EC 360: Industrial Organization
Lecture 4 - private antitrust enforcement

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Private enforcement

- Last lecture, we discussed how the US government can enforce antitrust laws
- The Clayton Act also allows private entities to enforce antitrust laws in court
  - "Any person who shall be injured in his business or property by reason of anything forbidden in the antitrust laws may sue therefor... without respect to the amount in controversy, and shall recover threefold the damages by him sustained, and the cost of the suit, including a reasonable attorney's fee" Clayton Act, Section 4

Private enforcement history

- Initially, very few private antitrust suits were brought to court
- In the 1960's, antitrust suits became much more common
  - The Supreme Court reduced hurdles for private plaintiffs
  - The Supreme Court broadened their definition of liability
  - Rules changes for class action law suits

Private enforcement history

Table: Private Antitrust Suits

Year	Cases Filed
1993	653
1994	686
1995	781
1996	689
1997	598
1998	580
1999	645
2000	858
2001	723

Antitrust standing

Antitrust standing

- **Antitrust standing** is the status of being an eligible party to pursue a private antitrust suit
  - A person may sue, does this exclude a business or group of people?
  - A person may sue only if they are injured, how is injury defined?
  - Damage must be done to the person's business or property, isn't this vague?
- Although the terms are somewhat ambiguous, Supreme Court cases help establish **precedent**
  - Precedent is a prior reported opinion of the court, which establishes legal rule in the future on the same legal question decided in the prior judgement

The Clayton Act: who is a person?

- Anyone considered a person (by the Clayton Act) has standing
  - An actual person
  - Corporations, partnerships, or other businesses
  - Municipalities
  - States and foreign governments
- The US government, however, is **not** considered a person

The Clayton Act: what is business or property?

- Section 4 of the Clayton Act gives standing to any person whose business or property has been hurt by an antitrust violation
  - Lost profits to a firm
  - A customer who was overcharged
  - Anyone who was directly affected by antitrust violations

Direct vs. indirect: example

- Suppose Che McKinnon, Inc. is a local bicycle retailer that was forced to close due to another firm violating antitrust laws
  - Che McKinnon lost profit due to the violation
  - The mechanics of Che McKinnon who lost their jobs
  - The landlord of Che McKinnon's building who lost its tenant
  - The city who can no longer collect tax revenue from Che McKinnon
- All of these people have experienced some damage from the antitrust violation; however, only the company Che McKinnon is considered to be directly affected by the antitrust violation

What is antitrust injury?
Brunswick Corp. v. Pueblo Bowl-o-Mat, Inc. (1977)

- The Supreme Court case of *Brunswick Corp. v. Pueblo Bowl-o-Mat, Inc.* helped establish precedent for the definition of **antitrust injury**
  - In the 1950's, bowling was popular and Brunswick was the primary supplier of most of a bowling alley's needs
  - Many alleys bought equipment on credit; however, these alleys defaulted on payments once the popularity of bowling declined in the 1960's
  - To recoup some of their losses, Brunswick bought and operated some of the failing bowling alleys

What is antitrust injury?
Brunswick Corp. v. Pueblo Bowl-o-Mat, Inc. (1977)

- Pueblo Bowl-o-Mat did not like this strategy
  - They believed Brunswick's acquisition of failing bowling alleys was an illegal merger that "might substantially lessen competition or tend to create a monopoly"
  - Pueblo asserted that this damaged their profits by keeping failing alleys in business, who would have otherwise closed
- Pueblo believed Brunswick should be liable to pay **treble** damages
  - Treble damages is a common term for threehfold the damages
  - Penalty may reflect under-enforcement risk

What is antitrust injury?
Brunswick Corp. v. Pueblo Bowl-o-Mat, Inc. (1977)

- The Supreme Court rejected the Clayton Act claim for lack of antitrust activity
  - Although Pueblo was harmed by the acquisition, it wasn't a harm the antitrust laws were meant to protect: the injury isn't antitrust injury
- The acquisition actually increased competition
  - Absent the acquisition, Pueblo would have gained market share; however, with the acquisition, the market included both Pueblo and the bowling alleys that would have left the market (i.e. more competition)
- Thus, a plaintiff cannot recover under the antitrust laws for an action that actually increases rather than decreases competition, even if the plaintiff is harmed
  - The court ruled "the injury should reflect the anticompetitive effect either of the violation or of anticompetitive acts made possible by the violation"

Direct vs. indirect injury

- The Supreme Court requires that a plaintiff be directly injured as a result of two separate cases
  - *Hanover Shoe v. United Shoe Machinery* (1968)
  - *Illinois Brick Co. v. Illinois* (1977)
- The intent of requiring direct injury is purely for the simplicity of proving damages
  - This helps facilitate damage estimation, and makes enforcing antitrust laws more practicable

Direct vs. indirect injury: difficult example

- Consider the Amino Acid antitrust litigation (1996)
  - Lysine is a common animal-feed additive, and a cartel existed that fixed prices
  - The directly affected parties were the producers of animal feeds, who were charged illegally high prices
  - These high prices meant that farmers paid more for feed
  - Meat packers had to pay higher prices for meat from the farmers
  - Consumers had to pay higher prices for packaged meat
- How would we distinguish direct vs. indirect injuries?

Direct vs. indirect injury: *Hanover Shoe v. United Shoe Machinery* (1968)

- Hanover Shoe created shoes using machinery leased from United Shoe Machinery
  - Hanover claimed United's machine rental policies were an illegal monopoly instrument
  - Hanover believed they were entitled to damages equal to the difference of the charged rental price and the price they would have paid if they had bought the machine
- United claimed they owed Hanover nothing, since all of the added cost was passed onto consumers
  - The Supreme Court sided with Hanover, and made United pay full damages
  - This set precedent that the **passing-on** defense is not valid in an antitrust case

Direct vs. indirect injury: *Illinois Brick Co. v. Illinois* (1977)

- The Brick case can be thought of as a converse of the Hanover Shoe case, as it forbids the use of the passing-on argument as an offensive tactic in an antitrust case
  - Brick manufactured concrete blocks that were used in construction in the city of Chicago
  - Contractors bought the bricks, while the state of Illinois hired contractors to build projects
- The state of Illinois wanted to sue Brick for the indirect damage it incurred
  - The Supreme Court refused to allow Illinois to sue, claiming it was inconsistent with the Hanover Shoe case and undermines the effectiveness of future antitrust suits

Direct vs. indirect injury: *Illinois Brick Co. v. Illinois* (1977)

- The Supreme Court was worried about making antitrust cases so complex, that damage estimation would be infeasbile
    - "Permitting the use of pass-on theories under Section 4 essentially would transform treble-damage actions into massive efforts to apportion the recovery among all the potential plaintiffs that could have absorbed part of the overcharge - from direct purchasers to middlemen to ultimate consumers. However appealing this attempt to allocate the overcharge might seem in theory, it would add a whole new dimension of complexity to the treble-damage suits and seriously undermine their effectiveness"
- This also avoids the possibility of multiple recovery by both direct purchasers and indirect purchasers
    - What is the marginal cost of increasing the complexity of damage estimation and allocation, relative to the marginal benefit of deterring antitrust behavior?

The cost-plus contract exception

- The Supreme Court allows those who were indirectly injured to sue under the **cost-plus** contract exception
- This precedent comes from *Kansas v. Utilicorp* (1990)
  - Suppose a company overcharges a retailer for a product
  - Suppose the retailer charges consumers the cost of the product, plus some predetermined markup
  - Under this type of contract, the consumer has standing for antitrust injury, even though they were injured indirectly
- The requirements for cost-plus antitrust cases are strict, thus it is rarely used

In pari delicto

- The **in pari delicto** defense says the plaintiff has no right to sue, as they were knowingly involved in the illegal activity with the defendant
  - The Supreme Court does not like this defense
  - To use it, the defendent must prove the plaintiff was an equal part of the illegal activity
  - Anything less than an equal participant is not sufficient evidence

Recent antitrust standing: *Apple Inc. v. Pepper et al.* (2019)

APPLE INC. *v.* PEPPER ET AL.

CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

No. 17–204. Argued November 26, 2018—Decided May 13, 2019

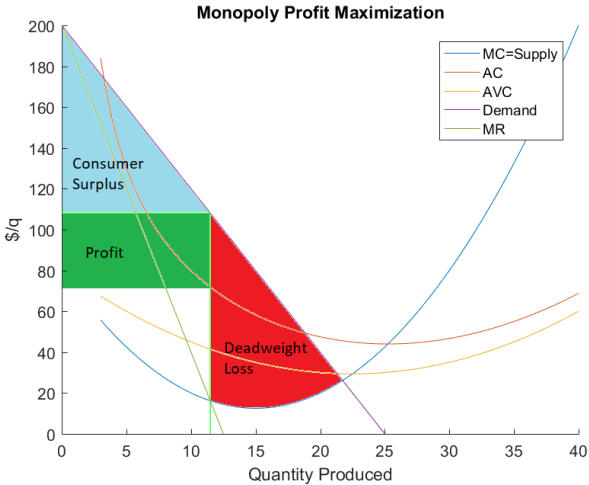
Apple Inc. sells iPhone applications, or apps, directly to iPhone owners through its App Store—the only place where iPhone owners may lawfully buy apps. Most of those apps are created by independent developers under contracts with Apple. Apple charges the developers a $99 annual membership fee, allows them to set the retail price of the apps, and charges a 30% commission on every app sale. Respondents, four iPhone owners, sued Apple, alleging that the company has unlawfully monopolized the aftermarket for iPhone apps. Apple moved to dismiss, arguing that the iPhone owners could not sue because they were not direct purchasers from Apple under *Illinois Brick Co.* v. *Illinois*, 431 U. S. 720. The District Court agreed, but the Ninth Circuit reversed, concluding that the iPhone owners were direct purchasers because they purchased apps directly from Apple.

Recent antitrust standing: *Apple Inc. v. Pepper et al.* (2019)

- iPhone users argued Apple's 30% commission on app sales increased prices for iPhone software above competitive levels
  - Apple argued consumers did not have antitrust standing since Apple was providing a marketplace, and that only the app developers had antitrust standing
  - "Apple could still win the case. Court didn't say they lose, it said consumers have the right to bring this case" Kevin Arguit, chair of the antitrust practice at Kasowitz Benson Torres

Damages

Measuring damages



Measuring damages is extremely difficult, since we do not observe how the market would have played out without the violations

- Recouping lost profit does not account for deadweight loss
- Treble damages is meant to cover the deadweight loss
- Treble damages may reflect under-enforcement risk

Proving antitrust damages

- A plaintiff must do 3 things to win an antitrust case
  - **Liability phase**: prove an antitrust law was violated
  - **Impact** or **fact of injury**: prove the plaintiff was injured by anticompetitive consequences of the antitrust violation
  - **Quantify the damages**: the plaintiff is required to give a just and reasonable estimate, backed by evidence, not speculation
- The plaintiffs are held to a standard of “reasonable certainty”

Proving antitrust damages: types of damages

- Overcharge cases
  - The defendant illegally imposes a noncompetitive price on products purchased by the plaintiff
  - Damages are the difference between the illegal price "but for" the violations, multiplied by the realized quantity
- Foreclosure cases
  - The defendant excluded the plaintiff from the market through illegal means
  - Damages are the difference between the plaintiff's actual profit, and the plaintiff's profit "but for" the violations

“But for” damage estimation

- **“But for”** estimation refers to estimating the world as if everything were the same, except for the illegal activities (i.e. counterfactual)
  - When estimating, the model assumes the only thing that changed was the presence of the violation
  - All other things that happened in the world exogenous to the violations remain the same

“But for” example

- Assume Che McKinnon, Inc. experienced lost profits in its bicycle business due to predatory pricing
  - Che McKinnon would present its profits over the periods the alleged predatory pricing occurred
  - Che McKinnon would present an argument (backed by concrete evidence) explaining what its profits would have been if pricing would have been competitive, called the “but for” scenario
  - When presenting the “but for” scenario, everything else must be kept the same, including bicycle demand, new laws, changes in costs, etc. (i.e. ceteris paribus)

Net harm

- An antitrust violation can result in both benefits and harms
  - The total damage payout must only be calculated off of the **net harm** of the violations
- *Los Angeles Memorial Coliseum Commission v. National Football League* (1986) set precedent for net harm
  - The NFl requires $\frac{3}{4}$ of owners to allow a team to move cities
  - The Oakland Raiders and the LA Coliseum claimed the owners conspired to block Oakland from relocating to the LA Coliseum
  - The LA Coliseum lost revenue from not hosting games, but also did not incur costs of hosting games
  - The Supreme Court ruled the Raiders and the LA Coliseum could only receive damages for their net loss

Damage methodologies

- There are two basic methodologies for measuring antitrust damages and calculating the “but for” outcome
  - Before-and-after approach: compare profits earned by the plaintiff before and after the violation occurred
  - Yardstick approach: use actual data on market performances in places where the violation did not occur
- Both approaches are inherently flawed
  - Modern econometrics attempts to overcome these flaws

Damage methodologies: flaws

- Before-and-after assumes the only thing that changed was the presence of the violation
  - Outside events that happened at the same time as the violation could give an inaccurate estimate of the effect of the violation
- Yardstick model is ideal if you can analyze a clone of the plaintiff “but for” the violation
  - This is impossible to do
  - A substitute is to analyze an entirely distinct market with a lot of the same characteristics
  - The market must sell the same product, but be far enough away so that it’s not influenced by the violation

Joint liability

- Often, the defendent is a group of firms
  - If they are found guilty of antitrust violations, then they share **joint and several liability**
  - The firms are liable as a group and individually to pay damages
  - The plaintiff can choose to split up the payment of damages however they see fit

Class action and parens patriae

Class action and parens patriae

- There exist situations in which groups of people may need to file a lawsuit for an antitrust violation
- Consider the following real situation that occurred in Hawaii (1969)
  - Standard Oil was accused of fixing gas prices, resulting in an increase in price to 300,000 Hawaiian motorists, valued at $2.18m per year
  - Treble damages came to $6.55m per year; however, this amounts to only $21.84 per person
  - Why would any single person want to go to court with Standard Oil?
- To remedy these types of situations, the courts allow **class action suits** and **parens patriae suits**

Class action suits

- Class action suits allow groups of people who all have small claims to a common offense to band together and file a suit with the courts
- The plaintiff is responsible for providing “individual notice” to all members of the class
  - Notice typically involves substantial costs (i.e received via mail or face-to-face interaction)
  - All potential members of the class are given time to decide if they would like to participate
  - Potential members of the class may opt out of the class do as they please (i.e. pursue individual litigation, move on)

Class action suits

"A class action is superior to other available methods for the fair and efficient adjudication of this controversy since individual joinder of all damaged Class members is impractical. Prosecution as a class action will eliminate the possibility of repetitious litigation. The damages suffered by individual Class members are relatively small, given the expense and burden of individual prosecution of the claims asserted in this litigation. Absent a class action, it would not be feasible for Class members to seek redress for the violations of law herein alleged. Further, individual litigation presents the potential for inconsistent or contradictory judgments and would greatly magnify the delay and expense to all parties and to the court system. Therefore, a class action presents far fewer case management difficulties and will provide the benefits of unitary adjudication, economy of scale and comprehensive supervision by a single court"
Kleen Products LLC et al. v. Packaging Corporation of America, et al. Complaint (2017)

Class action suits

- The courts must consider four criteria for a class action suit
  - The interests of members of the class in individually controlling prosecution of separate actions
  - The extent and nature of any litigation concerning the issue already started by members of the class
  - The desirability of concentrating the litigation in the particular forum
  - The difficulties likely to be encountered in the management of a class action suit

Parens patriae suits

- Parens patriae suits are legal actions brought on by the government, on behalf of a group of peopole
  - They are designed to protect those who cannot protect themselves
- The goal is to recover damages caused to all individuals of the state
  - The government cannot file a suit to benefit only a particular group of individuals
  - The government can choose to keep the damages as general revenue or distribute it to its citizens

Attorney fees

Attorney fees

- In addition to damages, a successful plaintiff of an antitrust violation is entitled to receive a “reasonable” attorney fee
  - Both attorneys meet with a judge after the trial
  - The attorneys submit affidaivits of the services rendered
  - The courts consider time spent, value of legal consultation, reputation of the winning attorney, size and complexity of litigation, the end results, and rates charged by others for similar efforts
  - Judges disregard time spent on unsuccessful parts of the case
- Class actions attorneys typically earn a premium for bearing the risk of the case

Settlements

Settlements

- Approximately 90% of all private antitrust cases are settled prior to the final judicial decision
  - A simple risk calculation of the expected outcome of the case justifies this large proportion of settlements
- We can show the probability of a settlement rests of three things
  - Damages
  - Differences between the defendant's and plaintiff's view on the success of the case
  - Cost of the case

Expected return

- Suppose the antitrust violation caused damage D, and the plaintiff believes they can win the case with probability P_p
  - A successful plaintiff recovers treble damages, plus the cost of the suit C_p
  - An unsuccessful plaintiff recovers no damages and must pay the cost of the suit
- We can calculate the plaintiff's expected return

$$\mathbb{E}[R] = P_p(3D) - (1 - P_p)C_p$$

Expected loss

- The defendant must always pay their costs C_d, and believes they will lose the case with probability P_d

- We can calculate the defendant's expected loss

$$\begin{aligned}\mathbb{E}[L] &= P_d(3D + C_p + C_d) + (1 - P_d)C_d \\ &= P_d(3D + C_p) + C_d\end{aligned}$$

When will a settlement occur?

- Mathematically, a settlement occurs when $\mathbb{E}[L] > \mathbb{E}[R]$

$$P_d(3D + C_p) + C_d > P_p(3D) - (1 - P_p)C_p$$

$$(P_d - P_p)3D + (P_d - P_p)C_p + (C_d + C_p) > 0$$

- Intuitively, a settlement occurs if it is cheaper for the defendent to pay everything the plaintiff expects to win, relative to the cost of going to court
  - If the defendant believes the plaintiff has a higher chance of winning, relative to the plaintiff's own belief they will win (i.e. $P_d \geq P_p$), then there will always be a settlement
- Example 4.1

Instruments of discovery

- Before the trial begins, both sides should have access to the same information through the process of fact discovery
  - Documents: any records that have some bearing on the case
  - Interrogatory answers: written responses to specific questions, posed before the trial
  - Depositions: sworn testimonies of anyone with relevant information (i.e. witnesses)
- Removing duplicative forensic analysis helps to keep litigation costs down