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The American
Antitrust Institute

TESTIMONY

OF

ALBERT A. FOER

ON BEHALF OF

THE AMERICAN ANTITRUST INSTITUTE

Regarding

H.R. 4321, The Antitrust Enforcement Improvement Act of 2000

U.S. HOUSE OF REPRESENTATIVES

COMMITTEE ON THE JUDICIARY

September 12, 2000

2919 ELLICOTT ST, NW • WASHINGTON, DC 20008
PHONE: 202-244-9800 • FAX: 202-966-8711 • E-MAIL: BFOER@AOL.COM
www.antitrustinstitute.org

I am Albert A. Foer, President of the American Antitrust Institute, an independent non-profit research, education and advocacy organization[1] that supports legislation to overturn the *Illinois Brick* decision[2] and other reforms aimed at increasing the effectiveness and reach of the antitrust laws by assuring both that victims will be compensated and that putative violators will be deterred.

We have been asked to focus on Section 3 of H.R. 4321, which provides amendments to the Clayton Act. I will address my remarks to the desirability of Congress providing a broader federal remedy for the problems caused in indirect purchaser antitrust cases by three Supreme Court decisions. Efforts to pass a federal legislative solution have failed in the past, but the problems for consumers that were predicted back in 1977 after the *Illinois Brick* decision was announced have only grown worse. Today, we have a situation that is injurious to consumers, to businesses, and to the administration of justice.

Background

The Clayton Act provides for damages to be awarded to "any person" who is "injured in their business or property" by an antitrust violation.[3] The antitrust laws do not provide, however, how damages are to be handled when damages are passed on from one set of victims to another. To simplify the issues dramatically, suppose that a manufacturing cartel violates the antitrust laws by fixing the prices of a particular product at a level above what would be the competitive price. The product is then sold to a wholesaler, who subsequently re-sells it to a retailer, who finally re-sells it to an end-use consumer. The direct purchaser is the wholesaler. Both the retailer and the consumer are indirect purchasers. It is likely that some, and sometimes all, of the monopoly overcharge (the difference between the competitive price and the illegally fixed price) was passed

[1] AAI is described at www.antitrustinstitute.org.

[2] *Illinois Brick Company v. Illinois*, 431 U.S. 720 (1977).

[3] Section 4 of the Clayton Act.

through the various levels of the distribution chain. The principal question is, at which levels do victims have the right to recover their damages?[4]

The question began to appear in the Supreme Court with the *Hanover Shoe* case[5] in 1968, where the issue was whether a defendant in an antitrust case would be allowed to argue that the plaintiff, a direct purchaser, had passed on the damages and therefore hadn't been injured. The Court rejected that idea, not wanting to complicate proceedings or undermine the incentive of claimants to bring treble damage suits.

This left open, however, an important question: if "passing on" could not be used defensively, could it nevertheless be used offensively? That is, could an indirect purchaser recover for illegal overcharges that were passed on to it? This was answered by the Supreme Court in 1977, in *Illinois Brick*. The Court held that an indirect purchaser may not recover damages. *Hanover Shoe* applied equally to plaintiffs and defendants. The Court also believed that the calculation of damages and their allocation among different levels of indirect and direct purchasers would be extremely difficult and cumbersome. Finally, the Court said that the deterrent purposes of the antitrust laws would be better served if the only plaintiffs were those with the largest stake, namely, in the Court's minds, the party or parties who were in privity with the law-violator. This opinion was rendered at a time when class actions were less well-established than they are today and the Court felt that indirect purchasers, each having only a small stake in the damages, would not have as much incentive to privately enforce the antitrust laws as direct purchasers. However, in the aggregate, consumer stakes frequently are significantly larger than any other group's. It should also be noted, as the Supreme Court has frequently stated, the purpose and ultimate test of the antitrust laws is consumer benefit, so it seems particularly odd that injured consumers are not made whole under the antitrust laws.

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[4] The typical situation becomes more complicated because some absorption of the overcharge may occur at succeeding levels and because the initial overcharge is likely to become enhanced at succeeding levels, as will be discussed later.

[5] Hanover Shoe, Inc. v. United Shoe Machinery Corp., 392 U.S. 481 (1968).

The immediate impact of *Illinois Brick* was to deprive consumers, indirect purchasers between the consumers and the direct purchasers, and end-users-- including many businesses of all sizes-- of the ability to be made whole from antitrust injuries. Such businesses and consumers are rarely the initial or direct purchasers of goods and services whose prices were artificially inflated, but they are usually the ones who paid all or most of the overcharges. Because of this inequity, states began passing what are known as Illinois Brick Repealer statutes to specifically permit indirect purchasers to recover damages under state antitrust statutes. By 1989, approximately fourteen states and the District of Columbia had passed repealers or had existing laws that could be interpreted to provide recovery for indirect purchasers.[6] But how would concurrent state and federal authority over business practices work out, with two sets of contradictory standards in play? Were the state laws preempted by federal law?

This question was answered by the Supreme Court in 1989. In *ARC America*,[7] the Supreme Court unanimously upheld the constitutionality of state indirect purchaser statutes. Since that time, the number of jurisdictions providing for indirect purchaser actions has grown to approximately twenty-four. The resulting dual system, while giving a significant proportion of the consumer population some hope of recovering damages under their state laws, varies greatly from state to state.

Many Consumers Are Deprived of a Remedy

From a consumer perspective, the current system is unfair if you live in a state that does not facilitate recovery for indirect purchasers in state antitrust cases. Consider the international food additive and vitamin cartel cases that generated headlines over the

[6] See ARC America Task Force Report of the American Bar Association Section of Antitrust Law, 59 *Antitrust L.J*. 273 (1990).

[7] *California v. ARC America Corp.*, 109 S.Ct. 1661 (1989). See Ronald W. Davis, "Indirect purchaser Litigation: ARC America's Chickens Come Home to Roost on the Illinois Brick Wall," 65 *Antitrust L.J*. 375 (1997).

past couple of years. Some of the world's largest companies were caught engaging in price fixing on an enormous scale. Perhaps a billion dollars in overcharges were systematically levied on middlemen and passed on, at least to a large extent, to consumers. Some of this colluding was secretly filmed by the FBI and many of the companies settled, paying the largest penalties in antitrust history.[8] The story of the food additive cartels is being told now in two new books aimed at a popular audience, replete with quotations from the top people at the ADM Company advising their co-conspirators that in their minds the competitor is their friend; the enemy is their customers.[9]

The middlemen were usually very large companies. As the direct purchasers, some of them turned around and sued the conspirators, even though there is reason to believe that they passed on most of the overcharges to consumers. One class of corporate victims reportedly settled for over a billion dollars. Others opted out of the class and are pursuing their own lawsuits. For these corporations, their recovery is to a large extent a windfall. But what about consumers?[10] Only those who happen to live in repealer states have a chance to claim damages, and relatively few have in fact recovered damages because trial courts have frequently refused to certify a class.[11]

What does this mean politically? As citizens in non-repealer states recognize that they were not able to share in the recovery from these dramatic international cartel cases,

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[8] F. Hoffman-La Roche Ltd. paid a criminal fine of $50 million. See James M. Griffin, "An Inside Look at a Cartel at Work: Common Characteristics of International Cartels," speech to American Bar Association Section of Antitrust Law, April 6, 2000, available at www.DOJ.gov.

[9] See Kurt Eichenwald, *The Informant*, and James Lieber, *Rats in the Grain*.

[10] Sen. Howard Metzenbaum (ret.) unsuccessfully attempted to gain standing for consumers before the court accepted the class settlement. An interesting case in the parade of horribles is *Campos v. Ticketmaster*, 140 F.3d 1166 (8th Cir. 1998), which denied standing, because of Illinois Brick, to individuals who alleged that they had paid too much to Ticketmaster for concert tickets that they obviously were purchasing "directly" from Ticketmaster, because the concert venues (arenas) were deemed the real "direct purchasers," for whom Ticketmaster was acting as an agent. See Albert A. Foer, "On the Appeal of Ticketmaster," http://antitrustinstitute.org/recent/21.cfm .

[11] William H. Page, "The Limits of State Indirect Purchaser Suits: Class Certification in the Shadow of Illinois Brick," 67 *Antitrust L.J.* 1 at 5 (1999).

it can be predicted that they will bring new pressures on their legislatures to pass repealer statutes.

Businesses Are Not Getting the Protection They Expected from Illinois Brick

Businesses that considered themselves potential targets of antitrust enforcement initially read the *Illinois Brick* opinion as holding forth the promise of a less threatening antitrust regime:

•Only one layer of plaintiffs would be of concern. There would be no tracing of damages beyond the direct purchaser. This had several advantages for a defendant. First, there would be fewer parties to deal with. The fewer the plaintiffs, the less expensive and less disruptive the litigation. Second, any damages would be based on injury to the direct purchaser. If subsequent levels of the distribution chain added markups that increased the actual damages caused by the initial overpricing, this would be irrelevant. Third, courts, knowing that direct purchasers are likely to obtain a windfall, might well be sympathetic to defendants, exhibiting what has been called "equilibrating tendencies of the court."[12]

•The potential plaintiffs would generally be limited to other businesses, which would be likely to have on-going relations with the accused. Direct purchasers would be relatively reluctant to initiate a lawsuit that would disrupt established relations, especially if they had passed on an overcharge and therefore weren't significantly damaged, and all the more so if the middlemen understand that they may be quietly sharing in some of the monopoly rents being obtained by their supplier. While it is true the Supreme Court made different assumptions, arguing that direct purchasers would have the most at stake and be most likely to bring a suit, the assumptions appear to have been wrong, resulting in a boon for defendants.

[12] See Stephen Calkins, "Equilibrating Tendencies in the Antitrust System, with Special Attention to Summary Judgment and to Motions to Dismiss," in *Private Antitrust Litigation*," 185 (Lawrence White, ed., 1988) and Robert H. Lande, "Are Antitrust 'Treble' Damages Really Single Damages?" 54 Ohio State L.J. 117 (1993).

Although antitrust defendants have often been the beneficiaries of *Illinois Brick*, things have not always worked out to their advantage. First, antitrust defendants now must not only deal with direct purchasers in the federal courts, but with indirect purchasers in a multitude of state courts. Second, whatever the complexities of tracing damages that were eliminated from federal cases, they exist in the state cases.[13] Third, the handling of cases in a variety of jurisdictions can be very expensive. Fourth, outcomes may be inconsistent. And fifth, as we've seen in the vitamin cases, where damages are great, corporate direct purchasers may have a large incentive to go for a windfall victory, even when the overcharges were probably passed on rather than absorbed. In other cases, they may not have significant incentive to seek recovery, preferring a private business solution, and leaving the antitrust violator with its windfall.

Overall, *Illinois Brick* has been a mixed bag for businesses, giving antitrust defendants a huge advantage in federal court, but creating a backlash in the states that to some extent undermines the benefits putative defendants had hoped for. For businesses that do not violate the antitrust laws and for businesses that suffer as indirect purchasers and cannot pass on their full losses, *Illinois Brick* presents no advantages.

Judicial Administration Has Been Harmed

The Supreme Court in both *Hanover Shoe* and *Illinois Brick* was concerned with judicial economy. It felt that tracing damages beyond the initial purchaser would be too complicated and difficult, and it believed that direct purchasers, having the largest individual stakes and being closest to the violation, would be most likely to reflect the public's interest in the private enforcement of antitrust. Time has proven the Supreme Court to be wrong on both counts.

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[13] It is an axiom of law that a party is responsible for the foreseeable or natural consequences of his act . The price-fixing manufacturer knows who is in the distribution chain all the way to the end consumer and can usually model the effects of any changes in price, most, if not all, of which are intended.

The widespread and still-expanding availability of a remedy under state laws has meant that complications have not been avoided. Rather, they have been displaced from a single federal case to a multitude of state cases. Further, the development of the consumer class action, while creating many complications, has demonstrated that there is a strong incentive to aggregate small damages in a manner that assures indirect purchasers can be at least as aggressive as direct purchasers (and probably more so, to the extent that they are the ones who suffer the main loss). This is not to suggest that a reform of the handling of indirect purchasers will be simple, but rather than the rationales supporting the status quo have been totally undermined.

Comments on H.R. 4321

The public has a large stake in private antitrust litigation. There are generally about ten private cases for each public case.[14] While federal cases often dig out the fact of violation and provide injunctive relief to protect the public at large, it is up to private litigants to seek remedies for the damages suffered by individuals and businesses. The risk of private litigation not only deters antitrust violations but also provides incentive for unearthing public wrongs. "Private attorneys general" supplement the limited federal and state resources that are devoted to keeping our industries fairly competitive and play a role that was anticipated when the authors of the Sherman Act first introduced trebled damages.[15] The overall scheme of antitrust requires that private litigation both provides recompense to those who are injured by antitrust violations and deterrence against such violations.

H.R. 4321 would permit any indirect purchaser to recover damages. This is the critical center of the reform, and may be the least complicated aspect. But the devil will be in the details. For example, the recovery allowed by the bill is "only with respect to

[14] Ernest Gellhorn and William E. Kovacic, *Antitrust Law and Economics* 462 (1994). If you exclude government merger cases and focus on Sherman Act claims, the ratio is probably far larger.

[15] It has been argued persuasively by Robert H. Lande that when all factors are taken into account, including detection problems, proof problems, antitrust damages generally should be substantially higher than singlefold . *Op. cit*. note 12 *supra.*

the amount of the initial overcharge proved to be passed on to him." Sec. 3(d). This provision simplifies the calculation of damages, but it would not be acceptable to consumers because it means that the indirect purchaser may not be fully compensated and violators may be unduly insulated.

For example, most players in a chain of distribution apply a markup to their costs in order to determine a retail price. If the standard markup is 20% at the wholesaler and 50% at retailer level, the scenario unfolds this way: the manufacturers would have a competitive price of $10, but by agreeing among themselves to fix prices illegally, they charge, let us say, $12 (a 20% premium). In a competitive market, the wholesaler would have added 20% to $10 and sold to a retailer at $12. The retailer would have added 50% and sold to the consumer at $18.00. But with price fixing, the wholesaler adds 20% to the inflated $12 price and charges the retailer $14.40. The retailer adds 50% to this and charges the consumer $21.60. Under H.R. 4321, the damages will be the initial charge of $2 trebled to $6. But the full damages suffered by the end-use consumer will be the difference between the inflated price of $21.60 and the competitive price of $18.00, or $3.60. Trebled, that would be $10.80, nearly twice as much as H.R. 4321 would authorize. This type of increase in damages that generally occurs from level to level is entirely predictable by price fixers. Given the large amount of money that is apparently at stake, it is not clear why plaintiffs should not be permitted to prove, if they can, that their damages surpass the initial overcharge.

H.R. 4321 applies to indirect sellers as well as to indirect purchasers. The problem here is with underpayments, not overpayments. The situation arises when buyers have monopsonistic market power and collude with each other to reduce the price that they pay to purchase inputs. Monopsony has not received the amount of attention that monopoly has, yet its consequences for the economy are so similar that Professor Hovenkamp calls it "the mirror image of monopoly."[16] A strong case can be made for antitrust to attack

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[16] Herbert Hovenkamp, *Federal Antitrust Policy*, 14 (1994).

monopsony with the same vigor it applies to monopoly.[17] In theory, both cattlemen and middlemen who have been underpaid as a result of an illegal conspiracy of, e.g. supermarkets that have jointly agreed to purchase beef at below-market prices, should have the opportunity to prove damages.

HR 4321 entitles a defendant to offer, as a partial or complete defense, proof that it passed on either an overcharge or an undercharge. This appropriately overturns *Hanover Shoe* in the indirect purchaser situation. If indirect purchasers are to be permitted to recover for overcharges, then middlemen who were not harmed should not be entitled to windfall damages. A question is left dangling, however. If a middleman passes on a higher price, in most situations this will result in fewer sales. Can the middleman collect damages for reduced profits caused by the smaller number of units sold? (Lost profits are not considered a suitable subject for a class action.) And the formulation of H.R. 4321 raises another, more important question, because the language is not limited to a case in which there is an indirect purchaser. H.R. 4321 would allow a defendant to escape antitrust liability on a passing off defense even when there is no indirect purchaser in the case. We believe that this could kill off direct purchaser suits, which would undermine the deterrence effect of the law.

H.R. 4321 provides that in a class action, the fact of injury and the amount of damages may be proven on a class-wide basis, without requiring proof of such matters by each individual member of the class. It simplifies the process by attributing damages in the ratio of an individual's purchases or sales to those of the class as a whole. This is an important provision because many indirect purchaser actions at the state level have been defeated at the class certification stage.[18] Some courts have been unwilling to make the types of category generalizations that are necessary to a class action. Certainly each individual suffers damages in his own way, and H.R. 4321 requires, appropriately, that damages shall be assessed only on behalf of any person who makes a valid damage claim,

[17]The American Antitrust Institute has advocated greater focus on problems of buyer power in the context of supermarket mergers. See http://www.antitrustinstitute.org/recent/79.cfm.

but without the type of generalizations that permit attribution in proportion to the class as a whole, courts will not be able to utilize indirect purchaser trials an effective tool for making victims whole.

What Next?

The American Antitrust Institute is delighted that Congressman Minge has introduced and the Judiciary Committee has taken up the indirect purchaser issue. We have established an internal committee of experts within the antitrust community who are working on this topic and our committee will be at your disposal as the legislative process moves forward.

We recognize that reform in this area is complicated and politically difficult. It is particularly important that reform at the federal level not have the unanticipated impact of reducing in practice the rights and remedies that currently exist for consumers in Illinois Brick Repealer states. Many of these states work together on indirect purchaser cases, often in cooperation with private parties, and achieve a notable level of justice for their citizens. Recognizing that many in the federal judiciary are not comfortable with consumer rights and reluctant to try class actions, it is imperative that any federal legislation be clear, strong, and precise, and that its implications be tested out by reference to the body of expertise that has come into existence in those states that have repealed *Illinois Brick*. This truly is a situation in which the states are testing laboratories for experimentation and in which the federal government should not act without evaluating these experiments. Research that can adequately guide the Congress is currently lacking.

We urge the Committee to hold additional indirect purchaser hearings to evaluate the experiences of the states, by taking testimony of Assistant Attorneys General, litigators, and consumers who have become familiar with the trial process. Which state

[18] See William H. Page, "The Limits of State Indirect Purchaser Suits: Class Certification in the Shadow of Illinois Brick," 67 *Antitrust L.J.* 1 (1999).

statutes have proven most workable? What problems have repeatedly arisen in litigation? What presumptions and assumptions work and which do not? What methodologies have been developed for proving or rejecting pass-through claims? How frequently and under what circumstances have pass-throughs been absorbed? What types of law violations have resulted in indirect purchaser cases? Are they almost always horizontal price-fixing cases? Does the legislation need to be broad enough to deal with other types of violations or does this add uncertainties and complications?

We hope that your hearing today will be seen from the future as a landmark in a process that will build political support, develop a firm empirical base for reform, and ultimately lead to a major advance in justice for consumers and businesses and in efficiency for the nation's judicial systems.

Curriculum vitae of Albert A. Foer

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Current: President, The American Antitrust Institute, 2919 Ellicott Street, NW, Washington, DC 20008.

Previous Positions: Executive Director, Education Services Council, Washington, DC (1996-97); Chairman and CEO, Melart Jewelers, Inc., Silver Spring, Md. (1983-1995); Attorney, Jackson, Campbell & Parkinson, Washington, DC (1981-83); Assistant to the Director, Assistant Director, and Acting Deputy Director, Bureau of Competition, Federal Trade Commission, Washington, DC (1975-81); Attorney, Hogan & Hartson, Washington, DC (1973-75).

Other Current Activities: Chairman of the National Capital Area affiliate of the American Civil Liberties Union; President of 8700 Georgia Avenue Partnership; National Board and Regional Vice Chairman, American Associates of Ben-Gurion University; Board of Governors, Washington region of Antidefamation League; advisory council member for several small businesses.

Other Previous Activities: President, Chairman, and Board of the Diamond Council of America; Board and Executive Committee of the Jewelers of America; Board and Executive Committee of the Jewelry Industry Council; adjunct professor of antitrust at both Johns Hopkins University and George Washington University; founding officer of the Washington International Trade Association.

Author of numerous writings relating to competition policy. Past three years available at www.antitrustinstitute.org.

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