendant, on the grounds of 'insurmountable' practical difficulties in proving the passing-on and its amount.[5] Moreover, reference was made to the actual dispersion of the indirect purchasers and their consequent weakness in claiming antitrust damages. Later, in *Illinois Brick* (1977), the court denied the indirect purchaser the right to claim for damages allegedly passed on to it.[6]

The author notes, however, that this approach was subject to certain criticisms. First, national courts started to legitimise indirect purchasers' suits, and a number of states passed the *Illinois Brick* repealer laws, or used consumer protection statutes to permit consumer standing. Second, at the federal level, the Antitrust Modernization Commission recommended that 'direct and indirect purchaser damages claims [be made] more in line with their actually lost profits from the cartel'.[7]

With regard to the European system, both the *Courage* and *Manfredi* judgments are clear-cut: 'any individual can claim compensation for the harm suffered where there is a causal relationship between that harm and an agreement or practice prohibited under Article 81 EC.'[8]

With a view to boosting damages actions and adopting a common pan-European approach towards POD, in its 2005 Green Paper the Commission discussed a number of options, each encompassing different benefits in terms of effective enforcement, as well as potential drawbacks. The more relevant problems underlying the main options for approaches towards POD were as follows.

- *Prohibiting the POD* would be contrary to the principle of strict compensation, according to which claimants must receive compensation for damages actually incurred. Eventually, it would also result in over-compensating claimants (above all, direct purchasers), bringing along the associated risk of 'US-style' abusive litigation.

- *Denying indirect purchasers' standing* would lead to unjust enrichment of the authors of the antitrust infringement, with a diminished deterrent effect.

- *Allowing the POD* would consequently introduce complex issues around allocating damages among the different parties involved in the passing-on.

- *Allowing indirect-purchaser standing* would then call for the need to establish effective means to coordinate and convey damages actions against the same infringer.

Italian case law: what can we draw from national experience?

Regarding the national experience, the author notes that the passing-on defence is not recognised as such by Italian legislation or case law. Therefore, the issue is construed in accordance with general civil liability principles, which provide that a claimant may seek compensation only for damages it actually suffered, provided that it did not concur in causing them.

If we look at the few antitrust cases on the issue, we find that courts actually applied general principles, concluding that *claimants have no standing with respect to damages they passed along to their customers*. This reasoning appears to have been endorsed in a number of Italian cases.

In *Indaba v. Juventus*,[9] a travel agency entered into a contract with Juventus Football Club, undertaking to sell tickets for the 1997 Champions League final match in Munich exclusively in a bundle with travel packages including services not normally needed by football supporters (such as transportation, local assistance and excursions). The venture proved to be unsuccessful, and the travel agency sued Juventus for antitrust damages. The court found that the agreement unduly restricted competition, and that Juventus had abused its dominant position in the relevant market for the sale of those tickets by imposing excessive prices and illegally tying the sale of the tickets to that of the travel package. However, no damages were awarded to the plaintiff. In fact, according to the court, the plaintiff had actually stipulated the restrictive agreement with an intention to 'pass on the damage' to its customers. The court therefore found that the plaintiff was not entitled to any damages because it had *purposely contributed to causing the harm*. It is unclear whether the passing-on defence was actually raised by the defendant or considered by the court on its own motion.

In this case, it seems that national judges applied the rule provided for by Article 1227 of the Civil Code, which gives relevance to the causal contribution of the injured party to the occurrence of the damage. As a consequence, the injured party has to behave with due diligence in order to lessen the harmful effects of the unlawful conduct, and can claim damages only to the

extent that they are not a consequence of its own misconduct.

In a second case, *Unimare v. Geasar*,[10] the judge, while concluding that there was no breach of antitrust law, incidentally added that, in any case, the claimant would not have been entitled to recover any damages since it had passed on to customers its additional costs. Unimare, a former provider of handling services at Olbia Airport in Sardinia claimed that Geasar, the current management body of Olbia Airport, had abused its dominant position by (i) increasing its fees excessively and without justification; and (ii) stealing Unimare's main client, the US Naval Service Order (NSO), by presenting itself as the only entity qualified to supply ground-handling services at the airport.

The court maintained that there was no abuse, but went on to state that, in any event, it is not possible to claim damages caused by an abuse of dominant position when the damages have been passed on in full to the customers. In the case in question, the fees imposed by Geasar were passed on from Unimare to the NSO as explicitly stated in the contract between the parties that provided for the reimbursement of expenses. More specifically, the court found that (i) the NSO had actually reimbursed any fees paid by Unimare, pursuant to a specific contractual duty; and (ii) the tariff increase had not caused the NSO to switch to another supplier, because the new fees applied equally to all operators. Therefore, *since Unimare had passed on the tariff increase in full to its client, it could claim no damages*.

More generally, Italian courts have often dealt with the issue of passing-on in the context of tax/subsidy refund cases because, under Italian law, the public administration must not refund illegally levied taxes if it is able to prove that the claimant has passed on the charge to its customers. In these cases, the courts have maintained that (i) a refund to the claimant of an illegally levied tax, a charge for which the claimant has already passed on to its customers, does not necessarily imply unjust enrichment; (ii) the claimant may obtain damages for any harm caused by the undue or discriminatory application of the tax (eg, the shortage of goods imported from other countries); and (iii) the claimant may also obtain damages for any reduction of its sales caused by the passing-on (ie, by the increase of prices aimed at compensating the increase in costs caused by the illegally applied tax).[11]

With regard to indirect purchasers' standing, this is generally recognised in national case law. In *Indaba v. Juventus*, the Court of Appeal of Turin maintained that the actual victims of Juventus's abuse were its football supporters (who had been forced to spend more than they would have otherwise), not the travel agency. The court thus stated in an *obiter* (incidental remark) that, because of the passing-on, those indirect customers 'would be the ones entitled to claim damages for the overcharges they did not want' (author's translation). Indirect purchasers can also sue the antitrust infringer for damages.[12]

Practical issues in estimating passing-on

POD and indirect-purchaser standing bring about the need to estimate the amount of pass-on within the context of damage allocation and quantification. Indeed, this could be a rather complex issue, which eventually would lead the judge to use equitable methods or presumptions in order to assess the quantum of the passing-on.

In this regard, the economic literature has tried to define some workable models to calculate pass-on.[13] These models rely mainly on decomposing the claimant's lost profits into three effects:

- *direct cost effect*: the price overcharge (the cartel input price minus the but-for input price), multiplied by the total inputs purchased from the cartel;
- *pass-on effect*: the increase in revenue that follows if the claimant passes part of the input price increase on to its customers in the form of a higher output price; and
- *output effect*: the lost profits associated with any lost sales as a consequence of the higher input price set by the passing-on claimant.

While the direct cost effect is always negative and represents a loss borne by the direct purchaser, the pass-on is always positive, thus counteracting at least part of the direct damages suffered as a consequence of the price overcharge. In this assessment, the output effect deriving from the pass-on would eventually determine the overall effect of the anti-competitive practice on the claimant: indeed, the output effect could dominate the pass-on effect, thus leaving the claimant with damages to obtain redress for *or* be compensated by the pass-on, leaving the claimant better off.

The magnitude of these effects therefore depends largely on the market circumstances of each case and in particular the following.

The *degree of competition* in the downstream market.

- In a market characterised by perfect competition, a marginal cost increase affecting all firms in the market can be expected to be passed on *in full*. At the same time, the output effect does not exist, since lost sales do not reduce the original margin.

- On the contrary, in an imperfect competition structure, the pass-on can be very significant (ie, a monopolist is expected to pass on 50% of a marginal cost increase to its customers), and the consequent output effect has some relevance: in the extreme case of a cartelised downstream market, the output effect can even fully offset the pass-on.

The *number of firms* affected by the cost increase.

- If only some downstream competitors have incurred higher input costs, their ability to pass on these higher costs might have been somewhat constrained by the fact that other competitors will have left their prices unchanged.
- Moreover, the output effect can be very significant, given the high likelihood that passing-on firms may lose market shares to rivals not affected by higher input costs.

Other factors that may be relevant to the assessment of pass-on effects include:

- *demand elasticity*: if the demand is inelastic (because of price-insensitive customers), firms tend to pass on a larger part of the price overcharge because so few customers stop buying after a price increase. Conversely, if demand is very elastic (because of price-sensitive customers), firms tend to pass on a small part of the price overcharge;

- *buyer power*: passing-on phenomena are more likely when downstream customers cannot oppose a material countervailing buyer power;

- *margins*: undertakings with high margins can potentially pass on less of the overcharge, since they may absorb it by lowering their mark-ups to maintain demand;

- *competition constraints*: constraints by competitors may induce a firm not to pass through its cost increases, to avoid lost of sales.

Access to empirical data in principle makes it possible to estimate the actual pass-on rates of relevance to the case at hand. However, this would require access to precise data on the actual prices and costs of the defendant, which is not always guaranteed under national procedural laws. Alternatively, complex econometric models can be constructed by the parties, in order to determine the 'but-for' scenario in the downstream market level, and eventually define the overcharge actually passed on.[14]

Concluding remarks: recent initiatives on collective redress

Collective redress has been at the heart of EU initiatives on private enforcement of competition law since the Green and White Papers. To ensure that victims receive compensation, it is crucial to establish a collective redress mechanism so as to improve access to justice and efficiency of civil litigation. This need has been clearly felt by the Commission, which has proposed in the White Paper, and set out in the Draft Directive, two different procedural instruments: (i) opt-in collective actions (group actions); and (ii) representative actions.

The mechanisms are deemed to be complementary. Opt-in mechanisms are no doubt closer to a European legal culture but, compared with opt-out mechanisms, they are more complicated, since they require the identification of the claimants, and the identification and demonstration of the damage suffered by each plaintiff. Opt-out actions, by granting the advantage of a wider representation of the victims, are more efficient and offer greater deterrence and corrective-justice effects, but they are also more likely to lead to excesses.

The scope of the new consultation started in early 2011 is much wider than that discussed in the 2008 White Paper. Indeed, following stakeholders' worries about a possible 'inconsistency between the different Commission initiatives on collective redress', the new consultation encompasses private enforcement of 'any EU legislation creating substantive rights'.[15]

In any case, collective redress mechanisms are strictly connected to the enforcement scenarios that POD would introduce in private antitrust litigation. Indeed, allowing POD by defendants requires effective mechanisms for indirect purchasers and consumers to be in place in order to avoid any possible unjust enrichment by the infringers, which would ultimately result in under-compensation and insufficient deterrence. Therefore, it has to be welcomed that the new initiative on collective redress aims at including not only consumers, but also 'EU citizens and businesses'.[16]

Following the consultation, the next step will be the 'definition of a general legal framework to collective redress' and, subsequently, 'this framework will be used to launch specific legislative initiatives in the different policy domains'.[17] Reportedly, the current Commissioner is likely to present a specific proposal on antitrust damages actions in the second half of 2011.

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[1] European Commission (2005), 'Green Paper – Damages Actions for the Breach of EC Antitrust Rules', COM(2005) 672 final, December.
[2] European Commission (2008), 'White Paper on Damages Actions for Breach of the EC Antitrust Rules', COM(2008) 165, April.
[3] See Oxera and a multi-jurisdictional team of lawyers led by Dr Assimakis Komninos (2009), 'Quantifying Antitrust Damages: Towards Non-binding Guidance for Courts', study prepared for the European Commission Directorate General for Competition, December.
[4] Centre for European Policy Studies, Erasmus University Rotterdam and Luiss Guido Carli (2007), 'Making Antitrust Damages Actions More Effective in the EU: Welfare Impact and Potential Scenarios', report for the European Commission, DG COMP/2006/A3/012, December 21st, pp. 467, 470.
[5] In particular, the Supreme Court observed that it was too difficult to establish the passing-on to consumers, as it would require convincing proof of 'virtually unascertainable figures', and it would render already complex antitrust damages actions completely unmanageable. See Parlak (2010), 'Passing-on Defence and Indirect Purchaser Standing: Should the Passing-on Defence Be Rejected Now the Indirect Purchaser Has Standing after Manfredi and the White Paper of the European Commission?', *World Competition*, **33**:1, p. 34. *Hanover Shoe, Inc.* v *United Shoe Machinery Corp.*, 392 US 481 (1968).
[6] *Illinois Brick Co. v. Illinois*, 431 US 720 (1977).
[7] Verboven, F. and van Dijk, T. (2007), 'Cartel Damages Claims and the Passing-on Defense', Katholieke Universiteit Leuven, Center for Economic Studies, Discussions Paper Series 07.15, May, p. 4. US Antitrust Modernization Commission (2007), 'Report and Recommendations', April 2nd.
[8] Joined cases C-295/04 to C-298/04, *Manfredi* [2006] ECR I-6619, para 61.
[9] Court of Appeal of Turin, judgment of 6 July 2000, *Indaba Incentive co. v. società Juventus F.C. S.p.A.*
[10] Court of Appeal of Cagliari, judgment of 23 January 1999, *Unimare S.r.l. v. Geasar S.p.a*.
[11] See, for all instances, Court of Cassation, judgment of May 24th 2005, No. 10939.
[12] For an application, see Court of Appeal of Rome, judgment of March 31st 2008.
[13] See Parlak (2010), op. cit., p. 37; and Verboven and van Dijk (2007), op. cit., p. 5.
[14] See Oxera (2009), op. cit., pp. 116–end.
[15] European Commission (2011), 'Towards a Coherent European Approach to Collective Redress: Next Steps', SEC(2011)173 final, February 4th, paras 11 and 7.
[16] Ibid., para 7.
[17] Almunia, J. (2010), 'Common Standards for Group Claims Across the EU', Speech/10/554, Valladolid, Spain, October 15th.

If you have any questions regarding the issues raised in this article, please contact the editor, Dr Gunnar Niels: tel +44 (0) 1865 253 000 or email g_niels@oxera.com

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