

ARE THE COURTS PASSING ON CATEGORY (III) MITIGATION DEFENCES?



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The Supreme Court's decision in Sainsbury's 'Supermarkets Ltd v Mastercard Incorporated' [2020] UK SC 24 ("Sainsbury's") recognised that faced with the imposition of an increased cost, such as that occasioned by an overcharge, a merchant may respond in several different ways. One such response is for the merchant to negotiate with its other suppliers, with a view to reducing its costs, and thereby reducing or negating the impact of the overcharge on its profit margin. We shall refer to this as a "Category (iii) Response", adopting the enumeration in Sainsbury's. The Supreme Court in Sainsbury's recognised that to the extent such a cost reduction was successful, it may reduce the loss the merchant has suffered, as a result of the overcharge. However, subsequent authorities, including the recent decision of the CAT in the Umbrella Interchange Fee Litigation [2023] CAT [60] ("Interchange Fees"), have elucidated the difficulties that confront any

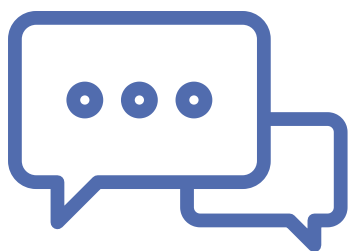


defendant seeking to prove this form of pass-on, particularly in relation to a claim arising from a cartel infringement.

The first difficulty arises at the pleading stage. A defendant must have a proper factual basis for pleading that a claimant offset the increased cost occasioned by an overcharge through negotiating cost reductions with its suppliers. This is inherently difficult, given that a defendant will not have detailed knowledge of a claimant's cost recovery processes absent disclosure, which in turn will only be ordered on the pleaded issues.

The Court of Appeal stated in 'NTN Corporation & Ors v Stellantis NV' [2022] EWCA Civ 16 ("Stellantis") that the mere fact that the claimants operated a cost control system involving targets was not a sufficient basis for such a plea, because it did not lead to the inferred conclusion that the claimants negotiated better prices from suppliers of other products than they would have done in the competitive counterfactual.

The court suggested that pleading a Category (iii) Response may be difficult in a case arising from a cartel infringement, because a claimant would not know that the price it was paying for the cartelised product was inflated.



There is also judicial scepticism as to whether a Category (iii) Response would ever be the rational response to an overcharge by a profit maximising firm to an increased input cost - see 'Royal Mail Group Limited & Anor v DAF Trucks Limited & Ors' [2023] CAT 6 ("Royal Mail"). The pass-on which the defendants in Royal Mail contended for at trial fell into category (iv) in Sainsbury's, i.e., an increase in the prices that the claimants charged their downstream customers. However, Derek Ridyard, a prominent economist and member of the Tribunal, addressed in his judgment each of the Sainsbury's categories. In relation to category (iii), he concluded that the "main thrust of economic thinking on pass-on" did not envisage that a profit maximising firm would react to an increase in input costs by reducing the amount it pays suppliers for unrelated products.

"There is normally no causal link between these elements because a well-run firm will already have taken steps to ensure it does not incur higher costs than are necessary to make other products. That is not to say that an [Category (iii) Response] can never be the predicted outcome, but it does indicate that a claim of mitigation that relies on such a mechanism is likely to find itself battling against established economic theory on pass-on."

Mr Ridyard's conceptualisation of pass-on, outlined in paragraphs 696 – 701 of his dissenting judgment, was quoted with approval by the CAT in Interchange Fees. Notably, however, the CAT observed that Mr Ridyard's analysis of category (iii) applied to the operations of a "well run firm", where there would be no scope for cost savings, irrespective of the price of the cartelised product,

because the firm would already have reduced the amount it paid suppliers to the lowest possible level in order to maximise profits. The CAT noted that firms do not exist in a state of perfect competition, and suggested that it may be "possible for a firm or industry to operate in such a state where cost cuts or effective cost cuts are possible or even causally likely".

So, where does this leave a defendant to a cartel claim, looking to prove that the claimant passed on any overcharge through negotiating cost reductions with its suppliers? The Court of Appeal in *Stellantis* recognised that raising a viable defence of this nature might be difficult, but did not accept that its judgment had put defendants in an "impossible" 'catch 22', where the requisite evidential underpinning necessary to plead the defence, and thereby obtain disclosure, could never be established. It is, however, difficult to see how a defendant to a cartel claim could muster sufficient factual evidence to establish a prima facie link between an increased cost occasioned by a (hypothetical) overcharge, and a reduction in a claimant's supplier costs, without receiving disclosure. In *Interchange Fees*, the CAT tied Mr Ridyard's scepticism to the operations of a well-run firm and, in so doing, seemed to posit a scenario where a Category (iii) Response might be tenable. But how is a defendant to know, prior to receiving disclosure, whether a particular business is "well run"; for example, how efficient its procurement processes were?

It may be that a Category (iii) Response is easier to argue in defending a claim brought by a public body. Mr Ridyard's analysis in *Royal Mail* was predicated on the reaction of a profit maximising firm to an increase in input costs. Many public bodies are not profit-maximising entities; rather, they are

often assessed against more qualitative KPIs. Further, public bodies tend to be scrutinised closely, and documentation on their procurement processes is often publicly available. That may assist in establishing the evidential "hook" necessary to plead a Category (iii) Response. In any event, it seems clear that the pathways for successfully establishing a Category (iii) Response are narrow and difficult to traverse successfully.

