

TWO WATERSHEDS: THE NEW CASE LAW OF BUNDLES, REBATES, AND CLASS CERTIFICATION

*George Mason Law Review's Thirteenth Annual Symposium on Antitrust
Law sponsored by Empiris LLC and O'Melveny & Myers LLP*

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INTRODUCTION

The *George Mason Law Review* hosted its Thirteenth Annual Symposium on Antitrust Law on February 4, 2010. The Symposium was held at the Willard InterContinental in Washington, D.C., with support from the law firm of O'Melveny & Myers LLP and from Empiris LLC. The Symposium brought together a distinguished group of scholars and practitioners to discuss the current state of antitrust law with respect to bundles, rebates, and class certification.

After Craig Lerner, Associate Dean for Academic Affairs and Professor of Law at George Mason University School of Law, welcomed the participants, Jeffrey A. Eisenach, Chairman and Managing Partner at Empiris LLC and Adjunct Professor at George Mason University School of Law, offered the opening remarks. The Honorable Thomas F. Hogan gave the keynote address, and the morning's two panels followed.

KEYNOTE ADDRESS: THE HONORABLE THOMAS F. HOGAN, UNITED STATES DISTRICT COURT FOR THE DISTRICT OF COLUMBIA

Ian Simmons, a partner at O'Melveny & Myers LLP, introduced the Honorable Thomas F. Hogan as the keynote speaker. Judge Hogan was appointed to the United States District Court for the District of Columbia in August 1982 and served as Chief Judge from June 2001 to May 2008, when he took senior status. Throughout his tenure on the bench, Judge Hogan has presided over a number of high-profile antitrust cases, including *In re Vita-*

mins Antitrust Litigation,¹ *FTC v. Staples, Inc.*,² and *Chrysler Corp. v. General Motors Corp.*³

Overall, Judge Hogan offered a judicial perspective on advocacy and strategy in antitrust cases, in hopes that he could impart advice that would help lead to speedy conclusions in these cases. He initially predicted that a substantial uptake in civil and criminal federal enforcement of antitrust laws will occur in light of the Obama administration's changes in antitrust policies. In terms of private enforcement, Judge Hogan noted that private antitrust actions increased significantly over the three-year span from 2006 to 2008, but that the number of actual trials decreased during that same timeframe. He also observed a decline in private enforcement in 2009 and posited that potential explanations for this dynamic include the recession and recent Supreme Court precedent, which has made it more difficult for plaintiffs to plead and prove their cases.

Judge Hogan indicated that he has found antitrust cases to be both challenging and intellectually stimulating, and he suggested that courts assign these cases to judges who understand antitrust, are prepared to fully immerse themselves in the material, and are capable of balancing these time-consuming cases with their otherwise busy dockets. Judge Hogan explained that it is very important for attorneys to educate judges throughout the process and to make common commitments to doing so. He recommended that attorneys develop an understanding of the management philosophy, style, and tendencies of the judges assigned to their antitrust cases.

Next, Judge Hogan briefly summarized how antitrust cases get to federal court and discussed the Judicial Panel on Multidistrict Litigation ("JPML"), which determines whether consolidated pretrial proceedings from different districts should be transferred for the mutual convenience of parties and witnesses. He noted that the JPML has wide latitude to transfer these proceedings based on efficiency concerns and has frequently exercised this authority during the last several years. Judge Hogan also discussed the changes the Supreme Court made to the pleading standard in *Bell Atlantic Corp. v. Twombly*⁴ and *Ashcroft v. Iqbal*.⁵ These new precedents, which require that a complaint contain sufficient factual matter to state a facially plausible claim for relief,⁶ have effectively put plaintiffs at a disadvantage in antitrust litigation. Judge Hogan explained that the Congressional Rules Committee is currently considering whether to change this standard or to enshrine *Iqbal* in the Federal Rules of Civil Procedure.

¹ No. MISC. 99-197(TFH), MDL 1285, 2001 WL 34088808 (D.D.C. Mar. 19, 2001).

² 970 F. Supp. 1066 (D.D.C. 1997).

³ 589 F. Supp. 1182 (D.D.C. 1984).

⁴ 550 U.S. 544 (2007).

⁵ 129 S. Ct. 1937 (2009).

⁶ *Id.* at 1949; *Twombly*, 550 U.S. at 556.

Judge Hogan further explained that the discovery phase of litigation is especially troublesome in antitrust actions. In particular, electronic discovery raises genuine issues regarding burdensome discovery requests, allocation of immense costs, production in multiple forms, and preservation orders. In addition, discovery involving international corporations or parties can be particularly difficult due to several countries' anti-discovery laws. Additionally, Fifth Amendment issues can arise even in the civil litigation context, and courts must find ways to adapt to these challenges. Judge Hogan advised that attorneys find ways to preemptively educate the court regarding these issues and come prepared with innovative ideas for handling discovery. In terms of resolving discovery disputes, the most important lesson Judge Hogan wanted to impart was that counsel must get to know the assigned judge and his or her view of case management.

Judge Hogan also touched upon litigation techniques. Although an extreme measure, the use of recusal or disqualification to remove a judge has been remarkably effective in the United States District Court for the District of Columbia. Another useful technique, which Judge Hogan utilized in *In re Vitamins Antitrust Litigation*, is to have the parties proffer an off-the-record, formal presentation about their respective theories of the case. He explained that this provides a tremendous roadmap for the case, delineates potential pitfalls, and allows the judge to understand the parties' legal theories in advance of complex litigation.

Next, Judge Hogan explained how the information age has radically affected the use of expert testimony. Today, parties can track nearly everything an expert has written or stated on the record. Consequently, experts face a great challenge, and it is more important now than ever that attorneys ensure that expert witnesses are sufficiently prepared and can present their testimony properly. Judge Hogan also argued that credibility with the court is more important in antitrust cases than in any other type of litigation. He therefore advised attorneys to always keep their credibility with the court in mind because once one loses it, one can rarely, if ever, regain it.

Finally, Judge Hogan explained that it is vital to have an interested judge in antitrust actions. Although attorneys have no choice in the judges assigned to their cases, it is their obligation to get the judge interested in the material. He suggested that counsel approach the judge early on for a case management plan and come prepared with proposals. It is also important that the attorneys cooperate with each other and bring forth innovative ideas for how to process the case. Otherwise, litigation can easily get bogged down in discovery. In closing, Judge Hogan emphasized that it is essential for attorneys to always maintain a sense of humor and approach judges in an open and fresh manner.

PANEL ONE: EVALUATING BUNDLING AND SHARE-BASED REBATES IN
HIGH-TECH INDUSTRIES

Moderator:

Alden F. Abbott, *Deputy Director, Office of International Affairs,
U.S. Federal Trade Commission, and Adjunct Professor, George Mason
University School of Law*

Speakers:

Nicholas S. Economides, *Professor of Economics, New York University
Leonhard N. Stern School of Business*

Kevin M. Murphy, *George J. Stigler Distinguished Service Professor of
Economics, The University of Chicago Booth School of Business*

Joseph Kattan, *Partner, Gibson, Dunn & Crutcher LLP*

Thomas Brown, *Partner, O'Melveny & Myers LLP*

Moderator Alden F. Abbott began the first panel by briefly discussing the issue of bundling and share-based rebates and noting that the legal status of this issue is very conflicted. He then introduced the panelists, who discussed their differing perspectives on this contested area of antitrust law.

Nicholas S. Economides

Professor Economides began his discussion by stating that the analysis that applies to multi-product bundling should also apply to single-product loyalty rebates. He equated the two types of conduct by suggesting that the uncontested section of the single-product market is comparable to the monopolized product in a bundling situation, while the contested part of the single-product market is comparable to the contested product in a bundling situation. Accordingly, any analysis that is applied to bundling cases should also apply to loyalty discount cases.

Professor Economides critiqued the analytical framework propounded by the University of Chicago for bundle and loyalty discount cases. The Chicago theory holds that these schemes will not produce extra profit for a dominant firm when: (1) it is capable of extracting the full consumer surplus from each buyer in market A; and (2) it cannot threaten to refuse to sell each buyer the full amount on the uncontested portion of the buyer's demand. However, Professor Economides asserted that these two conditions, especially the requirement that the selling firm extract the full consumer surplus, rarely hold. As a result, a bundling or loyalty discount scheme could be profitable without cost savings from joint production, distribution, and sale.

Professor Economides focused the majority of his discussion on the price allocation test ("PAT") proposed by the Antitrust Modernization Commission ("AMC"). This test applies conditional discounts to all units

sold in the contested product market, creating an effective price for the product. Liability exists when: (1) the effective price is below the variable cost of the monopolist in the contested market; (2) the dominant firm is likely to recoup its losses; and (3) the requirement contract is likely to have anticompetitive consequences. The PAT implicitly includes a safe harbor, which exists when effective price is above the variable cost.

According to Professor Economides, the AMC standard has flaws that should mitigate against its use. First, the PAT uses the monopolist's costs, instead of the rival's costs, as the point of comparison, even though a higher cost competitor can still constrain pricing. Second, the PAT applies to all units produced, even when a significant portion of the sales of the dominant firm is uncontested. Professor Economides proposed that the PAT should only apply to the contested market because dominant firms will not offer discounts or bundles to attract buyers to the uncontested market. Third, the PAT ignores the difficulty of rivals in calculating the effective price offered by the dominant firm and how this hindrance significantly reduces their ability to match that price. Fourth, Professor Economides argued that the recoupment prong is irrelevant given that it is unclear the monopolist will actually lose money under the requirement contract as compared to the but-for world. Finally, buyers often face a "prisoner's dilemma," as individual buyers will choose to buy under the requirements contract to avoid higher pricing, but all buyers will collectively lose by increasing the monopolist's market power. Therefore, acceptance of the contract itself does not imply higher consumer surplus in this market.

Professor Economides proposed the structured rule of reason test as an alternative to the PAT. The central question of this inquiry is whether the introduction of a "loyalty/requirement" program decreases consumers' surplus. This requires analysis of numerous factors and eliminates a safe harbor based on a price-cost test. The rule of reason test establishes three situations in which anticompetitive liability will hold: (1) when the effective price based on contested units is below the incremental cost of the dominant firm; (2) when the effective price based on contested units is below the incremental cost of the competing firm, and it can be shown that the elimination of the competing firm reduces competition and decreases consumers' surplus; or (3) when the dominant firm's prices outside the "loyalty/requirement" contract are higher than in the but-for world.

Kevin M. Murphy

Professor Murphy initially responded to Professor Economides's arguments by discussing the areas in which bundled and loyalty discounts tend to occur most frequently. He argued that these discounts exist in precisely the competitive environments that the laws of economics predict they will occur. Specifically, these discounts are prevalent in industries like healthcare, which have high fixed costs and high margins. These discounts

are frequent among buying organizations such as Preferred Provider Organizations.

Professor Murphy began by hypothesizing a baseline monopolist in the market and suggested that the monopolist and the buyer can improve their respective positions so long as the buyer's marginal value for the product exceeds the seller's marginal costs. When this scenario exists, the monopolist and the buyer can obtain mutual gains from contracts that require increased purchases for lower costs. Professor Murphy demonstrated his assumptions in a graph that exhibited a downward-sloping demand, an indifference curve for the buyer, and an iso-profit curve for the seller. The area between the indifference curve and the iso-profit curve suggests that there are possible points where the buyer and the seller are both better off, even though the seller is selling below cost and the buyer is buying more units at a given price than she would otherwise prefer. The result is an outcome that is "off the demand curve" but mutually beneficial to both the buyer and the seller.

Professor Murphy noted numerous practices that fit this model, including quantity discounts, loyalty discounts, exclusive contracts, bundled pricing, shelf space contracts, and exclusive promoting contracts. Professor Murphy concluded that consumers and sellers may benefit from bundles and loyalty discounts, while efficient rivals may be forced to exit the competitive market. This exclusion is something that antitrust laws generally seek to prevent, and Professor Murphy therefore proposed the benefits of the PAT as an effective means of identifying when bundling and loyalty discounts are likely to exclude efficient competitors.

Professor Murphy's test, as discussed by Professor Economides, applies the discounts to the contested product, creating an effective price, and then compares this price to the costs of an equally efficient competitor. In effect, the PAT looks to determine if the effective price is below or above the cost. The PAT is beneficial in that it will not chill procompetitive price-cutting and it easily identifies cases in which an equally efficient competitor cannot match the monopolist discounts. Finally, Professor Murphy suggested that courts, after applying the PAT, may go beyond the simple test by considering other factors, such as the actual effects of the bundle and loyalty discounts on output and competitors.

Joseph Kattan

Mr. Kattan opened by commenting that Professor Economides's approach sounds like a "Full Employment Act for Economists" in the modern economy because of the need to evaluate numerous factors to determine liability. He posited the central question of whether a complicated test such as the one proposed by Professor Economides would be accessible to businesses and judges without the guiding hand of an economist.

Mr. Kattan emphasized the need for careful consideration moving forward. He explained that lowering costs is a practice that should generally be encouraged, but the fear of incurring liability for cutting costs too far could chill competition that would benefit consumers. Mr. Kattan also stated that whatever test courts ultimately adopt, it must be one that businessmen can apply *ex ante*. He noted that businesses are working in real time and making important decisions every day. They need a test that imposes reasonable information demands because courts cannot reasonably expect businesses to rely on evidence that is only attainable years after the bundling and loyalty discount decisions are made.

Mr. Kattan argued, therefore, that there is a need for a tractable and predictable test that can be employed by both businesses and courts. He suggested that the best test for this is the PAT suggested by Professor Murphy. While Mr. Kattan never suggested that the PAT was ideal, he noted that it requires only reasonable information demands and has been previously employed by courts, including the United States Supreme Court. Mr. Kattan did not consider the alternatives to the PAT to be tractable or predictable.

Thomas Brown

Mr. Brown opened his presentation with a quick experiment, asking the members of the audience to raise their hands if they had participated in an airline miles program and whether that program had ever affected their flight decisions. With nearly every hand raised, he insinuated that each individual was involved in a Section 2 conspiracy of bundling and loyalty discounts.

Mr. Brown's point was that bundling and loyalty discounts are neither all good nor all bad and that economists and courts have generally agreed on this principle. These schemes are beneficial in that they can increase welfare for both buyers and sellers, as evidenced by the fact that buyers often demand loyalty discounts from sellers. However, bundling and loyalty discounts can be predatory or exclusive, and may even lower consumer welfare under certain conditions. It is noteworthy that these discounts have sparked extensive academic discussion, yet they have not received significant judicial attention.

Mr. Brown urged the importance of developing a method for determining whether a bundle or loyalty discount hurts or improves consumer welfare. He asserted that a PAT is necessary, but not altogether sufficient. While the PAT can stand as a proxy for predatory practices, the real inquiry must be whether or not the firm had engaged in predatory practices. Although failure of the first prong of the PAT "should suggest that something is wrong," such a finding should be buttressed with additional evidence, economic or otherwise, to show that the anticompetitive harm has occurred.

Finally, Mr. Brown proposed a practice point for attorneys who might face the issue while working with firms. When a firm seeks counseling on a bundle or loyalty discount, the attorney should ask the firm why it wants to implement this tactic. The answer will give the attorney insight into the motivation and likely effect of the bundle or loyalty discount, and it will allow the attorney to advise the firm on how to avoid potential litigation.

PANEL TWO: CLASS ACTION IN THE WAKE OF *MONSANTO*, *IPO*, AND
HYDROGEN PEROXIDE

Moderator:

Peter C. Thomas, *Partner, Simpson Thatcher & Bartlett LLP*

Speakers:

Ian Simmons, *Partner, O'Melveny & Myers LLP*

Eric L. Cramer, *Shareholder, Berger & Montague, P.C.*

Edward A. Snyder, *Dean & George Shultz Professor of Economics, The University of Chicago Booth School of Business*

Hal J. Singer, *President & Managing Partner, Empiris LLC and Adjunct Professor, McDonough School of Business, Georgetown University*

Moderator Peter C. Thomas began the second panel by providing a brief overview of the class certification phase of antitrust lawsuits. Mr. Thomas explained that plaintiffs must demonstrate the predominance of common issues of fact by showing common proof of an antitrust injury. He went on to state that this had been a relatively easy hurdle to meet until quite recently, but that now defendants stood a chance of defeating class certification. Mr. Thomas then introduced the panelists to begin discussion on the recent changes in the class certification process and to explain the ramifications of these developments on antitrust practice.

Ian Simmons

Mr. Simmons focused his presentation on four important issues pertaining to class certification in antitrust cases: (1) class certification standards; (2) the role of the merits; (3) the role of experts; and (4) the definition of predominance. He first described the confusion over the standard that class action plaintiffs must meet to show common antitrust injury and achieve certification under Rule 23(a) of the Federal Rules of Civil Procedure ("FRCP"). Mr. Simmons suggested that the correct showing, based on the 2003 amendments to FRCP 23, is a preponderance of the evidence standard; that is, to achieve class certification, class action members must show the predominance of common issues of fact by a preponderance of the evidence.

After describing the relevant standard, Mr. Simmons moved on to discuss the role of the merits in the class certification standard. He identified the tension between the Supreme Court's statement in *Eisen v. Carlisle & Jacquelin*,⁷ that judges refrain from conducting an inquiry into the merits during class certification,⁸ and the Court's insistence in *General Telephone Co. of the Southwest v. Falcon*,⁹ that judges conduct a rigorous analysis and probe beyond the pleadings.¹⁰ Mr. Simmons contended that Judge Newman, of the U.S. Court of Appeals for the Second Circuit, reconciled these instructions best in *In re Initial Public Offerings Securities Litigation*¹¹ where he held that district court judges should "resolve[] factual disputes relevant to each [FRCP] 23 requirement," but "not assess any aspect of the merits unrelated to a [FRCP] 23 requirement."¹²

Next, Mr. Simmons analyzed the role of experts in antitrust class certification. He first pointed out the current confusion over the relevant burden that experts must meet in demonstrating a common antitrust injury. This issue amounts to what level of detail the expert must provide at the class certification stage. Mr. Simmons suggested the best approach would be to require plaintiffs to provide a model tailored to the particular facts of the case. The last problem Simmons identified involved the definition of predominance. FRCP 23(b)(3) requires that questions of law or fact common to all members predominate over any individual issues.¹³ While noting the disagreement as to the correct definition, Mr. Simmons argued that the correct reading of FRCP 23(b)(3) requires plaintiffs to show that common issues predominate for each and every element of the offense. Mr. Simmons's remarks outlined the main areas of dispute on class certification for the panel, as well as the legal and academic communities more generally.

Eric L. Cramer

Mr. Cramer's discussion demonstrated his opposition to the recent judicial revisions to the class certification standard. He disagreed with Mr. Simmons as to the correct interpretation of FRCP 23's predominance standard and argued that plaintiffs must only show that common questions of law or fact predominate in general. Accordingly, he maintained that the Third Circuit erred in *In re Hydrogen Peroxide Antitrust Litigation*¹⁴ in al-

⁷ 417 U.S. 156 (1974).

⁸ *Id.* at 177-78.

⁹ 457 U.S. 147 (1982).

¹⁰ *Id.* at 160-61.

¹¹ 471 F.3d 24 (2d Cir. 2006).

¹² *Id.* at 41.

¹³ FED. R. CIV. P. 23(b)(3).

¹⁴ 552 F.3d 305 (3d Cir. 2008).

lowing that common issues predominate for each element of the offense.¹⁵ In explaining his position, Mr. Cramer identified two conceptual errors that lead courts, like the Third Circuit, astray. The first, he explained, is a failure to frame the issue as whether class members will rely on common evidence at trial. Mr. Cramer's emphasis on trials illustrates his view that the proper inquiry is not whether the plaintiffs should win on impact, but rather what they will use in attempting to win on impact. His position is that a class should be certified when impact is capable of proof through common evidence, and conversely, class certification should fail only when individual issues overwhelm common issues.

The second conceptual error Mr. Cramer discussed involved the requirement that all or nearly all of the class show injury in order to achieve certification. Two basic views exist on this point: one side would require that all or nearly all of the class suffer injury, and the other would allow class certification to be based on a showing of widespread injury throughout the class. Mr. Cramer expressed his agreement with the widespread injury standard and suggested this was the more widespread view by stating that many judges, including Judge Posner, do not require 100 percent impact. In addition to arguing for the widespread injury standard over the "all or nearly all" requirement, Mr. Cramer also described the entire inquiry as a red herring because the percentage of the class injured would not come up at trial, and therefore it is not an important inquiry at the class certification phase. Critics of this view, like Mr. Simmons, maintain that if the class contains uninjured members, then the pertinent question is that of impact. Mr. Cramer disagreed on this point, viewing it as a question of damages, and argued that so long as aggregate damages are correct, the presence of uninjured class members creates no practical difference. Mr. Cramer's remarks created vigorous debate on both the interpretation of FRCP 23 and the issue of percentage of class injured.

Edward A. Snyder

Mr. Snyder focused on how regression analysis can be used to show proof of common impact during the class certification stage. The recent trend is toward courts requiring more concrete proof of common injury at the certification stage, as evidenced by the Third Circuit vacating the district court's class certification after finding the plaintiff's regression analysis lacking in *Hydrogen Peroxide*. A regression equation is used to describe a linear relationship between two or more variables and, if properly specified, can identify a central, or average, tendency between the dependent and independent, or explanatory, variables. For example, a regression could provide proof that prices in one market are higher on average than prices in

¹⁵ *Id.* at 325.

another market. Class certification, however, requires not only evidence of average impact but also inquiry into the potential differences among class members. Therefore, it is possible that regression analysis can mask important differences across subgroups, as well as differences among individuals.

Mr. Snyder explained that regressions can be used to demonstrate proof of common impact when the regression analysis satisfies tests of both macro-commonality and micro-commonality. When a regression meets the macro-commonality test, it provides evidence of common impact by showing that the results are common across subgroups of the proposed class. In comparison, a regression that satisfies the micro-commonality test illustrates that common issues do not predominate over individual issues. Mr. Snyder stressed that regression analysis can be successfully employed to demonstrate proof of common impact at the class certification stage, as long as the equations satisfy the tests of both macro- and micro-commonality.

Hal J. Singer

As an economist, Mr. Singer sought to clarify the role of an expert in class certification. He emphasized that the class certification expert should be limited to demonstrating the cohesion of the class with respect to the challenged conduct. Mr. Singer explained that if a mechanism relates the challenged conduct to each of the class members, it shows cohesion. His proposed approach is a base price strategy, which purports to show that the prices paid by all class members are linked by a common pricing element and that the defendant's challenged conduct materially affected the common pricing element. Critics of the base price method argue that firms deviate from the base price by offering private discounts and that this severs the connection. In response to this criticism, Mr. Singer argued that any discounts shrink with the deterioration of available substitutes, and therefore it is unlikely that private discounts would offset any inflation in the common base price caused by the challenged conduct.

Mr. Singer further supported his economic approach for demonstrating common proof impact to achieve class certification by arguing that the method is consistent with *Blades v. Monsanto Co.*,¹⁶ *In re New Motor Vehicles Canadian Export Antitrust Litigation*,¹⁷ and *Hydrogen Peroxide*. In discussing Mr. Singer's theory, Mr. Snyder proposed that it be tested to see if a change in list prices resulted in the array of prices remaining the same relative to the list. Mr. Singer and Mr. Snyder disagreed about the showing the expert must make at the class certification stage, with Mr. Singer maintaining that the expert should only have to describe what he or she planned

¹⁶ 400 F.3d 562 (8th Cir. 2005).

¹⁷ 522 F.3d 6 (1st Cir. 2008).

to show. Mr. Singer's remarks illustrated one possible approach that plaintiffs can use to demonstrate the cohesion of the class.

CONCLUSION

Overall, the Symposium was immensely successful. The Symposium participants and audience left with a deeper understanding of the current state of antitrust law with respect to bundles, rebates, and class certification.