

# SULLIVAN & CROMWELL LLP

TELEPHONE: 1-212-558-4000  
FACSIMILE: 1-212-558-3588  
WWW.SULLCROM.COM

*125 Broad Street*  
*New York, NY 10004-2498*

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June 17, 2005

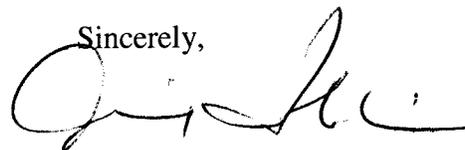
Via E-mail and Federal Express

Andrew J. Heimert,  
Executive Director and General Counsel,  
Antitrust Modernization Commission,  
1120 G Street, N.W.,  
Suite 810,  
Washington, D.C. 20005.

Dear Mr. Heimert:

Attached is my written testimony for the June 27 hearing.

Sincerely,



David Tulchin

cc: William Adkinson

**WRITTEN TESTIMONY OF DAVID B. TULCHIN  
BEFORE THE ANTITRUST MODERNIZATION COMMISSION**

**STATE INDIRECT PURCHASER ACTIONS  
IN THE U.S. ANTITRUST ENFORCEMENT SYSTEM**

**Introduction**

My name is David B. Tulchin and I am a partner of Sullivan & Cromwell LLP in New York. Since late 1999, I have represented Microsoft Corporation in connection with more than 150 putative class actions brought by private plaintiffs alleging that they have been overcharged for certain Microsoft software as a result of alleged anticompetitive conduct. More than 70 such cases were filed in, or removed to, a federal court and were consolidated for pretrial proceedings pursuant to the federal multidistrict litigation statute in the United States District Court for the District of Maryland.<sup>1</sup> The remainder were state-law actions prosecuted in the courts of 37 states. These state-court actions were brought by “indirect purchasers,” *i.e.*, individuals or entities who acquired the software at issue from someone other than Microsoft.

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<sup>1</sup> The federal district court presiding over the consolidated actions against Microsoft dismissed the federal damages claims of all indirect purchasers and foreign purchasers. *In re Microsoft Corp. Antitrust Litig.*, 127 F. Supp. 2d 702 (D. Md. 2001). An appeal of the decision dismissing the indirect-purchasers’ claims is currently pending before the United States Court of Appeals for the Fourth Circuit. The district court also declined to extend class certification to end-using businesses that purchased directly from Microsoft, *In re Microsoft Corp. Antitrust Litig.*, 214 F.R.D. 371, 376 (D. Md. 2003), and denied certification to a putative class that would have included all personal computer manufacturers who had purchased software directly from Microsoft. *In re Microsoft Corp. Antitrust Litig.*, 218 F.R.D. 449 (D. Md. 2003). The federal court did certify a narrow class of end-users who purchased operating systems directly from Microsoft. *In re Microsoft Corp. Antitrust Litig.*, 214 F.R.D. at 377-78. Microsoft eventually agreed to a settlement with that certified class.

## Summary

In 1977, the United States Supreme Court in *Illinois Brick Co. v. Illinois*, 431 U.S. 720 (1977) determined that indirect purchasers are not eligible to recover money damages under federal antitrust law. Over time, the consequences of that ruling have been substantially undermined by the decisions of numerous states to allow indirect purchasers to pursue damages claims under state antitrust, unfair competition or consumer protection law. The resulting two-tiered system of private antitrust enforcement means that direct-purchaser claims are often litigated in federal court, perhaps on behalf of a nationwide class, while indirect purchasers in numerous “repealer” states pursue parallel actions, based on virtually identical allegations, in state court and often for a state-wide class. This has introduced needless complexity into the realm of antitrust litigation and created significant burdens for the courts, litigants and society as a whole. The present system is wasteful of social and judicial resources, requiring essentially identical claims to be litigated in dozens of jurisdictions, and those costs seem to outweigh the small benefits received by some -- indeed, often a small percentage of -- indirect purchaser class members. Importantly, the present system also makes it exceedingly difficult for a defendant to go to trial, for the risk of collateral estoppel when ten or twenty or more almost identical state-court actions are pending is so enormous that a defendant can hardly insist upon putting plaintiffs to their proof. This is a system of near-coercion, not justice.

Although I believe that the difficulties and complexities of indirect-purchaser litigation counsel in favor of retaining the rule announced in *Illinois Brick*, even more important is the desirability of a national system of adjudicating private

antitrust litigation in cases involving interstate (not purely local) commerce. A uniform federal system that preempts state law (when constitutionally permissible) would significantly streamline antitrust litigation, reduce the overwhelming pressure to settle questionable claims and eliminate the unnecessary burdens and inefficiencies the present system imposes on both private litigants and the courts.

### **Testimony**

In the years since the Supreme Court's decision in *Illinois Brick*, the legislatures of at least 18 states have specifically authorized damages claims by indirect purchasers. Even in the absence of "repealer statutes," courts in several other states have allowed indirect-purchaser actions to proceed under their states' antitrust, consumer protection, or similar statutes.<sup>2</sup> In addition, unless there is clear law barring such actions, the plaintiff class action antitrust bar will also bring suits in other jurisdictions as well. As a result, and although the "count" can be somewhat imprecise, antitrust defendants are likely to face actions under various state laws in the courts of more than half the states.

In my view, the concerns expressed by the Supreme Court in *Illinois Brick* regarding the difficulties and complexities inherent in indirect-purchaser damages litigation are sound. The "principal basis" on which the *Illinois Brick* Court rested its holding -- the difficulty of measuring and proving the amount of any overcharge that is "passed on" through the distribution chain in the form of higher prices charged by distributors and ultimately paid by end users, 431 U.S. at 731 -- is every bit as valid today

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<sup>2</sup> See, e.g., *Arthur v. Microsoft Corp.*, 676 N.W.2d 29 (Neb. 2004); *Comes v. Microsoft Corp.*, 646 N.W.2d 440, 451 (Iowa 2002); *Elkins v. Microsoft Corp.*, 817 A.2d 9 (Vt. 2002).

as it was in 1977. Indeed, in the context of a class action (the only economically practicable means by which most indirect-purchaser actions can be litigated), it is often not possible to prove the amount of “passed-on” overcharges paid by each individual class member in any satisfactory way.

The decision of a distributor or other middleman as to whether, when and by how much to raise prices charged to customers in response to a change in costs charged by one or more of its suppliers is highly individualized and depends on, among other things, both the particular circumstances of the middleman and conditions in the market in which it competes. Where the alleged anticompetitive conduct relates to a product that makes up only a small portion of the cost of a larger product ultimately sold to consumers -- for example, a PC operating system installed on a personal computer by the manufacturer, or the bricks at issue in the *Illinois Brick* case, which were purchased by contractors and incorporated into buildings that were purchased by the indirect-purchaser plaintiffs, 431 U.S. at 726 -- determining how, if at all, a price increase of the small component has affected the total price paid by a consumer downstream for the finished product is extraordinarily difficult.

To take a somewhat simplified example, a restaurant charging \$2.99 for a “breakfast special” -- two eggs, toast, potatoes and coffee -- is not likely to adjust its price with each fluctuation in the price of eggs. And even if there is an apparently permanent increase in the cost of eggs, a significant number of consumers may pay nothing extra for some period of time. This is because although the restaurant owner might at some point change his price as his costs increase, the size and timing of any such increase would depend on a number of additional factors such as the price of other ingredients, the

restaurant's overhead and salaries, competition from other restaurants, human psychology, etc. If the price charged by producers for one egg goes up by 1¢ (about a 20% increase), will the restaurant owner increase his \$2.99 price just because his cost for the two eggs has now risen by a total of 2¢? If the cost of printing new menus exceeds the likely extra revenue, or if the new price pushes the total above a "focal point" such as \$3.00, might the restaurant owner absorb the increase? And, proving the amount of a cost increase paid by any individual customer -- let's say a class member complaining about a conspiracy to fix egg prices by egg producers -- would depend on when and how often the customer visited the restaurant, the items he or she purchased and whether those purchases occurred before or after the price change took effect. It is likely that no one will have good records of any of this.

Of course, the complexities described above are confined to the context of a single "reseller" of eggs. In the world of indirect-purchaser class actions, the supposed "classes" -- which might be made up of millions of consumers of eggs -- might include not only the customers of a single restaurant but also those who purchased from other restaurants and those purchasing through many other channels of distribution, such as supermarkets, convenience stores, bakeries, pastry shops, etc. In different geographical locations, competitive conditions will differ significantly as well. It is not possible to determine the precise amount of any cost increase passed on to any given consumer without making assumptions and waving one's hand across the many differences in circumstances. Indeed, in the vast majority of indirect-purchaser class actions, even identifying the members of a class presents substantial difficulties because it is unlikely

that there are adequate records of the identity of individuals who have indirectly purchased the products at issue, the amounts paid, the dates of purchases, etc.

Despite these kinds of complexities, a number of state courts will certify classes of indirect purchasers.<sup>3</sup> In the majority of these kind of cases, plaintiffs will propose simplified methods of proving damages incurred by individual class members that attempt to smooth over -- one might say ignore -- the complexities of proving pass-through. Two possible approaches are (1) a “tax incidence” analysis, in which the effect of an alleged price increase in a product resulting from the challenged conduct is analogized to an excise tax on resellers and is then analyzed in accordance with economic literature on the effect of taxes on prices; and (2) a regression analysis in which the effects of a price increase would supposedly be analyzed by applying statistical methods to various data regarding prices, costs, and other relevant factors. *See A&M Supply Co.*, 654 N.W.2d at 586 and n.59. As the Michigan Court of Appeals noted, in a market that “is less than perfectly competitive” -- which means almost all markets -- the utility of “tax incidence” analysis “declines drastically.” *Id.* at 601. Similarly, the Michigan court noted that in that case plaintiffs had “provide[d] no reasonable basis on which a court might reach the conclusion that a regression analysis would actually compute the amount of the pass-on rate on a class-wide basis or with respect to individual consumers.”

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<sup>3</sup> In the cases against Microsoft, state courts in eleven states -- Arizona, California, Florida, Iowa, Kansas, Minnesota, New Mexico, North Dakota, South Dakota, Tennessee and Wisconsin -- granted certification to proposed classes of indirect purchasers of Microsoft software. In two states -- Michigan and Maine -- courts denied certification. *See A&M Supply Co. v. Microsoft Corp.*, 654 N.W.2d 572 (Mich. Ct. App. 2002); *Melnick v. Microsoft Corp.*, No. CV-99-709, 2001 WL 1012261 (Me. Super. Ct. Aug. 24, 2001).

Nevertheless, for better or worse, state courts faced with an indirect-purchaser motion for class certification may not be likely to analyze the economics -- and the related legal issues -- with as much rigor as the Michigan court did or as economists might. Because it is impractical for an individual indirect purchaser to litigate his or her claim on an individual basis, a denial of class certification will effectively end the large majority of indirect-purchaser actions. As a result, many state courts are -- wrongly, in my view -- reluctant to deny class certification in those circumstances. *See, e.g., Gordon v. Microsoft Corp.*, No. MC 00-5994 (Minn. Dist. Ct. March 30, 2001) (unpublished opinion) at 7 (“In order to effectuate the Minnesota Legislature’s intent [in allowing indirect purchaser suits], standards for class certification should be interpreted if at all possible in a fashion that indirect purchasers can meet.”)

Thus, state courts may decide that, at the class certification stage, they need not subject the methodology of plaintiffs’ expert to a rigorous and searching inquiry to determine whether it is capable of establishing injury and damages for each class member by means of proof common to the class as a whole, and instead apply a lenient standard requiring only that the methodologies suggested by plaintiffs at the class certification stage be “more substantial than no method at all.” *See, e.g., Gordon v. Microsoft Corp.*, at 24. Other courts say that they will decline to referee a “battle of the experts” at the class certification stage -- meaning that if plaintiffs’ counsel has an expert who says that he can prove pass-through (even though he has not yet even attempted to do so), those courts also may certify a class. *See, e.g., Gordon v. Microsoft*, at 17 (holding that Microsoft’s “many counterarguments” to the pass-on theories of plaintiffs’ damages expert “can be better considered” in the context of a jury trial).

The idea that a trial can resolve the “famously difficult” pass-through issues (*see In re Brand Name Prescription Drugs Antitrust Litigation*, 123 F.3d 599, 605 (7th Cir. 1997) (Posner, J.)) is not realistic. For one thing, the present system of serial state-by-state indirect-purchaser damages litigation makes it highly unlikely that state-court antitrust class actions will reach a jury verdict. An antitrust defendant litigating separate class actions in numerous state courts faces the risk that a single adverse decision in one state could be accorded collateral estoppel treatment and effectively foreclose any possibility of success in all the other related cases. Rather than facing the mere risk of a treble-damages verdict, an antitrust defendant contemplating a single trial - - with many related cases also pending in the background -- might be presented with the risk of, for example, 100-fold damages (*i.e.*, treble damages in 33 states). This creates tremendous pressure on defendants to settle, regardless of the strength of their underlying case. Unsurprisingly, a good portion of the state-court actions that survive a motion to dismiss and reach class certification result in settlement. While the prospect of a single trial of all purchasers’ damages claims in a single forum would certainly not eliminate the pressure on defendants to settle (since such pressure is present in any case in which the amounts at issue are substantial), there would at least exist some prospect of success commensurate with the risks involved.

The burdens imposed by the present system are not borne solely by antitrust defendants. Rather, the inefficiencies and wastefulness inherent in the present system are shared by society as a whole. Even in the Microsoft litigation, where substantial efforts were made to coordinate discovery between the federal and state actions and where plaintiffs received access to a substantial amount of documentary

evidence produced in prior government actions and investigations, the requirement that essentially identical claims be litigated in dozens of separate forums has squandered significant private and judicial resources. State courts have been occupied for years in examining virtually identical motions for class certification, motions to dismiss or for summary judgment, motions seeking collateral estoppel and numerous motions relating to discovery disputes. In addition to occupying the dockets of dozens of state trial courts, the Microsoft litigation has resulted in numerous appeals requiring the attention of both the intermediate appellate courts and the highest courts in several states. In the state-court actions that have approached a trial date (and in the one state where an action actually proceeded to trial), both the parties and the courts have been required to expend considerable additional resources. All of this has been in addition to the efforts undertaken in connection with the federal litigation in the District of Maryland.

These costs cannot, in my view, be justified in circumstances where class members purchase items of relatively low cost and thus each has little to gain from a settlement or recovery. This is especially true where, as will often be the case, there are no comprehensive records of all indirect purchasers. Because the antitrust defendant will, in most situations, possess no record of who indirectly purchased its products or how much they purchased or when, notice is generally accomplished by mass mailings and/or by relying on the legal fiction of notice by publication. Even in situations where actual notice of a settlement reaches a member of the class, the class member must read and understand the notice, which can be challenging even with carefully designed, user-friendly notices. And in order to obtain any settlement benefits, the class member will likely be required to provide information on a claim form, which in and of itself may

discourage some from acting. The result is that many class members receive no actual notice of the settlement and those that do may choose to avoid the claims process. In many cases, claim rates may be well under 5%. This means that even in those states where plaintiffs have succeeded in obtaining a recovery for class members, the great majority receive nothing.

Low claims rates are probably more likely in indirect-purchaser cases than where there are claims by direct purchasers from the alleged antitrust violator, in part because of the difficulty of identifying and locating members of the class and the perception among many individuals that relatively small individual recovery amounts (which are often a feature of indirect-purchaser litigation) are not worth the time or effort required to fill out a claim form.<sup>4</sup>

The primary beneficiaries of the present system of duplicative federal and state antitrust litigation have been the lawyers -- on both sides. Microsoft, for example, has been required to employ local counsel in about forty states, even though the underlying factual claims in each of the state-court actions have been essentially identical. Significant additional resources have been required to coordinate a unified national strategy and to deal with the many largely identical motions filed in the various state courts. Similarly, plaintiffs' lawyers in the individual states have had to engage in

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<sup>4</sup> It should be noted that the difficulties involved with notifying the class and encouraging them to participate in the claims procedure are not unique to the settlement context. Because the large majority of antitrust defendants are not likely to have identifying information for indirect purchasers of their products, a notice and claims process would likely be required even if an indirect-purchaser action resulted in a jury verdict for plaintiffs.

largely duplicative efforts to acquaint themselves with the many factual and legal issues common to all of the state cases.

Further, when plaintiffs' counsel seek an award of fees from the courts, they may obtain fee awards that are in some cases many times the aggregate recovered by the class. (I note here, for example, that plaintiffs' lawyers in the California litigation against Microsoft were awarded fees totaling more than \$100 million.) Any given state-court judge may overestimate the contributions of the lawyers for plaintiffs in his or her particular state. Individual courts may not be in the best position to determine what portion of a recovery is attributable to the lawyers who have appeared before him (as opposed to work done by other lawyers in prior federal or other state-court proceedings) and to determine how much, if any, of a lawyer's "lodestar" (hours times hourly rate) represents work that is duplicative of work done in other jurisdictions.

As a result, it is tempting for a local court to be generous in awarding fees, particularly when dealing with local lawyers with whom they are familiar and when attorneys' fees are paid by the defendant rather than out of the class recovery. It is one thing to have an award of fees in one national case; where there are dozens of cases in dozens of state courts, the inefficiencies are manifest.

Much of these costs and inefficiencies could be avoided by consolidation of all cases in a single jurisdiction under a uniform set of governing laws. The recently-enacted Class Action Fairness Act, which allows state-court class actions to be removed to federal court where the aggregate value of the claims of all class members exceeds \$5 million and at least one plaintiff is diverse from at least one defendant, represents a welcome step toward the sort of consolidation that is necessary. But that Act is not

sufficient to alleviate many of the difficulties described above. Although a large number of future indirect-purchaser actions will likely be removable to federal court under that Act, these actions will still be governed by multiple differing state laws and varying class certification decisions. A single trial is highly unlikely.<sup>5</sup> While some degree of duplication might be avoided by consolidation of cases for pretrial discovery and other proceedings, these problems have not yet been eliminated.

I believe that a single, comprehensive scheme of federal law governing all antitrust claims would best effectuate the purposes of antitrust policy, would avoid the needless waste of private and judicial resources inherent in the present system, and would be fairest to the parties. In a national economy, there should be one national action based on the same underlying set of facts (where interstate -- not purely local -- commerce is involved) and governed under a single set of laws. Such a lawsuit would proceed toward a single trial on the merits that could resolve all of the issues in the case at one time rather than the state-by-state process that is presently required. This would free up substantial judicial resources at the state level and would allow litigants and their lawyers to expend their time on more socially productive activities than navigating the burdensome and duplicative requirements of the present system. It would also reduce the coercive effect

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<sup>5</sup> Of course, for such proceedings to culminate in a single trial of all claims in one court, the Supreme Court's holding in *Lexecon Inc. v. Milberg Weiss Bershad Hynes & Lerach*, 523 U.S. 26 (1998) would likely need to be reversed by legislation or judicial decision. But a uniform national system of antitrust damages remedies would result in substantial benefits even if that decision is allowed to stand.

of the threat of many judgments in other pending cases under the doctrine of collateral estoppel.

While I believe that the complexities and difficulties inherent in indirect-purchaser class action litigation argue against a reversal of *Illinois Brick* (particularly in light of the minimal benefits obtained by some indirect purchasers in “successful cases”), one might easily conclude that a uniform national system that recognized such a cause of action would be preferable to the present divided system.<sup>6</sup>

### **Conclusion**

The present two-tiered system of antitrust damages litigation is inefficient and wasteful. And many indirect-purchaser plaintiffs who are the intended beneficiaries of expanded state damages remedies receive little from the present system, while the lawyers often reap huge rewards. Combining all antitrust damages litigation under a uniform set of federal laws that can be litigated within the federal judicial system would simplify and expedite the resolution of such claims, would be efficient and fair, and would eliminate the drag the present system imposes on both the judicial system and the national economy.

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<sup>6</sup> If an indirect purchaser right of action is to be recognized, the Supreme Court’s holding in *Hanover Shoe, Inc. v. United Shoe Machinery Corp.*, 392 U.S. 481 (1968), which held that antitrust defendants are precluded from attempting to prove the amount of passed-on overcharges as a defense in a damages action brought by direct purchasers, should be legislatively reversed in order to prevent the potential for duplicative recovery recognized by the Court in *Illinois Brick*, 431 U.S. at 730.