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Surviving the broad axe: The UK class action regime is alive and kicking, but what can the Supreme Court's judgment in Merricks/Mastercard tell us about the role of economics in class certifications going forward?

Introduction

On the 11th December 2020, the UK Supreme Court ("SC") handed down its judgment in the case between Walter Hugh Merricks, CBE ("Merricks") and Mastercard Incorporated ("Mastercard").[1] The judgment concerns Merricks' Collective Proceedings Order ("CPO") application to pursue a class action for follow-on damages against Mastercard for £14 billion (after interest), on behalf of 46.2 million people.[2] The application was originally rejected by the UK Competition Appeal Tribunal ("CAT") in 2017, before the CAT's ruling was overturned on appeal by the Court of Appeal ("CoA") in 2019.[3] Mastercard then appealed the CoA's decision before the SC, but was unsuccessful, with the SC sending the case back to the CAT for re-consideration.

Much anticipated by practitioners, the SC judgment addresses a number of important issues in terms of what is required for claimants to obtain class certification before the UK courts (and the avenues that are open to defendants should they wish to contest certification). It has been widely perceived as setting a lower bar for obtaining class certification than was set by the CAT when it first presided over Merricks' application, with the SC finding that a number of issues debated before the CAT should only be properly considered at the trial stage.

The SC judgment also clarifies important aspects of the test to be applied by the CAT at the certification stage. In doing so, it confirms the role of economic input at this stage and endorses the approach taken by the CAT to question economic experts (where appropriate) at the certification hearing itself. This brief expands on this and other important economic considerations that arise from the SC judgment, including how failing to interrogate a claimant's proposed damages estimation methodology in sufficient detail is liable to cause serious issues at trial.

Insights from the SC judgment

One of the main areas of focus throughout the various proceedings was the standard that should be applied when determining whether Merricks' claim was **suitable for class certification**.[4] Much of this debate focussed on the methodology proposed by Merricks' economic experts for estimating damages, and the data that they proposed in order to do so.

The CAT's main concern had been that although Merricks' proposed approach to estimating damages was *"methodologically sound"*, it could not have been reliably applied using any of the data sources proposed by Merricks (namely other actions against Mastercard, disclosure from third parties and published data and studies).[5] The SC found that the standard applied by the CAT had been too strict, but importantly it did not dismiss the importance of carefully evaluating the damages estimation methodology and the availability of suitable data to operate it at the certification stage.

1. *Mastercard Incorporated and others v Walter Hugh Merricks CBE*, [2020] UKSC 51, 11 December 2020. RBB was not involved in this matter.

2. The claim itself stems from the European Commission's finding that Mastercard breached Article 101 in respect of the Intra-EEA fallback multilateral interchange fees ("MIFs") that it set for Mastercard branded consumer credit and charge cards and for Mastercard or Maestro branded debit cards. See the European Commission's decision, CN 34579.

3. *Walter Hugh Merricks CBE v Mastercard Incorporated and others*, [2017] CAT 16, 21 July 2017, and *Walter Hugh Merricks CBE v Mastercard Incorporated and others*, [2019] EWCA Civ 674, 16 April 2019.

4. The other main issue considered by the SC was the distribution of aggregate damages. However, since the SC judgment appears to dismiss the relevance of distribution considerations at the certification stage, we do not discuss this further in this brief.

5. The CAT found that other actions against Mastercard (e.g. *Sainsbury's, Morrisons*) were, at the time, at too early a stage to provide concrete pass-on estimates and in any case covered only a small part of the infringement period, that sourcing the required data from third parties would likely be highly burdensome and prohibitively expensive, and that estimates from published studies would likely be incomplete and/or difficult to interpret. Regarding this last point, the CAT cited similar views expressed in "Cost pass-through: theory, measurement, and potential policy implications", a report prepared by RBB for the Office of Fair Trading in 2014, which contains a review of the economic theory and empirical literature relevant to estimating pass-on in different settings.

Instead, the SC clarified that, at the certification stage, the relevant threshold should be whether the claimant's proposed methodology offers *"a realistic prospect of establishing loss on a class-wide basis"* and that, regarding data specifically, *"there must be some evidence of the availability of the data to which the methodology is to be applied."*[6]

Unlike the CoA, the SC did not consider the extent to which the CAT sought to interrogate the proposed damages methodology and the available data to be inappropriate or that it amounted to a *"mini trial"* that demanded too much of the claimant. This would seem to permit the CAT some leeway for detailed interrogation of experts to establish whether a claimant's case meets the *"realistic prospect"* standard.[7]

Another important economic issue considered by the SC (albeit one that played only a limited role in the CAT's original determination) was the threshold to be applied when assessing "commonality". Here, the debate centred on whether pass-on was a common issue, with the CAT having previously found that it was not on the basis that merchants were likely to have engaged in markedly different levels of pass-on.[8]

The SC disagreed, concluding that commonality should be interpreted more broadly. In particular, it determined that the claimants would not need to be affected by an issue to the same extent for it to be considered to be common.[9] This could superficially be viewed as narrowing the role for economic evidence in respect of commonality (if not removing it altogether). However, as we highlight below, other aspects of the SC judgment mean that the kinds of economic evidence that have historically been used to address commonality are likely to remain highly relevant to certification hearings going forward.

The role for economics

While the SC judgment is likely to influence the ways that economic evidence is deployed in future class certifications (e.g. in the context of establishing commonality), it also confirms the important role of economic evidence at the certification stage. In particular, the SC judgment endorses the CAT's view that it is not sufficient for claimants to propose a purely theoretical damages estimation methodology – they must provide evidence that the methodology has a realistic prospect of success at trial.

In this context, the CAT engaged significantly with the economic evidence, testing the proposed methodology through careful questioning and cross-examination of Merricks' experts. Unlike the CoA, which found the level of this questioning to be disproportionate, the SC approved of the CAT's approach, finding that it resulted in *"greater clarity and a considerable improvement in the quantification methodology"*.[10]

One of the CAT's main lines of questioning was how Merricks' experts planned to estimate a nation-wide pass-on rate that would need to incorporate a large and diverse range of markets, including how the proposed methodology would accommodate different pass-on rates for not only different markets, but also for different firms within the same market (and in different geographies).[11] The CAT also sought to examine carefully whether there would be suitable data available to operate the proposed methodology. Importantly, this included not only whether the data sources proposed by Merricks were likely to be available at trial, but also whether they would likely be reliable and would cover a sufficiently large proportion of the time period and the markets covered by the claim.[12]

As we discuss below, while the extent can be expected to vary with the complexity of the issues involved, it seems likely that economist engagement (and cross examination) will frequently be useful to determine whether any proposed damages estimation methodology has a realistic prospect of establishing the loss suffered.

6. See for example the SC's citing of *Pro-Sys Consultants Ltd v Microsoft Corpn* [2013] SCC 57, at paragraph 40 of the SC judgment.

7. Indeed, the SC noted at paragraph 78 that *"[t]he CAT's own questioning of the experts achieved both greater clarity and a considerable improvement in the quantification methodology then being proposed on Mr Merricks' behalf, in a case of unprecedented size and complexity."*

8. CAT judgment, paragraphs 63-66.

9. SC judgment, paragraph 64. This was also the CoA's conclusion (see CoA judgment, paragraphs 45-47).

10. SC judgment, paragraph 78.

11. CAT judgment, paragraphs 41-43.

12. CAT judgment, paragraphs 70-75.

Implications arising from the need for a class-wide methodology

An important clarification in the SC judgment is that, although issues such as overcharge, pass-on or volume effects can still be considered common even if the magnitude of their effects might vary substantially across class members, the damages estimation methodology must still be viable on a **class-wide basis**. In other words, the same damages estimation methodology should be able to be applied across all class members (i.e. as opposed to using different methodologies to assess damages for different groups of members). This makes sense since otherwise the efficiency benefits from grouping the claims together would be substantially diminished.

The SC judgment does not address the extent to which it will be permissible to make adjustments to a common estimation methodology in order to reflect differences amongst (groups of) class members. Accordingly, this is something that the CAT will need to consider carefully in future decisions, since a failure to make appropriate adjustments may give rise to highly unreliable damages estimates. Importantly, this is unlikely to be an issue of mere imprecision (as might otherwise be soluble through the application of the "broad axe" principle). The inability to adjust a given methodology to address real world issues could give rise to significant biases – in other words, damages estimates that are just plain wrong.

To see this, consider the simple example of an overcharge to two different groups of direct purchasers, in two separate relevant markets, each with a demand of 50 units for the product in question. Direct purchasers in market A are overcharged by £2 per unit and direct purchasers in market B are overcharged by £10 per unit. The firms in market A then pass-on 100% of the overcharge, while the firms in market B pass-on only 10% of the overcharge.

An approach that does not have regard to the different dynamics across markets A and B would essentially estimate an average overcharge and an average pass-on rate.[13] Here the average overcharge would be £6 per unit, and the average pass-on rate would be 55%. Thus, the estimated damages to downstream customers would be £3.30 per unit, and aggregate damages £330.

However, this is very different from the correct figure. Specifically, customers buying from firms in market A would face a damage of £2 per unit (i.e. £2 of overcharge passed-on in full), while customers buying from firms in market B face a damage of £1 per unit (i.e. 10% of £10). The aggregate damage would therefore be only £150 (or £1.50 per unit on average).

If permissible, this issue could be addressed by undertaking separate analyses for each of the two markets and then combining the damages estimates later to yield an aggregate award. However, even this could potentially require the court to grapple with different data sources and different factual and economic issues.

Moreover, it is easy to see how more complex adjustments might be needed. For instance, what if the role that costs play in determining prices for two groups of direct purchasers is completely different? An example would be if, for one group, the relationship between prices and costs is fairly continuous (in the sense that an increase in cost will lead to an increase in price – the question is only by how much), but another group employs discrete price points that they change only when the cumulative impact of changes in their input costs warrants such a move.[14]

The factual and economic enquiries required to produce a reliable estimate of damages would evidently be very different for each group, and it would be (at the least) challenging to incorporate these nuances into a common approach to estimating damages. What if the class was comprised of firms that may themselves have engaged in pass-on, but to varying degrees? This would make an already challenging exercise even more difficult.

13. An example would be using a single regression to estimate overcharge across both markets and a single regression to estimate pass-on across both markets.

14. Such "stepwise" pass-on is one of the issues discussed in the RBB report referenced in the CAT and the SC judgments, "Cost pass-through: theory, measurement, and potential policy implications", A Report prepared for the Office of Fair Trading, RBB Economics, February 2014.

These simple examples illustrate how difficult it may be for the CAT to determine (as it must) whether any claim has a realistic prospect of success without traversing material amounts of factual and economic evidence. Claimants would presumably need to set out (and be prepared to be interrogated on) how the damages estimation methodology proposed is capable of taking into account at least the most obvious real-world features of the markets in question and any data issues that arise from them.

At a minimum, it would seem necessary for the CAT to undertake targeted reality checks to ensure that the methodology proposed (in combination with the available data) is unlikely to give rise to biased damages estimates. Indeed, were it not to do so at the certification stage, this could prove problematic at the trial stage, where it could quickly become apparent that the damages methodology that had been proposed at the certification stage is not, in fact, fit for purpose (causing any efficiency benefits from bringing the claim in question as a class action to quickly unravel).[15]

The relevance of data availability at the certification stage

The SC judgment makes plain that the CAT's threshold regarding the availability of suitable data was too high. Core to its reasoning was that data issues that would not stop an individual claimant bringing an individual action for damages should not prevent a class representative from doing so. Nevertheless, since the issues of data availability and damages estimation methodology are inherently intertwined, there are a number of reasons why data issues should not simply be ignored at the certification stage.

Most obviously, even if a particular damages estimation methodology is conceptually valid, the data must exist to operate the methodology if there is to be a realistic prospect of establishing damages reliably. For instance, if there is reason to believe that rates of pass-on vary across direct purchasers, or that the role that costs play in shaping prices differs fundamentally across customer groups, suitable data must be available to capture these nuances if the methodology is to be viable. Since the absence of such data would inevitably cause the claim to fail at the trial stage, an expert should give this issue great consideration.

Moreover, it would be incorrect to assume that all data issues can be addressed through the application of the "broad axe" principle. Data issues can cause results to be fundamentally biased (not just imprecise). To have a realistic prospect of reliably establishing damages, a proposed methodology must be tailored to reflect the available data. Economic evidence will inevitably offer limited insights if based purely on theoretical models that bear little resemblance to the real-world.

Engaging with these issues at the certification stage, at least insofar as they are likely to be determinative, seems critical if the UK class action regime is to function efficiently. At some stage the CAT may also need to grapple with the question of how broad the axe can become before the level of uncertainty around a damages estimate is simply too broad to infer anything.

Concluding remarks

While potentially lowering the bar for certification in some respects, the SC judgment highlights how economic analysis is likely to retain an important role at the certification stage. Indeed, in some respects the judgment may give rise to a greater role for economists at the certification stage than some practitioners may have previously envisaged. Notably, the judgment makes clear that a damages estimation methodology that is developed in an ivory tower and not grounded in the real-world facts and data seems unlikely to meet the standard required.

15. The CoA decision sought to address this concern by reminding that the CAT can revoke the CPO at any point between the initial granting of the application and the trial, if needed. However, it is difficult to see how this could operate in practice without a significant level of substantive engagement, and would likely require a further "mini-hearing". Lord Sales and Lord Leggatt disagreed with CoA's reasoning on this point on the same basis (see paragraph 164 of the SC judgment).