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Pass-on in the UK MasterCard litigation

Does legal and economic pass-on really differ?

Sainsbury's Supermarkets v MasterCard is a landmark decision – it establishes the pass-on "defence"; and it is the first reported UK competition case to award substantial damages and compound interest. What is less welcome is the UK Competition Appeal Tribunal's (CAT) confused treatment of pass-on. Below the Tribunal's reasoning is critically assessed.

The facts

Sainsbury is the first decided case of at least eight retail actions and one collective proceeding currently being pursued against MasterCard in the CAT and High Court. It is a standalone action which found that MasterCard had infringed Article 101TFEU by charging excessive credit and debit card interchange fees. Interchange fees are wholesale charges paid to card issuers by the acquiring banks which process merchant transactions. MasterCard set default Multilateral Interchange Fees (MIFs) which placed a floor to these fees as set out in European Commission's 2007 *MasterCard* infringement decision. The CAT calculated that Sainsbury paid £100m in overcharges which was reduced to about £69m when the benefits to Sainsbury Bank of credit card fees were deducted.

Under the MasterCard scheme the acquiring banks levied a Merchant Service Charge (MSC) on each transaction which contained the MIF overcharge. It was uncontested that the MIF was passed-on to retailers because acquiring banks used a cost-plus approach to set the MSC. The central pass-on issue was the extent to which Sainsbury passed-on the MSC to their customers in higher retail prices. MasterCard pleaded that Sainsbury fully passed-on the MIF overcharge and hence suffered no loss. The CAT (para 457-464) accepted that in principle most of the MIF would have been passed-on but that this was not proved - how Sainsbury allocated its costs and whether specific product prices had increased due to the overcharge was said the Tribunal (para 464) "unknowable". The pass-on "defence" failed. Despite this, the CAT found that Sainsbury had passed-on 50% of the overcharge to its customers when awarding compound interest on half the claim.

Pass-on is not a defence

The CAT rejected the propositions that there was a pass-on "defence" or that pass-on was based on the principle of "unjust enrichment". The Tribunal (para 484(3)) stated: "The pass-on "defence" is not a defence but it simply reflects the need to ensure that a claimant is sufficiently compensated, and not over-compensated, by a defendant". Pass-on was also not to avoid "unjust enrichment" as a competition damage claim was one of compensation not restitution.

Does legal and economic pass-on differ?

The CAT (para 484) went to make a controversial and misconceived distinction between legal and economic pass-on:

> (4) … whilst the notion of passing-on a cost is a very familiar one to an economist, an economist is concerned with how an enterprise recovers its costs, whereas a lawyer is concerned with whether a specific claim is or is not well-founded. We consider that the legal definition of a passed-on cost differs from that of the economist in two respects:
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> (i) First, whereas an economist might well define pass-on more widely (i.e. to include cost savings and reduced expenditure), the pass-on defence is only concerned with identifiable increases in prices by a firm to its customers.
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> (ii) Secondly, the increase in price must be causally connected with the overcharge, and demonstrably so. There is danger in presuming pass-on of costs to indirect purchasers (*pace* Article 14 of the Damages Directive), because of the risk that any potential claim becomes either so fragmented or else so impossible to prove that the end-result is that the defendant retains the overcharge in default of a successful claimant or group of claimants. This risk of under-compensation, we consider, to be as great as the risk of overcompensation, and it informs the legal (as opposed to the economic) approach. It would also run counter to the EU principle of effectiveness in cases with an EU law element, as it would render recovery of compensation "impossible or excessively difficult".
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> (5) Given these factors, we consider that the pass-on "defence" ought only to succeed where, on the balance of probabilities, the defendant has shown that there exists another class of claimant, downstream of the claimant(s) in the action, to whom the overcharge has been passed on. Unless the defendant (and we stress that the burden is on the defendant) demonstrates the existence of such a class, we consider that a claimant's recovery of the overcharge incurred by it should not be reduced or defeated on this ground.

What can be made of these statements?

1. The CAT's view that the economist's concept of pass-on is more diffuse and less factual than that in law is spurious. An economist asked to address

whether prices increased as a result of an overcharge would address that specific issue. As the CAT (para 432-435) set out when a firm faces an unavoidable cost increase it has several options – pass-on; pass-back (reduce costs), reduce spending, and/or reduce its profit margins. This breakdown of its potential responses is part of the assessment not to be confused with what the economist means by pass-on. If a firm responds by reducing its suppliers' costs this is "pass-back", as are the other cost-savings listed in the judgment when causally related to the overcharge. In principle, pass-back in response to an overcharge ("mitigation" in legal terms), whether or not associated with a reduction in profits, should be offset and gives the firm's suppliers and workers a claim in damages (as difficult and improbable as this may seem).

2. The CAT's requirement that "the increase in price must be casually connected with the overcharge, and demonstrably so" set a high evidentiary standard. The Tribunal (para 434) accepted that pass-on was a complex matter: "The problem is that it can be very difficult to ascertain whether and, if so, how, a given cost has been passed-on". It (para 468) further accepted that in the commercial environment in which Sainsbury operated full pass-on was "blindingly obvious" – "If Sainsbury's did not seek to recover the inevitable costs of its business from its customers, it would rapidly lose more than it made, and become an ex-business." Yet, the CAT (para 469) stridently admonished MasterCard for pleading this point:

> However, if MasterCard, by its submissions, was seeking to assert that it was possible to link a given cost incurred by Sainsbury's to a specific price charged by Sainsbury's for a product sold by it or to a specific saving, then that is a submission that we have to reject as unarguable. It is obvious from the manner in which Sainsbury's carried on its business that such a nexus does not exist. It is quite simply impossible to say that of the price for Sainsbury's Loose Fairtrade Bananas – which at the time of this Judgment sell for 68p per kilogram – 0.1p (or any other amount) is attributable to the UK MIF and is the means by which Sainsbury's recovers the cost of the UK MIF. Given the manner in which Sainsbury's does business, the proposition that such a nexus exists would be a frankly absurd one.

The CAT, based on the evidence of Sainsbury, concluded that there was a "detachment" between costs and prices, and that product prices were determined by competitive pressures rather than costs. This applied to all costs not just the MIF overcharge – the price of bananas did not necessarily reflect the cost of bananas. This is not all that surprising, At any one time Sainsbury's sold over 2,000 mainly food products and changed hundreds of their prices each week in response to the competition. Thus while the price of a specific product may not have reflected the MSC, this does not rule out that over the whole product range prices reflected costs on average. The Tribunal came close to suggesting that only a regime of cost-plus pricing would satisfy the legal test for pass-on while at the same time accepting that competition between retailers would force them to cover their costs, or become, to use its words, "ex-businesses".

Having said this, there remained the issue of proof that overcharge had been passed-on. Great weight was given to Sainsbury's evidence on how it set its budgets and prices; and little weight to broader factors pointing, as the Tribunal accepted, to a large pass-on rate. But Sainsbury's evidence amounted to ignorance as to how the MSC affected it prices, and how the competitive forces in the market influenced the incidence of the MSC.

In any case it was not at all apparent how the CAT's (para 423) hard line sat with its endorsement of Shaw L's *obiter* in *Watson Laidlaw* that "where there is an element of estimation and assumption… restoration by way of compensation is often accomplished by "sound imagination" and a "broad axe"". Uncertainty as to causation and damages is frequent in commercial litigation, and not treated as an insurmountable challenge to the courts. Why in such a crucial aspect of cartel damage actions with its acknowledged complexity, the CAT should have decided to take such a hard-line is difficult to explain (although see the next comment).

3. The judgment (para 484(4)(ii)) sets out a contentious (or else badly expressed) justification for its hard-line on pass-on. It stated that the risk of under-compensation should be guarded against as much as the risk of over-compensation. This proposition has nothing to do with economics as claimed by the CAT, and seems in our lay opinion bad law. To the extent it is valid, it is in respect of the claimants in the action only not to all potential claimants at large as asserted by the CAT. Indeed, the Tribunal came close to distorting the compensatory objective of damages by transposing full compensation to the claimants with the notion of full compensation paid by the Defendant. While one appreciates that pass-on is routinely pleaded by defendants to avoid paying damages downstream claimants are unlikely to bring actions, this does not provide a legal basis for over-compensating a claimant. The overcompensation to one class of claimants cannot be justified by the risk of under- or no compensation to another class of indirect purchasers not party to the action. It is also not apparent why the Tribunal could not identify the class of downstream claimants required under its legal test (para 484(5)) – they were Sainsbury's customers (although the fact that further standalone actions were time barred may have been a factor). The irony is that just as the ink was drying on the

Tribunal's judgment, a collective proceeding (*Walter Merricks v MasterCard*) was launched in the CAT against MasterCard representing all downstream consumers premised on a high pass-on rate.

Pass-on for interest

The CAT's (para 525) treatment of pass-on in awarding interest is the most perplexing part of the judgment:

> Sainsbury's would have sought to pass the cost of its UK MIF on to its customers. Although Sainsbury's would not have been unconstrained in its ability to pass this cost on, because the UK MIF was a cost common to Sainsbury's and its supermarket rivals, we consider that a substantial amount of the UK MIF – 50% – would have been passed-on (albeit not in a manner which would have amounted to a "defence" of pass-on, for the reasons given at paragraphs 484 to 485). It follows that had the overcharge not been made, Sainsbury's would not have received any interest: it would simply have not passed on the overcharge.

The same economics the Tribunal dismissed to deny pass-on was now sufficient to find that half the overcharge had been passed-on in higher prices by Sainsbury. Where now was the "demonstrable" proof? How did the Tribunal conclude that only 50% of the overcharge had been passed-on? Was the CAT setting out two different evidentiary standards? Or, as has been suggested, this part of the judgment was written by a different Tribunal member and simply was not consistent with the earlier "legal test" of pass-on (as indeed suggested by the wording above)?

Yet further questions

The Tribunal's judgment prompts other questions. If pass-on is not a "defence", why does the Defendant have the burden of proof? Does the same "hard" standard of proof apply when pass-on is being used as a "sword" to claim damages rather than as a "shield"? Does the judgment leave open the possibility of an asymmetric standard of proof which is lower when pass-on is pleaded to enable compensation or the award of interest? How does the CAT's "demonstrable proof" apply to mass consumer claims where pass-on can be economy wide covering thousands of retailers and millions of end customers?

Conclusion and summary

Pass-on is one of the most difficult evidentiary issues that confronts the CAT, claimants and defendants in cartel damage actions. Taking a hard line on pass-on may block defendants from failing to compensate direct purchasers, but the CAT seemed to forget that pass-on is essential to enable indirect purchasers, including end consumers, from claiming compensation for their losses (as set out in the EU Damages Directive). Indeed, the decision expressly overrides the EU Damages Directive presumption of pass-on, and ignores the *Consumer Rights Act 2015* which is designed to foster consumer collective proceedings.

The economic and legal bases for pass-on set out by the Tribunal are weak and create another layer of confusion which will now have to be resolved. Given the large number of cases in the pipeline this will not take long.

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