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The American
Antitrust Institute

Date: April 30, 2007

The Honorable Patrick J. Leahy,Chairman
Committee on the Judiciary
United States Senate
433 Russell Senate Office Bldg.
Washington, DC 20510

The Honorable Arlen Specter, Ranking Member
Committee on the Judiciary
United States Senate
711 Hart Building
Washington, DC 20510

The Honorable Herb Kohl, Chairman
Subcommittee on Antitrust, Competition Policy and Consumer Rights
United States Senate
SD-224
Washington, DC 20510

The Honorable Orrin G. Hatch, Ranking Member
Subcommittee on Antitrust, Competition Policy and Consumer Rights
United States Senate
SD-152
Washington, DC 20510

The Honorable John Conyers, Jr, Chairman
Committee on the Judiciary
United States House of Representatives
2426 Rayburn House Office Building
Washington, DC 20515

The Honorable Lamar S. Smith, Ranking Member
Committee on the Judiciary
United States House of Representatives
2184 Rayburn House Office Building
Washington, DC 20515

Dear Senators and Members:

The Antitrust Modernization Commission ("AMC") has made a number of recommendations to Congress for revision of the antitrust laws. The American Antitrust Institute ("AAI"), which monitored the AMC's hearings and deliberations closely and provided public comments throughout the three-year life of the AMC, plans to offer further comments on the AMC's Report and Recommendations. This is the first in this series of analyses.

In the enclosed document we focus on the recommendation concerning indirect and direct purchasers. By ignoring the dynamics of the litigation process, we believe that the AMC's recommendation will likely have an effect quite the opposite of its professed objective and that instead of helping America's consumers and businesses to gain standing in federal court, it will dramatically undermine their ability to obtain compensation for antitrust injuries, and will in fact reduce the deterrent effects of antitrust in a serious way. Far and away the primary beneficiaries of this AMC proposal, if implemented in its present form, will be price fixers and monopolists.

If Congress decides to consider legislation along the lines of the AMC's recommendation, it is imperative that it understands the nature of

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the devils that are in the details of this very important but complex issue. Please feel free to call upon us for any assistance we might render.

Sincerely,

Albert A. Foer
President

Enclosure:
Comments of the AAI Concerning the AMC's Recommendation

COMMENTS BY THE AMERICAN ANTITRUST INSTITUTE[1] CONCERNING THE ANTITRUST MODERNIZATION COMMISSION'S RECOMMENDATIONS REGARDING DIRECT AND INDIRECT PURCHASER ACTIONS[2]

APRIL 30, 2007

Summary

[1] The American Antitrust Institute ("AAI") is an independent education, research, and advocacy organization. See www.antitrustinstitute.org. The Advisory Board of the AAI consists of over 90 lawyers (plaintiff, defense, and other, including academics), economists, and business professors, many of whom have participated in the development of these comments. The comments, however, should not be understood to reflect the position of any or every advisor. They have been approved only by the five-person Board of Directors, which includes an economist, three lawyers and a law professor.

[2] See AMC Report & Recommendations, dated April 2, 2007 ("AMC Report").

Despite apparently substantial disagreement among the AMC's Commissioners,[3] the AMC has proposed a radical rewriting of the laws governing private antitrust litigation. The centerpiece of the proposal is the legislative overruling of two Supreme Court cases – *Hanover Shoe*[4] and *Illinois Brick*[5] – precedents that have governed private antitrust litigation for almost forty years, and which themselves were based on well-established legal principles extending at least as far back as the dawn of the twentieth century.[6]

The AMC proposal contains some important suggestions for improvement of the current system. In particular, making it possible for indirect purchasers everywhere in the nation to recover for antitrust damages they have suffered would be a major step forward. It is estimated that only about half of the population lives in States that currently provide standing for indirect purchasers to claim damages. We praise the AMC for urging this expansion of the Illinois Brick repealer principle. As we will discuss below, however, it appears to us that under the AMC proposal, this theoretical expansion will be much more than offset by the decimation of the direct purchaser recovery, with the result that there will be less deterrence for price-fixers and monopolists who will end up not having to pay full compensation for their illegal acts. This will cause consumers and victimized businesses to suffer.

While we do not suggest that the current system cannot or should not be improved, one might expect, however, that a proposal as revolutionary as the AMC's would come adorned with compelling justifications based on sound empirical evidence of the flaws of the current system, as well as careful study of all reasonably probable consequences of such a significant departure from current practice. Unfortunately, the AMC report is deficient in both respects: there is little sound evidence of an existing problem that is not otherwise being solved by recent less radical legal changes (such as

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[3] Six commissioners stated that, "if writing on a clean slate," they would favor only direct purchaser actions because such a result "would provide the most effective deterrence mechanism, and would avoid . . . speculative inquiries about how damages may have been passed on through the chain of distribution[.]" AMC Report at 266. Three of the commissioners dissent from the AMC's recommendation in this area entirely. Id. at 267. The AAI strongly supports the right of indirect purchasers to recover damages under the antitrust laws, but also strongly believes that direct purchasers must play an important role in any just and workable process of private antitrust enforcement.

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

[5] Illinois Brick Co. v. Illinois, 431 U.S. 720 (1977).

[6] See Chattanooga Foundry & Pipe Works v. City of Atlanta, 203 U.S. 390, 396 (1906) ("[a] person whose property is diminished by a payment wrongfully induced is injured in his property"); Southern Pacific Co. v. Darnell-Taenzer Lumber Co., 245 U.S. 531, 533-34 (1918) (Holmes, C.J.) (the question of whether plaintiffs who paid an overcharge could recover even if the overcharge was passed on was "not difficult" because the overcharge claim "accrued at once" and "the law . . . does not inquire into later events"; the "plaintiffs have paid cash out of pocket that should not have been required of them" and the defendant "ought not to be allowed to retain his illegal profit"); Adams v. Mills, 286 U.S. 397, 407 (1932) (Brandeis, J.) ("claim for damages arose at the time the extra charge was paid"; subsequent reimbursement of plaintiffs by third parties is of no concern to the wrongdoers).

the adoption of the so-called "Class Action Fairness Act"), or which could not be solved by other more surgical legislative solutions (such as, *e.g.*, seeking legislative reversal of the Supreme Court's Illinois Brick or *Lexecon* decision).[7] And, while private antitrust actions,[8] and more specifically class actions on behalf of overcharged direct purchasers,[9] have long been recognized as critical to deterring antitrust violations, the AMC does not straightforwardly address the foreseeable effects that its proposal – if it became law – would have for dramatically *reducing* deterrence. There is a lot of devil hiding in the details.

The bottom line is that the AMC's proposal, if enacted into law, could cripple what six AMC Commissioners explicitly and correctly stated in the report provide "the most effective deterrence mechanism" for anticompetitive conduct: the direct purchaser action. While the AAI has set out its Working Group's reasoning in more detail in prior submissions to the AMC,[10] the essence of our objection is that the AMC proposal would dramatically decrease the incentives for direct purchasers to incur the risk and expense of filing actions against their suppliers, and make it extremely difficult to find competent counsel willing to fund and prosecute litigation in those rare instances where direct purchasers decided to do so.[11] The AMC proposal, thus, would leave the indirect purchaser action – which would now proceed under federal law – to somehow fill the void. But, the AMC does not credibly make the case that the indirect purchaser actions could possibly play the role that the direct purchaser action now plays. Indeed, the only

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[7] See AMC Report at 269-274 (discussing the "Class Action Fairness Act"and the Supreme Court's decision in Lexecon v. Milberg Weiss).

[8] Perma Life Mufflers v. International Parts Corp., 392 U.S. 134, 139 (1968) (private antitrust actions are "a bulwark of antitrust enforcement."); Pillsbury Co. v. Conboy, 459 U.S. 248, 262-63 (1983) ("This Court has emphasized the importance of the private action as a means of furthering the policy goals of certain federal regulatory statutes, including the federal antitrust laws.") (citations omitted).

[9] See Hawaii v. Standard Oil Co. of Cal., 405 U.S. 251, 266 (1972) ("Rule 23 of the Federal Rules of Civil Procedure provides for class actions that may enhance the efficacy of private [antitrust] actions by permitting citizens to combine their limited resources to achieve a more powerful litigation posture."); In re Lorazepam & Clorazepate Antitrust Litig., 202 F.R.D. 12, 21 (D.D.C. 2001) (noting "long ago the Supreme Court recognized the importance that class actions play in the private enforcement of antitrust class actions"); In re Carbon Black Antitrust Litig., No. 03-10191-DPW, 2005 U.S. Dist. LEXIS 660, at *44 (D. Mass. Jan. 18, 2005) (internal quotes and citations omitted)("The allowance for treble damages in antitrust actions was designed to encourage private enforcement of the antitrust laws by offering generous recompense to those harmed by the proscribed conduct and simultaneously to erect a deterrent to those contemplating similar conduct in the future. . . Courts have noted that class actions are a particularly appropriate mechanism for achieving such enforcement[.]").

[10] See, e.g., submissions by the AAI's Working Group on Civil Remedies, dated July 10, 2006 and March 2, 2007 (both of which are available at www.americanantitrust.org and www.amc.gov.).

[11] The vast majority of private direct and indirect purchaser cases are brought as contingent fee actions, where the plaintiffs' counsel bears the expenses and opportunity costs of litigation, which are recovered only if the litigation is successful. Therefore, it is critical to understand the dynamic effects of any proposal in this area upon the cost/benefit analysis that putative plaintiffs' counsel go through in determining whether to represent a client. A proposal which undermines the incentives for representation of injured plaintiffs may fairly be described as eviscerating private enforcement of the antitrust laws.

solid empirical evidence about the relative importance to antitrust deterrence of direct versus indirect actions known to AAI has revealed that in a survey of 29 successful private antitrust cases, direct actions have recovered more than five times that of indirect actions (collectively, at least $11.2 billion vs. $2.1 billion).[12]

If this empirical information is accurate -- and it is the only empirical information that appears to have been presented to the AMC -- then even if awards to indirect purchasers doubled (such as might be expected once the 50% of the nation's population currently unable to bring indirect cases at all are given the opportunity) such an increase would not nearly offset the decrease in expected awards to direct purchasers, pursuant to the AMC's proposal. For example, using this same data, if direct purchaser recoveries dropped by even 25% -- and they likely would drop much more than this -- this decrease would entirely offset gains by indirect purchasers, even if their recoveries doubled (25% of $11.2 billion = $2.8 billion). In fact, we fear that recoveries by direct purchasers would drop precipitously, and we would not be surprised if class actions by direct purchasers were decimated.

In short, the AMC proposal could cripple the "most effective" method for deterring anticompetitive conduct without providing a suitably equivalent replacement. The result would be a dramatic and immediate reduction in the damages exposure of those who engage in anticompetitive practices and, ultimately, a substantial reduction in disincentives for violating the antitrust laws.

Curtailment of Direct Purchaser Actions: The AMC proposal applies to class and non-class actions alike, whenever there is a direct or indirect purchaser as the plaintiff. Under the existing legal regime, a direct purchaser is deemed harmed by the full amount it was overcharged from an antitrust violation without regard for whether it "passed on" a portion of that overcharge to downstream purchasers. If there are also indirect purchasers, according to the proposal, the total amount of damages cannot exceed the overcharges (trebled) incurred by direct purchasers.

Forget for the moment that the damages to indirect purchasers (who suffer the foreseeable markups of overcharges that are passed along to them) may in actuality substantially exceed the overcharges to directs. Computing the overcharge to directs, while relatively straightforward using standard economic and statistical techniques, is nonetheless not an insignificant undertaking, as it involves market-wide economic analysis of the artificial price inflation caused by the antitrust defendants' conduct. However, computing the actual net economic harm suffered by direct purchasers ("lost profits"), as the AMC plan *requires*[13], would necessarily involve considerably *more* complex and expensive economic and statistical analyses. Indeed, the practical difficulties of such an endeavor would likely be prohibitive in many cases. For instance,

[12] See "Interim Report of the American Antitrust Institute's Private Enforcement Project," by Profs. Lande & Davis, dated and submitted to the AMC on November 14, 2006 (available at www.antitrustinstitute.org).

[13] The AMC proposal provides, "Damages should be apportioned among all purchaser plaintiffs—both direct and indirect—in full satisfaction of their claims in accordance with the evidence as to the extent of the actual damages they suffered." Report at 177.

computing the "lost profits" of a class of direct purchasers would invariably necessitate individualized, detailed, costly, and burdensome discovery from *each and every direct purchaser* (potentially thousands of entities in a class action). Moreover, such a computation would also typically involve computing losses on the foregone sales (due to artificially inflated prices) of each direct purchaser – a notoriously difficult task for one entity, and a nearly impossible task for hundreds or thousands of entities. Furthermore, in many cases, direct purchasers pass on a significant portion of any overcharge due to an antitrust violation to the next link in the chain of distribution, thereby diminishing (and, in some cases, substantially so) potential damages available to direct purchasers even assuming those damages could be accurately computed within any reasonable time-horizon.

For these reasons and others, courts have repeatedly and correctly recognized that determining *actual* economic harm caused by an antitrust violation, or "lost profits," can be complex, inefficient, and, therefore, prohibitive. Indeed, based upon these practicalities that the AMC has seen fit to elide, the Third Circuit recently went so far as to conclude that forcing purchasers to recover their "actual damages"– as the AMC now proposes – would "practically deny recovery" in many instances. *Howard Hess Dental Laboratories, Inc. v. Dentsply Int'l, Inc*., 424 F.3d 363, 374-75 (3d Cir. 2005). And, it is essentially this reasoning that led the Supreme Court to observe that the principle of antitrust deterrence would be served best by "holding direct purchasers to be injured to the full extent of the overcharge paid by them than attempting to apportion the overcharge among all that may have absorbed part of it."[14] By allowing direct purchasers to recover the full extent of the overcharge, direct purchaser damages are likely to be substantial, relatively straightforward, and simple to compute, thereby supporting "the legislative purpose in creating a group of 'private attorneys general' to enforce the [antitrust] laws[.]"[15] Elimination of this rule, as the AMC now urges, would have serious consequences for antitrust enforcement.

If AMC's proposal became law, few direct purchasers would bring cases against their suppliers, or be able to litigate them aggressively if they did, and the direct purchaser action would cease to play a material role in antitrust enforcement. [16]

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[14] Illinois Brick Co. v. Illinois, 431 U.S. 720, 746-47 (1977).

[15] Id.

[16] In his Separate Statement appended to the AMC Report, Commissioner Jacobson argues, responding to the AAI's March 2, 2006 public comments, that the proposal "should not, by itself, reduce incentives for anyone to sue." He admits that there is a "theoretical" possibility that uncertainty as to the amount of pass through would create a disincentive for directs to sue, but postulates that the degree of disincentive will be "trivial". At 420. In fact, if the directs know they have passed on all or nearly all of their damages, they would have no incentive to sue. Commissioner Jacobson offers no evidence, and the absence of a voice for the plaintiffs' bar on the Commission makes it highly unlikely that the Commissioners seriously considered any evidence on this matter. Commissioner Jacobson next argues, "To the extent there is any diminution of the incentives affecting direct purchaser lawyers, the increases on the indirect purchaser side will more than offset it." Id. Again, there is no evidence offered. Contrary to Commissioner Jacobson's pungent reference to the AAI's March 2 comments as representative of "those with vested interests in the current regime," the AAI's point has nothing to do with assuring employment for attorneys who represent plaintiffs. Rather it is that as a result of dynamics created by the AMC proposal, consumers and businesses who are harmed by

Lack of Adequate Replacement: While indirect purchaser actions are a critical part of the existing antitrust enforcement regime (and would become even more so if *Hanover Shoe* and *Illinois Brick* were legislatively overruled), indirect purchaser actions could not adequately substitute for the role now played by direct purchaser actions in antitrust enforcement.[17]

The fact is, indirect purchaser actions are weakened in their potential impact by two factors which the AMC plan fails to address or ameliorate in any material way. First, indirect actions are sometimes plainly inappropriate or unduly difficult due to "remoteness" issues raised by the need to trace the pass-on down the chain of distribution. Where, for instance, the price-fixed product at issue is an "input" into other products (such as, for example, high fructose corn syrup, or most industrial chemicals), there is often no end purchaser of the price-fixed product in its pure form. By the time the overcharge on the input makes its way into a final product (possibly as a small part of that product), and wends its way down the chain of distribution, its impact on any particular consumer may be uncertain or remote. In a world without *Hanover Shoe*, there may be no cognizably "injured" party in a good deal of cases. In cases where the directs "pass on" the overcharge, but there is no (or few) non-remotely injured consumers, under the AMC's plan, the antitrust violator simply keeps its ill-gotten gains. **If Congress decides to legislate based on the AMC's proposal, it must at the very least assure that the pass-on defense would apply ONLY if there is actual and substantial recovery by indirects. Otherwise, it would be making an enormously valuable gift to wrongdoers whose hands are not clean. The deterrent factor of having to pay civil damages could be entirely discounted in future decisions by such companies.**

Second, courts have – often improperly – erected significant barriers to class certification in such cases. As two prominent antitrust defense lawyers recently observed in a submission to the Commission of the European Union, difficulties in computing "overcharge absorption and pass-through rates among different types of purchasers . . . has led some courts to finally conclude that such an overarching calculation could not be accomplished on a classwide basis."[18] One need not agree with the opinion of these defense attorneys or the courts they are citing (and the AAI does not) to recognize that barriers to indirect purchaser actions currently exist – barriers which indisputably render the indirect purchaser action an inadequate substitute for the role that direct purchaser actions play in the existing legal regime.

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such antitrust violations as price fixing would simply not be able to obtain relief, which we believe is unfair and inappropriate.

[17] It is difficult to understand how the proposed cap on damages will be determined if the directs choose not to litigate. In this situation, if indirects do litigate, their damages will be capped in a thoroughly arbitrary way, based on what might have been the overcharges to directs who are not even a part of the litigation. E.g., would the phantom class of directs include all possible directs in the world? And what if only one direct litigates: would damages for all indirects be capped at that one plaintiff's overcharges?

[18] See "U.S. Antitrust Class Actions: Lessons for Europe," by Tefft Smith & Sarretta McDonough of Kirkland & Ellis LLP, dated March 7, 2007, at 17-18.

Despite these substantial issues and concerns, the AMC proposes nothing to ameliorate the existing barriers to certifying classes in indirect purchaser actions, nor does the AMC provide a remedy in "input" cases.

Conclusion

In short, by vacating *Hanover Shoe* and resuscitating the "pass on" defense, the AMC would go far toward eliminating the direct purchaser action as we know it and would in all probability not be enhancing the ability of indirect purchasers to recover their damages by nearly enough to offset this loss. Yet the AMC offers no equivalent substitute. The AMC's proposal would, thus, curtail the private enforcement of the antitrust laws, reduce deterrence of anticompetitive conduct, and offer a windfall to those who would violate the antitrust laws, harming victimized consumers and businesses alike.

Sincerely,

Albert A. Foer
President