COMPASS LEXECON

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Quantification of overcharge and value of commerce

FW discusses quantification of overcharge and value of commerce with Catalina Campillo, Soledad Pereiras and Bernardo Sarmento at Compass Lexecon.

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THE PANELLISTS

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FW: Could you provide an overview of the recent trends and developments in follow-on damages cases across different jurisdictions? How would you characterise activity in terms of cases pursued and damages awarded?

Pereiras: The most tangible development is the increase in the number and size of follow-on cartel damage cases. While this was a trend we have been observing in recent years, it is undeniable that the full implementation of the Damages Directive has boosted litigation across all jurisdictions in the European Union (EU). We are also seeing more sophisticated courts with a legitimate interest in understanding the entire process of damage estimation and incorporating a more rigorous assessment of the economic evidence that parties present in their rulings. The increase in large-scale litigation in certain jurisdictions has also been quite a unique phenomenon. This is generating some tensions and we are seeing contradictory rulings for similar cases. These discrepancies will tend to disappear once the case law increases and courts become more familiar with the standard scientific practice in the evaluation of economic evidence.

Sarmento: The increase in the number of follow-on damage cases in Europe is to a great extent related to the trucks cartel. This case has triggered multiple follow-on claims in various European jurisdictions. When the dust has settled, it will be a good case study and provide a great opportunity to understand potential differences in the assessment of follow-on cases across European jurisdictions. While most claims are still ongoing, we can already observe

and identify some clear differences across jurisdictions. For instance, while in some countries follow-on cases are assessed in specialised courts such as the Competition Appeal Tribunal (CAT) in the UK or the Competition, Regulation and Supervision Court in Portugal, in some other countries, like Spain, follow-on litigation cases are assessed by myriad different first instance commercial courts. Consequently, the outcome of claims is expected to be more consistent in jurisdictions where all decisions are issued by a specialised court, whereas a higher degree of asymmetry is likely in jurisdictions where multiple courts assess the case, at least in first instance decisions. This is something we are already observing with the first decisions in Spain. We are also observing some differences related to the importance of disclosure. While in the UK the disclosure stage has a prominent role and will likely be very material for the quantification of damages, in other jurisdictions, like Spain, disclosure has played a minimal role in most claims.

FW: In terms of quantifying damages in follow-on cartel cases, what factors need to be considered to determine how an overcharge has occurred and the extent of the loss incurred?

IDENTIFYING THE AFFECTED SALES OR VALUE OF COMMERCE IS A HIGHLY CASE-DEPENDENT EXERCISE.

BERNARDO SARMENTO
Compass Lexecon

Campillo: First, an analysis of the decision issued by the competition authority is crucial to understand whether the authority determined an infringement by effect, in that the authority demonstrates that the conduct had anticompetitive effects on the market; or whether the conduct is sanctioned by object, and therefore the authority does not need to conduct an effects analysis. The latter case would require a study of the mechanism through which the conduct could have had an impact on the critical variables of competition in the market, for example the prices effectively paid by consumers, the margins earned by the companies or the volumes sold in the market. Once the plausibility of damage is assessed, one needs to look at the market characteristics and how the negotiations in the affected transactions took place to determine the factors that should be taken into account to quantify the damage. For this, the natural starting point should be the economic theory, which will always help us to define the quantification methodology and the data that is more suitable for each case.

Pereiras: To determine the amount of damage, three elements are crucial: good data, a well-founded methodology, and a narrative that fits the facts. The assessment of the potential damages should start by establishing the context of the case – our factual scenario – the anticompetitive conduct, such as a collusion agreement, exclusionary conduct, or abuse of a dominant position, and present the question that we aim to address. We may want to measure the total damage or just focus on one dimension of the potential harm, which could be the effect on prices, volumes, quality, final customers, providers, intermediate distributors or the entire value chain. With this in mind, we come to the data – its source, relevance and potential biases should be considered as well as the methodology. Again, we should be able to explain why our approach is well suited to define the counterfactual scenario and to identify the causal effect of the infringement. Finally, any damage estimation should be accompanied by a comprehensive assessment explaining why the results that we get are reasonable; that is, why the results are in line with what one would expect, given the market context, the particularities of the infringement, the situation of the claimant and the relevant economic theory.

FW: What models and methodologies may be used to identify and interpret causal effects and counterfactual scenarios?

Campillo: The various methodologies that are generally used in damage quantification are well-established, among other things thanks to the European Commission's guidelines on this matter. These can be grouped into three main domains – comparator-based methods, simulation methods and finance methods – which essentially differ in the approach that is taken to define the counterfactual scenario; that is, the situation that would have prevailed in the absence of the infringement. The functioning of the market, the description of the conduct and ultimately, the data availability and its quality will help us to identify the adequate method to define the most plausible counterfactual scenario, and whether we can establish a causal relationship between the infringement and the changes in the market. Among the three methods, comparator-based methods are the most widespread, since they do not require defining strong underlying assumptions, and allow for the application of econometric methods, which are one of the most useful tools in economic analysis. In particular, the correct application of econometric methods allows us to establish causal effects that will ultimately show whether the estimated changes in the market could be attributed to the infringement.

Pereiras: In my experience, the most used methodologies to estimate overcharges, which is, usually, the starting point of the damage estimation, are based on comparator approaches. One tries to reconstruct the counterfactual scenario – absent the infringement – by comparing the actual situation with the prices, or margins, in a market or period not affected by the

infringement. Simulation methodologies are not that frequent, probably because they are more complex and, sometimes, more intensive in terms of data requirements. Another limitation is that they rely heavily on certain assumptions about the effectiveness of the infringement, the competitive dynamics or the evolution of the demand absent the infringement that may be difficult to calibrate. However, more data and IT capabilities are developed every day which should facilitate the use of simulation methods. Finally, financial methodologies are not common in follow-on damage cases but are used extensively in arbitration. In some cases, they are not the best-suited models to estimate cartel damages, for example if accounting data is not available or if it is particularly difficult to estimate a counterfactual for certain financial figures. But in other cases, a finance-based methodology may be the most sensible approach.

FW: Could you outline best practices for how economic evidence should be presented in a court or before a tribunal? How would you define the role of expert testimony and its importance in quantifying damages?

Sarmento: Most economic evidence submitted in follow-on litigation cases is empirical. In such cases, data used in the analysis should be explained carefully and in detail to the tribunal. How was the data obtained? Which assessment was done to verify the data is reliable? Are there any potential problems with the data that could impact the results of the analysis? Besides this clear description and critical validation of the data used, it is also crucial to be very transparent about all the underlying assumptions inherent to the analysis being submitted, and why the expert believes that such assumptions are adequate in the case at hand. Ultimately, all economic analysis is a simplification of reality, and as such, assumptions are required. Being transparent and clear about the assumptions allows the court to take a stance on the analysis being carried out and, to a certain extent, to assess its validity. Expert testimony can, of course, be very important in achieving the above. On the one hand, under direct examination the expert has the possibility of highlighting all the aspects they deem to be most relevant to the case. On the other hand, under cross-examination the expert will have to clarify all the aspects that they might not have been clear about or for which they might not have provided all the relevant information, and of course, will have to justify their methodological decisions and computations in front of the tribunal.

Campillo: The description of the methodology, the data and their potential limitations should be sufficiently informative for the judge, or the court-appointed expert, to form a view on whether the counterfactual is consistent with the facts of the case and provides the more adequate alternative scenario. For example, in the application of comparator methods, evidence should be provided to show that the comparator market – a different product, geographic area or period – is indeed the most likely scenario in the non-infringement world. If there are any confidentiality issues with the information used by the parties, the use of data rooms to make this information available is recommended, to guarantee transparency at all stages of the process. In this regard, expert testimony is very useful to clarify all the elements indicated above, explain the potential limitations of their analysis, and why these limitations do not, in their view, lead to material flaws in the analysis or biased results.

FW: What challenges do courts and tribunals face in terms of assessing the pros and cons of opposing analyses presented by different economic experts? What can be done to make it easier for judges or arbitrators to decide on these cases?

Sarmento: Most courts and tribunals do not have economists on their staff, which means that, in the absence of a court-appointed expert, judges and arbitrators will have to navigate the significant amount of economic evidence that is submitted in follow-on litigation cases themselves. While in many cases this can be a daunting task, several aspects can make it easier. Economic experts have, of course, a great deal of responsibility in this process. How transparent and clear they are about the methodology they have used, the assumptions they have made, and the data they have relied on is of crucial importance to the court or tribunal. Given that in these cases the economic evidence is often put forward by more than one expert, experts must make it clear to the court what they agree on and what they disagree on. 'Agree and disagree' statements are a very useful tool for this effect. Experts can make the tribunal's task of assessing the competing economic evidence much easier by making it clear to the tribunal the issues on which they disagree and agree, and identifying those which are material to the conclusions of the economic analysis. After this, if there are still relevant points of disagreement between experts where the tribunal or court feels that it does not have enough information to decide on the competing views, expert testimony can be a valuable tool. Both cross-examination and expert hot tubbing can further clarify the reasons for the points of disagreement between the experts and help the tribunal or court to come to a view on which is the most adequate.

> TO DETERMINE THE AMOUNT OF DAMAGE, THREE ELEMENTS ARE CRUCIAL: GOOD DATA, A WELL-FOUNDED METHODOLOGY, AND A NARRATIVE THAT FITS THE FACTS.
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> SOLEDAD PEREIRAS
> Compass Lexecon

Pereiras: It is difficult to evaluate contradictory evidence if reports are, sometimes intentionally, obscure about the underlying assumptions of their estimation or the limitations of their data. Judges and arbitrators should be prepared to ask questions that are relevant to understanding the analysis and unveil potential limitations. This is not easy. A starting point could be confronting the economic experts on the data that they use, and which data they think is most adequate, and on every methodological choice they have made for the analysis – the question they are responding to, the variable of interest, the set of explanatory variables and the estimation methodology, among other things. To make this enquiry process effective, judicial procedures should be sufficiently flexible to allow access to the data and to encourage a meaningful discussion between opposing experts. From an economic expert perspective, we should be transparent about the data and the identification strategy that we are using, and our testimony should be presented together with an honest self-evaluation of the potential limitations of the analyses presented.

> AN ANALYSIS OF THE DECISION ISSUED BY THE COMPETITION AUTHORITY IS CRUCIAL TO UNDERSTAND WHETHER THE AUTHORITY DETERMINED AN INFRINGEMENT BY EFFECT.
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> CATALINA CAMPILLO
> Compass Lexecon

FW: Taking into account the characteristics of the relevant markets and the nature of the infringement, what issues have an influence on determining the value of commerce?

Sarmento: Identifying the affected sales or value of commerce is a highly case-dependent exercise. It requires a careful evaluation of the nature of the conduct and its duration, as well as the relevant characteristics of the market. The usual departing point is that sales taking place during the infringement period correspond to the affected sales. This, however, can be quite an inaccurate approach in many cases. For example, there are many markets where prices are set at a given moment in time and the sales relating to those prices take place in a moment in the future. In such cases it is important to identify prices that were affected by the infringement and their corresponding sales, as the period of such sales might not correspond to the infringement period, even though the price was affected by the infringement. Another potential troublesome case is when sales are done under long-term contracts with price revisions. In such cases, while the initial contracts might fall within the infringement period and consequently its price might be affected by the infringement, the existence of price revision clauses might lead to a situation where sales after the price revision might not be affected by the infringement. Of course, whether this is the case or not requires a detailed understanding of the conduct and the price-setting mechanisms in the case at hand. Another important consideration when assessing the value of commerce is the so-called 'overhang' effect. In principle, anticompetitive agreements can have an impact on prices after the infringement has ended. This can happen either because companies can keep colluding tacitly or because prices are rigid and take some time to get back to the competitive level. This means that companies might be paying higher prices than they would have paid in the absence of the infringement for sales that took place after the infringement has ended.

Campillo: The market structure, the type of contracts and negotiations and the nature of the conduct are all factors that play a role in identifying the sales that could potentially have been affected by the infringement. Depending on the plausibility of the existence of pass-on, the ultimately affected products or services may have actually been purchased in a downstream market by indirect clients of the sanctioned companies, for example if the product subject to the infringement has been used as an intermediate product to manufacture a final good. In addition, in some instances, the existence of 'umbrella' effects may also be plausible when agents that were not involved in any transaction with the parties that infringed the competition rules suffer indirectly the effects of the anticompetitive conduct through transactions with other competitors of the sanctioned companies.

FW: Looking ahead, how to you expect the process of quantifying damages in follow-on cartel cases to evolve over the coming years? What changes to models and methodologies do you expect to see?

Campillo: The increasing data availability and the sophistication of markets will certainly have an impact on the future of damage quantification, but I do not expect material changes to the models and methodologies that are currently in use. Firms are collecting more detailed and better data, and this will allow economic experts to conduct robust analyses even in markets where there are many economic forces involved in the determination of prices or margins, for example. This growing data complexity may trigger the implementation of data rooms, or the development of data disclosures in jurisdictions where this is still not covered by the current legal framework. In my view, the application of more sophisticated empirical techniques and in particular, the application of comparator-based methods, will continue to be the most common approach, since the necessary information to implement these techniques will be available. For this to happen, we need a solid normative framework that allows economists to explain the application of

these techniques in a friendly manner, and judges to have all the necessary elements to identify the pros and cons of different sets of information or alternative methodologies.

Sarmento: I would not expect a significant departure from the three main methodologies used in the quantification of damages in follow-on cases: comparator-based methods, financial-based methods and simulation models. In particular, I would expect comparator-based methods to continue being the most widely used methodology for the quantification of damages in follow-on cases. On the one hand, the underlying assumptions of comparator-based methods are simple and intuitive, making it easier for courts and tribunals to assess their adequacy in each case. On the other hand, companies will increasingly have more available data, which will make it possible for economists to implement comparator methods based on advanced empirical techniques, allowing them to reach more rigorous results when implementing such methodologies. We might, however, observe changes in the relative importance of the quantification analysis relative to other relevant economic analyses and stages of the process. For instance, it remains to be seen the role that disclosure will have in follow-on cases and whether it will play an important role across all jurisdictions. It also remains to be seen how important pass-on defences will be and whether companies will use them often and, more interestingly, how courts will view such arguments and, if a pass-on defence is successful, whether it will trigger additional claims from the entities to which the overcharges would have been passed on to.

Pereiras: I do not expect major methodological development that will substitute the standard approaches that are currently used. I do expect more quality and complexity in the analysis presented. Courts are becoming more sophisticated and more familiar with scientific standards in economics and this raises the bar for economic analysis. Along with this, we will face a re-evaluation of the role of economic experts and about the incorporation of the results of economic evidence in the judicial review. Courts need more time and resources to understand the economic analysis that the parties present and to confront contradictory results. I also expect new damage cases arising for different types of antitrust infringement, such as competition infringements in labour markets, exclusionary conducts or big tech, and new challenges in terms of market power, privacy and innovation. The construction of the counterfactual scenario in these cases may be a challenge and it will require the use of extensive data, new statistical analyses, data science and simulation models that we do not usually find in follow-on cartel cases. ■