

# ANTITRUST CLASS CERTIFICATION: TOWARDS AN ECONOMIC FRAMEWORK

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## INTRODUCTION

Class action lawsuits offer a valuable and often viable mechanism for case management in private antitrust litigation when the number of potential plaintiffs is large. From a plaintiff's perspective, the class certification mechanism is an effective and often efficient device that provides individuals, who might otherwise find it unaffordable, access to the legal system. By comparison, defendants find class certification to be a costly and burdensome process that leads to over-deterrence and social waste. This Article takes a position between these two views, determines that there is room for substantial improvement in the system's efficiency, and offers suggestions for improvement.

To be certified according to the Rules of Civil Procedure, a putative class of direct or indirect purchasers must satisfy several criteria. First, the putative class must meet the four prerequisites specified in Rule 23(a):

- (1) the class is so numerous that joinder of all members is impracticable ["numerosity"];
- (2) there are questions of law or fact common to the class ["commonality"];
- (3) the claims or defenses of the representative parties are typical of the claims or defenses of the class ["typicality"]; and
- (4) the representative parties will fairly and adequately protect the interests of the class ["adequacy"].<sup>1</sup>

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1. Fed. R. Civ. P. 23(a) (brackets added).

In addition, a putative class must also demonstrate that the requirements of one Rule 23(b) subsection have been met. Typically, antitrust plaintiffs rely on subsection 23(b)(3), which requires that “the court finds that the questions of law or fact common to class members predominate over any questions affecting only individual members, and that a class action is superior to other available methods for fairly and efficiently adjudicating the controversy [“predominance”].”<sup>2</sup>

Courts have frequently certified classes in antitrust cases, particularly when the numerosity prong has been satisfied. Moreover, when there are numerous putative plaintiffs, the class certification debate has often focused on commonality and predominance—do common elements predominate over individual elements? While many plaintiffs have cleared these hurdles, some recent decisions against class certification suggest that courts have begun to raise the bar for class certification, particularly with respect to the predominance requirement.<sup>3</sup> One notable recent decision is the Third Circuit’s unanimous opinion in *In re Hydrogen Peroxide Litigation*.<sup>4</sup> However, judicial commentary on the economics underlying the commonality/predominance issue has been limited because courts have struggled to find a framework in which to evaluate whether common issues are subject to generalized proof and whether those common issues predominate over individual issues.

This Article seeks to advance the debate concerning the conditions for class certification towards a more coherent economic

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2. Fed. R. Civ. P. 23(b)(3).

3. For decisions pointing to higher class certification hurdles for plaintiffs, see *In re New Motor Vehicles Canadian Exp. Antitrust Litig.*, 522 F.3d 6 (1st Cir. 2008); *Blades v. Monsanto Co.*, 400 F.3d 562 (8th Cir. 2005); *Reed v. Advocate Health Care*, No. 06 C 3337, 2009 WL 3146999, at \*1 (N.D. Ill. Sept. 28, 2009); *Fleischman v. Albany Med. Ctr.*, No. 1:06-CV-765, 2008 WL 2945993 (N.D.N.Y. July 28, 2008); *In re NCAA I-A Walk-On Football Players Litig.*, No. C04-1254C, 2006 WL 1207915, at \*3 (W.D. Wash. May 3, 2006); *In re Pub. Offering Fee Antitrust Litig.*, No. 98 Civ. 7890 LMM, 00 Civ. 7804 LMM, 2006 WL 1120498 (S.D.N.Y. Apr. 26, 2006).

4. See *In re Hydrogen Peroxide Antitrust Litig.*, 552 F.3d 305 (3d Cir. 2008); see also Paul E. Godek & Janusz A. Ordover, *Economic Analysis in Antitrust Class Certification: Hydrogen Peroxide*, 24 ANTITRUST 62, 62–63 (2009). According to the Third Circuit, the “district court must formulate some prediction as to how specific issues will play out in order to determine whether common or individual issues predominate in given case.” *In re Hydrogen Peroxide Antitrust Litig.*, 552 F.3d at 311 (internal quotation marks and citation omitted). Furthermore, “the court must resolve all factual or legal disputes relevant to class certification, even if they overlap with the merits . . .” *Id.* at 307. Other circuits have not been as explicit as the Third Circuit. See, e.g., *In re Cardizem CD Antitrust Litig.*, 391 F.3d 812 (6th Cir. 2004).

framework. It begins by commenting on the commonality issue, which has recently received significant consideration by economists.<sup>5</sup> It explains why substantial price dispersion (i.e., different prices paid by different purchasers) should not, in itself, be a sufficient basis to defeat class certification when the numerosity prong is clearly satisfied. It then suggests when variability in the harms allegedly suffered by plaintiffs should be a concern. It emphasizes that common elements will not predominate if a significant number of putative plaintiffs were not injured by the alleged wrongful antitrust actions.

This Article also highlights the economic issues that support the need for greater emphasis on typicality and adequacy. Specifically, it explains that class certification should be seen as problematic when there is an inherent conflict as to the appropriate damages framework between the named plaintiff(s) and other putative class members.

This Article is organized as follows. Section I provides a characterization of the economic concerns that generally surround commonality and predominance issues in class certification, using two recent class certification case as examples. Section II provides an overview of the issues relating to typicality and adequacy that are highlighted in two recent class certification cases. Section III offers some concluding remarks.

## I. COMMONALITY/PREDOMINANCE

### A. *A Class Certification Framework*

A central issue in class certification involves whether common elements dominate individual elements.<sup>6</sup> As Johnson and Leonard point out, there is an inherent paradox as plaintiffs are expected to demonstrate that individual data is not required to prove causation or damages; yet plaintiffs often do not have access to all of the individual data needed to evaluate the question.<sup>7</sup> This Article agrees

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5. See, e.g., Pierre Cremieux, Ian Simmons & Edward A. Snyder, *Proof of Common Impact in Antitrust Litigation: The Value of Regression Analysis*, 17 GEO. MASON L. REV. 939 (2010); James F. Nieberding & Robin A. Cantor, *Price Dispersion and Class Certification in Antitrust Cases: An Economic Analysis*, 14 J. LEGAL ECON. 61 (2007); John H. Johnson & Gregory K. Leonard, *Economics and the Rigorous Analysis of Class Certification in Antitrust Cases*, 3 J. COMPETITION L. & ECON. 341 (2007).

6. Class certification issues can arise with respect to antitrust liability, impact (causation), and damages. To simplify the discussion that follows, this Article focuses solely on impact and damages.

7. Johnson & Leonard, *supra* note 5, at 342.

with Johnson and Leonard that the right approach should involve (i) a valid theoretical framework that builds on a specific economic theory of the case and (ii) the presentation of sufficient empirical evidence to assess damages on a class-wide basis and show that common proof can demonstrate impact on all (or almost all) class members.<sup>8</sup> The remainder of this section offers an overview of how such a class certification exercise might proceed.

Assume that the case at issue involves a conspiracy to fix prices. Plaintiffs propose a class of direct purchasers, claiming that all such purchasers were overcharged as the result of the conspiracy. Plaintiffs agree that the prices paid by individual purchasers vary, but claim the price variation is irrelevant since there was individual price variation both before and after the alleged conspiracy. According to plaintiffs, the effect of the price fixing was to raise prices for all putative class members. Plaintiffs further claim that the overcharge may vary among class members, but the variation in prices can be taken into account through the use of multiple regression.<sup>9</sup>

In its most basic form, the economic model of overcharge would focus on price as the variable affected by the alleged conspiracy. Price is presumed to have been determined by supply and demand in a pre-conspiracy period.<sup>10</sup> To model this for a sample of  $N$  individuals or firms, let

$P_{it}$  = the price paid by the  $i^{\text{th}}$  individual at time  $t$  ( $i = 1, 2, \dots, N$ );

$X_{it}$  = a list of explanatory variables (“covariates”) not affected by the conspiracy, whose values are individual specific;<sup>11</sup>

$D_t$  = a dummy variable indicating the period of the alleged conspiracy.

The economic model underlying the theory of overcharge is given by:

$$P_{it} = \alpha_i + X_{it}\beta_i + \theta_i D_t + \varepsilon_{it} \quad (1)$$

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8. *Id.* at 344.

9. Multiple regression analysis has been widely accepted by the courts for use in a variety of contexts, including class certification. *See, e.g.*, Daniel Rubinfeld, *Reference Guide on Multiple Regression*, in REFERENCE MANUAL ON SCIENTIFIC EVIDENCE 179 (Fed. Judicial Ctr. ed., 2d ed. 2000).

10. There is no loss of generality; the same analysis would apply if there were data for a post-conspiracy period only, or for a combination of pre- and post-conspiracy periods.

11. To simplify, it is assumed that all of the covariates are exogenous. Note that some of the covariates may vary over time, but not over individuals, and thus will be common to all members of the putative class. We do not separately treat those variables because they do not raise class certification concerns.

This relatively general specification takes into account the possibility that the alleged conspiracy will directly affect the price, as given by given by  $\theta_i D_t$  (e.g., through an increase in price at each point in time in the damage period).<sup>12</sup>

Note that Equation (1) allows for the possibility that the prices paid by putative class members will vary among individuals (through the  $\alpha_i$ ), that the effects of the supply and demand variables on price may also be individual specific (through the  $\beta_i$ ), and that the effect of the alleged conspiracy on price may be individual specific (through the  $\theta_i$ ).

While (1) appears as a single equation, it is in fact a simple representation of  $N$  separate regression equations, one for each individual in the putative class. If (1) is the appropriate model, then individual elements will predominate, unless the covariates take on values that are similar across all putative class members. The key here is that the  $\theta_i$  coefficients, which measure the overcharge per unit of output, may vary among individuals. This variation will be lost if one were to run a single regression of the average price in each time period on the average values of  $X$  and  $D$ . This will generate at best an estimate of the average effect of the alleged conspiracy, which will be measured as the average of the  $\theta_i$ . It follows that the single regression approach will not provide accurate measures of individual effects. It is important to note that even if there is a measurable average adverse effect of the conspiracy, if one relies on the estimation of a single regression, the possibility that a substantial number of putative class members will not have been injured cannot be ruled out.

The central empirical issue surrounds the distribution of the  $\theta_i$ . If the distribution has a very small variance, then the mean (or average) of the elements of the distribution will provide a reasonable estimate of the individual overcharges. However, if the distribution has a large variance, the mean will not reliability characterize individual elements. Moreover, even with a positive mean that is statistically significantly different from zero, a substantial number of individuals may not have been injured (those for whom the  $\theta_i$  are negative).

To illustrate, assume that the distribution of harms associated with an antitrust violation is normally distributed with a mean of \$1000 and a standard deviation of \$1000, as shown in Figure 1, at-

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12. A more complete model would take the form:  $P_{it} = \alpha_i + X_{it}\beta_i + \theta_i D_t + \gamma_i D_t X_{it} + e_{it}$ . This version of the model takes into account the possibility that the effect of the conspiracy will also be felt through one or more of the supply and demand variables, as given by the term  $\gamma_i D_t X_{it}$ .

tached. With the normal distribution, it is well known that approximately sixteen percent of those affected by the violation will be more than one standard deviation below the mean, as the figure illustrates.<sup>13</sup> It follows that sixteen percent of the putative class will have benefited and not been harmed by the antitrust violation.

*B. Do Common Issues Predominate?*

In support of class certification, plaintiffs in the prototypical price-fixing case might put forward an alternative model, as shown in the following equation:

$$\bar{P}_t = \alpha + \bar{X}_t\beta_i + \theta D_t + \varepsilon_t \quad (2)$$

Here the variables  $\bar{P}_t$  and  $\bar{X}_t$  represent the means of the original price and covariates at each time period. Note that Equation (2) is a special case of Equation (1), where  $\alpha$ ,  $\beta$  and  $\theta$  do not vary across individuals. If (2) is the appropriate model specification, then common elements will predominate and questions concerning antitrust impact and damages can be evaluated for the class as a whole.<sup>14</sup>

Defendants will likely object to the specification given by Equation (2), since the specification *presumes* that there are dominant common elements. However, if one could estimate the set of regressions inherent in Equation (1) as well as Equation (2), one could readily test to see whether the parameter restrictions implied by model (2) are reasonable, but this is the point at which the paradox pointed out by Johnson and Leonard comes to the fore. In many cases, it will not be possible to estimate the model given by Equation (1) because often such specific pricing information is not available. How is it decided whether Equation (2) is appropriate? While there is no easy answer, it is suggested below how the analysis might proceed.

Suppose that the number of putative class members is large and that the court is looking to find the most suitable means of litigating causation and damages. Assume further that the  $N$  individual putative class members can reasonably be assigned to a series of  $S$  potential subclasses ( $s$  runs from 1 to  $S$ ). These subclasses

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13. See, e.g., ROBERT S. PINDYCK & DANIEL L. RUBINFELD, *ECONOMETRIC MODELS AND ECONOMIC FORECASTS*, tbl. 1 at 561 (3d ed. 1991).

14. Again for simplicity, the Article focuses on antitrust impact and the average effect of the alleged conspiracy. For a discussion of the econometric issues associated with damage estimation, see Daniel L. Rubinfeld, *Quantitative Methods in Antitrust*, in 1 ABA ANTITRUST SECTION, *ISSUES IN COMPETITION LAW AND POLICY* 739–42 (Wayne D. Collins ed. 2008); Justin McCrary & Daniel L. Rubinfeld, *Measuring Benchmark Damages in Antitrust Litigation* (Oct. 2009), available at [http://ec.europa.eu/competition/antitrust/actionsdamages/rubinfeld\\_mccrary.pdf](http://ec.europa.eu/competition/antitrust/actionsdamages/rubinfeld_mccrary.pdf).

might account for individual differences such as the volume of product purchased, the geographical location (or market) in which the purchase was made, and so on. The class certification issue can then be thought of as involving a choice between Equation (1) and Equation (2), where the number of subclasses,  $S$ , is to be determined as part of the class certification investigation. If  $S$  is determined to be one, a single class should be certified. If  $S$  is determined to be greater than one, but small, then it will be plausible to consider the certification of a series of subclasses. However, if  $S$  is determined to be large, then class certification is not appropriate.<sup>15</sup>

Using this framework, the following set of equations describes the relevant pricing model:

$$\bar{P}_s = \alpha_s + \bar{X}_{st}\beta_s + \theta_s D_t + \varepsilon_{st} \quad (3)$$

While this specification is similar to that of Equation (1), there are now  $S$  individual equations, one for each subclass (rather than one for each individual). According to Equation (3), the damages per unit of output are given by  $\theta_s$  for each of the subclasses. At this point, the variance in per-unit damages measured across potential subclasses should be analyzed. If the variance of the  $\theta_s$  across subclasses is equal to zero or is relatively small, then it is appropriate to certify the putative class. However, if the variance is relatively large, then a single class should not be certified.

Even if it is determined that the certification of a single class is inappropriate, it may still be appropriate to certify a set of subclasses. To evaluate this question, ideally the variance of the  $\theta_s$  as the number of subclasses  $S$  is increased would be determined. As the number of subclasses increases the variance across subclasses will grow, while the variance within each (now smaller) subclass will decline. The appropriate number of subclasses would be resolved by trading off any decrease in variance within classes as the number of subclasses increases against the resulting increases in the cost of litigation.

To illustrate, assume that the distribution of harms is given by a normally distributed bell-shaped curve similar to the one shown in Figure 1. Assume also that there are three “types” of putative class members: (1) type  $L$  members place a relatively low value on the

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15. Failure to certify a class does not necessarily mean that plaintiffs cannot pursue their cases further. An alternative approach would be for a number of individual plaintiffs to pursue their cases in separate trials. If successful, plaintiffs are likely (given the high cost of litigation) to be able to leverage those successes into settlements of many other cases.

product whose price has allegedly been increased as the result of price fixing, (2) type *H* places a high value on the product, and (3) type *M* are in the middle. Figures 2A and 2B, attached, show two possible characterizations of the distributions of harms of the three types of direct purchasers. In Figure 2A, the distributions of harms for each of the three types have relatively little variance and therefore relatively little overlap. Here the case for subclasses (rather than a single class) is strong. In Figure 2B, however, the distributions have relatively high variance and high overlap. Consequently, there is a stronger case for the certification of a single class.

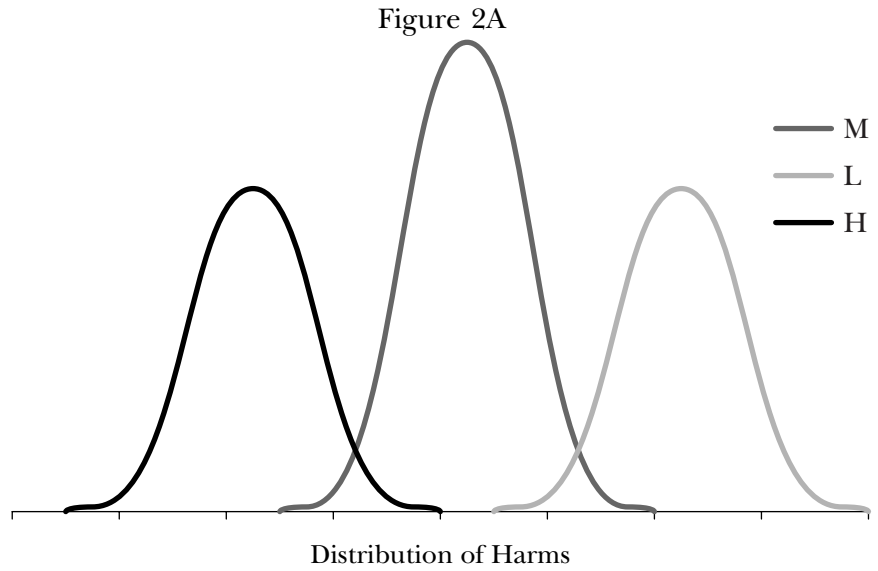
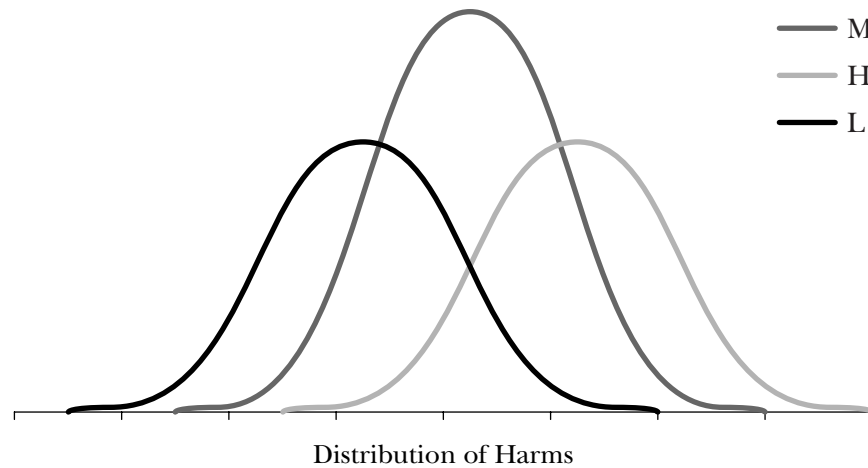




Figure 2B



Of course, one cannot avoid entirely the paradox of class certification. Nevertheless, the approach just described does offer some useful insights. First, a key element in the analysis is the variation in the per-unit damage measure, not the variance in the supply-demand variables themselves. This analysis suggests that, where plaintiffs put forward a credible case for class certification, including a model that would allow for the evaluation of issues relating to both injury and damages, defendants should not be able to defeat class certification by showing only that there is substantial variation in one or more explanatory variables. Rather, defendants should be expected to explain why the variation in the demand and supply variables is likely to lead to variation in per-unit damages.

Simply put, if the plaintiffs propose a pricing model such as the model given by Equation (2), defendants might argue that each purchase by an individual plaintiff occurs at a different price due, for example, to the presence of volume discounts or individual contract negotiations. If this is the case, Equation (1) rather than Equation (2) is appropriate, which argues against class certification. Plaintiffs might respond that the individual pricing associated with these differences arose both before and during the alleged conspiracy, and that the per-unit damage is the same for all individuals. In that special case, an analysis of average prices as given in Equation (2) can be used to evaluate injury and damages issues. The debate would then most likely continue with the defendants seeking to explain that the effects of the alleged conspiracy will be differentiated among putative class members, and as a consequence, plaintiffs' response is not dispositive.

C. *The Glass Containers Antitrust Litigation: Subclasses Certified*<sup>16</sup>

Plaintiffs brought a price-fixing case against the major manufacturers of glass containers, including Owens-Illinois, Brockway, and Dart.<sup>17</sup> Plaintiffs sought to certify a single, national class that included all direct purchasers of manufactured glass containers. Plaintiffs' experts supported class certification, arguing that common questions of law and fact predominated over the questions affecting only individual members. Furthermore, plaintiffs offered a methodology that purported to allow for the determination of aggregate damages to the class.

In its simplest form, plaintiffs' economic and statistical argument was that profit margins prior to the alleged price fixing conspiracy would serve as a suitable benchmark for what profit margins would have been during the conspiracy period but-for the conspiracy. In essence, the methodology would allow the calculation of a series of but-for profit margins, which when compared to actual profit margins during the conspiracy period, would provide a measure of aggregate overcharges.<sup>18</sup> In opposition to class certification, defendants' economic expert argued that there was substantial price variation among different types of glass containers (e.g., wine bottles versus wide-mouth containers for refrigerated products). He argued further that the price variation was evidence that any harm that might have been suffered by putative class members would have varied substantially among individuals.

In order to assist in the resolution of this difficult class certification matter, the district court judge appointed a neutral court-appointed expert. After further discovery, the court-appointed expert analyzed the variation in glass container prices among putative class members and among the major categories of glass containers. Focusing on profit margins as well as prices, the court-appointed expert was able to estimate models similar to those given by Equation (3) for each of the glass container categories. Comparing those

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16. Daniel Rubinfeld, co-author of this Article, served as a court-appointed expert in this case. Due to the confidential nature of portions of the proceedings, certain relevant documents are still under seal or covered by protective order. Where citation is not provided, the statements reflect confidential documents in his possession that are covered by the protective order. Where available, citation is provided to publicly available documents.

17. *Superior Beverage Co. v. Owens-Illinois, Inc.*, No. 83 C 512, 1989 U.S. Dist. LEXIS 6662, at \*11 (N.D. Ill. June 5, 1989).

18. The use of profit margins to determine a measure of overcharges requires an assumption that the conspiracy did not affect costs or an in-depth analysis of how costs were affected by the conspiracy.

results to the estimation associated with a comparable version of Equation (2), the expert concluded that common elements did not predominate. In essence, the variance in the distribution of the  $\theta_i$  was very substantial. At best, there was an uncertain case to be made for the certification of a set of subclasses given the available information. The set of subclasses, made up of a variety of types of glass containers, was chosen in a manner that substantially reduced the within-class price variation in alleged damages per class member (the vast majority of which purchased only one type of container), while maintaining substantial variation in alleged damages across classes.

After a hearing and a post-hearing debate as to the appropriate burden shifting with respect to the proposed set of subclasses, the Court chose to follow the proposed framework, and to certify a set of subclasses.

D. *In re K-Dur Antitrust Litigation: Lack of Predominance*<sup>19</sup>

*In re K-Dur Antitrust Litigation*<sup>20</sup> provides an example in which the distribution of the  $\theta_i$  had a variance that was so large that  $\theta_i$  was negative for a large number of putative class members. *K-Dur* was a consolidated private action which followed the Federal Trade Commission (FTC) investigation of Schering-Plough's patent settlement agreements with generic companies Upsher-Smith and ESI Lederle.<sup>21</sup> Schering-Plough had a patent on the potassium chloride drug K-Dur. Upsher-Smith and ESI Lederle filed Abbreviated New Drug Applications (ANDAs) with the Food and Drug Administration, indicating their desire to enter with generic versions of K-Dur prior to patent expiration. Schering-Plough sued both companies and eventually settled the patent litigation with each. Under the settlement with Upsher-Smith, Upsher was able to enter with a generic version of K-Dur in September 2001, five years prior to the expiration of the patent. Schering also paid Upsher-Smith \$60 million to license a portfolio of Upsher drugs. Under the settlement

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19. Daniel Rubinfeld and Bret Dickey, co-authors of this Article, served as expert witness and consultant, respectively, for defense in this case. Due to the confidential nature of portions of the proceedings, certain relevant documents are still under seal or covered by protective order. Where citation is not provided, the statements reflect confidential documents in their possession that are covered by the protective order. Where available, citation is provided to publicly available documents.

20. *In re K-Dur Antitrust Litig.*, No. 01-1652 (JAG) (D.N.J. Apr. 23, 2008).

21. This section relies on the factual background of the litigation presented in the Eleventh Circuit's opinion *Schering-Plough Corp. v. FTC*, 402 F.3d 1056, 1058-61 (11th Cir. 2005).

with ESI Lederle, a subsidiary of American Home Products (now Wyeth), ESI Lederle was able to enter with a generic version of K-Dur in January 2004. The agreement called for payments of up to \$30 million to ESI, including payment for the licensing of two ESI drugs.

The consolidated private action included several groups of plaintiffs, including a putative class of direct purchasers, a putative class of indirect purchasers, and several direct and indirect purchasers suing individually. This Article focuses on the class action motion of the putative class of indirect purchasers.<sup>22</sup> The proposed class representatives included two health insurers, eight labor union health and welfare funds, and six individual consumers.<sup>23</sup> The class representatives were attempting to represent a putative class that included the ultimate “purchasers” of K-Dur—i.e., the individuals and entities that made the final payments. The putative class included private managed care organizations and insurance companies, uninsured consumers, and individuals who made co-payments and co-insurance payments in order to fill prescriptions for K-Dur.<sup>24</sup>

The indirect purchaser plaintiffs’ theory of antitrust harm was similar to that of the FTC and the other private plaintiffs, in that the payments to Upsher-Smith and ESI Lederle were payments to delay entry, disguised as licensing fees. The plaintiffs argued that but-for the payment, Upsher-Smith would have entered the market in November 1998. In response, Schering argued that the settlements did not delay generic entry; rather, the payments were legitimate licensing fees.<sup>25</sup> Moreover, according to Schering, the settlement benefited the parties and society by eliminating the cost and uncertainty associated with the patent litigation.<sup>26</sup>

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22. The direct purchaser class was certified by the Court.

23. Special Master’s Report and Recommendation on the Indirect Purchaser Plaintiffs’ Amended Motion for Class Certification at 3 n.3, *In re K-Dur Antitrust Litig.*, No. 01-1652 (JAG) (Consolidated Cases), MDL Docket No. 1419 (D.N.J. Feb. 6, 2009) [hereinafter Special Master’s Report]. As noted in the Special Master’s Report, plaintiffs withdrew several class representatives and the claims of several others were dismissed on summary judgment, leaving only two insurers, two health and welfare funds, and one consumer. *Id.*

24. The class definition excluded state government entities (e.g., Medicaid) that reimbursed pharmacies for *K-Dur*.

25. In the initial case brought by the Federal Trade Commission, the Eleventh Circuit ultimately determined that the settlement agreements were not anticompetitive. *Schering-Plough Corp.*, 402 F.3d at 1076.

26. *See id.* at 1075. There is considerable debate in the legal and economic fields about the conditions under which such settlements are anticompetitive. For a discussion in the context of the FTC’s challenge of the *K-Dur* settlements, see

The plaintiffs sought certification pursuant to Rule 23(b)(3), i.e., a finding that “questions of law or fact common to the members of the class predominate over any questions affecting only individual members, and that a class action is superior to other available methods for the fair and efficient adjudication of the controversy.”<sup>27</sup> In their motion for class certification, the indirect purchaser plaintiffs’ economist argued that if defendants’ conduct had delayed generic entry, such a delay would have harmed all members of the indirect purchaser class, since all would have paid more for K-Dur than they would have for its generic equivalents.

The plaintiffs’ economist primarily relied on two types of evidence. First, he applied the actual experience of K-Dur after generic manufacturers entered in September 2001, pursuant to the settlement agreement. Using IMS Health data on retail pharmacy prescriptions, he demonstrated that after September 2001 the vast majority of K-Dur prescriptions were written for generic potassium chloride.<sup>28</sup> He also demonstrated that the average retail price of generic potassium chloride was lower than the average retail price of K-Dur. He performed similar analyses on manufacturer prices of K-Dur and its generics and found similar results. Second, the plaintiffs’ expert referred to academic studies analyzing the competitive effects of generic entry. The studies relied on by plaintiffs’ expert found that generic entry lowered average prices.<sup>29</sup>

It is notable that all of this evidence relates to the effect of generic entry on *average* prices. The IMS Health data relied on by plaintiffs’ expert provides information only on total prescriptions and total dollars by month. The data does not offer information about the variation in prices paid for a given product in a given

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John P. Bigelow & Robert D. Willig, “Reverse Payments” in *Settlements of Patent Litigation: Schering-Plough, K-Dur, and the FTC (2005)*, in *THE ANTITRUST REVOLUTION: ECONOMICS, COMPETITION, AND POLICY* 248 (John E. Kwoka, Jr. & Lawrence J. White eds., 2009). For a more comprehensive discussion of the economic issues, see Bret Dickey, Jonathan Orszag & Laura Tyson, *An Economic Assessment of Patent Settlements in the Pharmaceutical Industry*, 19 *ANNALS HEALTH L.* 367 (2010).

27. Special Master’s Report, *supra* note 23, at 14 (citing to Fed. R. Civ. P. 23(b)(3)).

28. Specifically, he relied upon the IMS National Prescription Audit data.

29. See, e.g., Henry Grabowski & John Vernon, *Longer Patents for Increased Generic Competition in the U.S.: The Waxman-Hatch Act after One Decade*, 10 *PHARMACOECONOMICS* 110 (1996) [hereinafter Grabowski & Vernon]; Duane M. Kirking et al., *Economics and Structure of the Generic Pharmaceutical Industry*, 41 *J. AM. PHARM. ASS’N* 578 (2001).

month.<sup>30</sup> Similarly, the expert's analysis of manufacturer data examined differences in averages (and manufacturer prices say little about any variation in the downstream prices paid by indirect purchasers). Thus, the economic analysis of plaintiffs' expert failed to investigate a key class certification question—were all or almost all class members injured?

The expert's analysis suffered from an even more significant flaw: all of the analysis focused on the average retail price. However, the pharmaceutical industry is unusual in that payment for prescription drugs is typically shared by multiple purchasers. The vast majority of prescription drug purchases are covered by insurance. When an insured patient fills a prescription, the cost of that prescription is typically paid in part by the patient and in part by the insurer. The patient's cost will be limited to a co-payment (either a dollar amount or a percentage of the prescription's cost).

As noted above, the putative class included both insurers and consumers. Where payment for a prescription is shared between insurer and consumer, the appropriate class certification question is not whether the total retail price is lower on average after generic entry but whether each individual class member (i.e., the insurer and consumer separately) would have paid a lower price had generic entry occurred earlier. Moreover, simply because the average price would have been lower does not mean that both the patient and the insurer would have shared in the savings; it is quite possible that the savings would be enjoyed entirely by one and not by the other.

In the *K-Dur* case, an evaluation of the evidence made it clear that there were broad groups of insured consumers that would not have benefited from lower generic prices. First, some insurance plans have a flat co-payment, whereby the patient pays the same amount (e.g., \$5) for all drugs. Patients covered by these plans would not have shared in any savings resulting from the entry of generic *K-Dur*.<sup>31</sup> Second, for various reasons, including brand loyalty and perceived and actual differences between the generic and branded versions, not all consumers are prescribed, dispensed, and/or take home the generic version when it is available.<sup>32</sup> Be-

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30. The academic literature relies on IMS and other similar data and therefore is similarly incapable of shedding any light on variations. See, e.g., Grabowski & Vernon, *supra* note 29, at 116.

31. Flat co-payments are much less common today than they were a decade ago, but they were still prevalent during the class period.

32. Indeed, one of the named plaintiffs switched back to branded *K-Dur* after trying the generic version.

cause branded manufacturers may have an incentive to increase prices after generic entry, cash-paying customers might have paid a higher price, not a lower price.<sup>33</sup>

Moreover, insured brand loyalists in a tiered co-payment system are likely to have been worse off.<sup>34</sup> In a three-tiered co-payment system, the branded drug typically moves from the second tier (which covers the preferred or formulary brand) to the third tier (which covers non-preferred, non-formulary drugs) upon entry of a generic version of that drug. As a result, brand loyalists will typically see their co-payment increase from the lower tier two co-payment to the higher tier three co-payment. Thus several types of consumers, collectively accounting for a substantial share of consumers, are not likely to have been harmed by a delay in generic entry.

A more detailed analysis demonstrated that the *K-Dur* experience was somewhat unusual. Not only did many consumers not benefit from generic entry, the same was true for many insurers. This is a surprising result because insurers typically benefit from the lower costs associated with generic entry. Indeed, because of the likely savings from generic entry, insurers typically provide incentives for doctors to prescribe and pharmacists to dispense generics when they are available.

Nevertheless, insurers do not always benefit. *K-Dur* is unusual in that it is a relatively low-priced branded drug. The average retail cost of a thirty pill prescription for *K-Dur* at a twenty milligram dosage was roughly \$15 in 2001. Insurers with tiered co-payments provide an incentive in the form of a lower co-payment to consumers to use the generic. Typically, this difference is on the order of \$5. Furthermore, because the co-pays are set without respect to the price of the drug, this co-pay differential holds whether the branded drug costs \$200 or \$20. With *K-Dur* being a very low-priced drug, and a drug with relatively few generic competitors, the difference in the average retail price between *K-Dur* and its generic competitors was well under \$5 after generic entry. Thus, for *K-Dur*,

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33. See, e.g., Henry G. Grabowski & John M. Vernon, *Brand Loyalty, Entry, and Price Competition in Pharmaceuticals After the 1984 Drug Act*, 35 J.L. & ECON. 331, 339 (1992); and Richard G. Frank & David S. Salkever, *Generic Entry and the Pricing of Pharmaceuticals*, 6 J. ECON. & MGMT. STRATEGY 75, 75–77, 89–90 (1997). See generally Henry Grabowski & John Vernon, *Longer Patents Lower Initiation Barriers: The 1984 Drug Act*, 76 AM. ECON. REV. 195, 195–98 (1986).

34. In a tiered co-payment system, the patient pays a small co-pay when filling a generic prescription that is on the insurer's formulary, a larger co-pay for a branded drug on the formulary, and an even larger co-pay or full price for drugs not on the formulary. See, e.g., Ernst R. Berndt, *Pharmaceuticals in U.S. Health Care: Determinants of Quantity and Price*, 16 J. ECON. PERSP. 45, 50–52 (2002).

consumers on average obtained more than a one hundred percent of the cost savings associated with generic entry. Indeed, net of co-payments, insurers actually ended up reimbursing *more* per prescription for the generic than for the brand.

As with consumers, there are several different types of insurers that would have been affected very differently by the alleged delay in generic entry. Insurers that provided little incentive for consumers to switch to generic drugs (e.g., insurers with flat co-payment structures or only small differences between tiers) may have been harmed by a delay in generic entry. Insurers that provided strong incentives for consumers to switch (e.g., insurers with large differences in co-payments between tiers) would in fact have shifted all of the generic savings and may in fact have paid more for generic potassium chloride. Using data produced by the named plaintiffs, the defendants' expert demonstrated that several of the class representatives actually paid more for generic potassium chloride than they did for K-Dur.

Plaintiffs did not dispute this evidence. Rather they advanced a novel "joint purchaser theory," arguing that in an insured transaction the insurer and the consumer are a single purchaser. According to plaintiffs' theory, what is relevant is the change in total retail price, not the change in the portion of the price paid by any particular entity. The Special Master rejected this theory.<sup>35</sup> Relying heavily on the analysis of the defendants' expert, the Special Master recommended denial of the plaintiffs' motion for class certification. Specifically, the Special Master concluded that the plaintiffs satisfied neither the predominance nor the superiority requirements of Rule 23(b)(3). He concluded that "individual issues of impact predominate in this case and preclude certification of the proposed class."<sup>36</sup> He also concluded that, where predominance does not exist, the economies of scale do not justify aggregating claims in a class action, and, therefore, a class action was not the appropriate setting for adjudication of the merits.<sup>37</sup> Following the

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35. The Special Master called such a theory "unprecedented" and pointed to several other decisions that specifically excluded indirect purchaser plaintiffs that could not demonstrate individual injury. Special Master's Report, *supra* note 23, at 26 (citing *In re Terazosin Hydrochloride Antitrust Litig.*, 223 F.R.D. 666 (S.D. Fla. 2004); *In re Relafen Antitrust Litig.*, 231 F.R.D. 52 (D. Mass. 2005); *In re Cardizem CD Antitrust Litig.*, 481 F.3d 355 (6th Cir. 2007)).

36. Special Master's Report, *supra* note 23, at 19.

37. *Id.* at 27–28. In their reply brief, plaintiffs proposed an alternative class that was essentially composed of six subclasses of payors that would have been harmed by a delay in generic entry. The Special Master rejected this class as well, in part because plaintiffs' expert had not proposed methodology by which impact



Special Master's ruling, the plaintiffs voluntarily dismissed all claims.<sup>38</sup>

## II. TYPICALITY/ADEQUACY: CONFLICTS AMONG CLASS MEMBERS

In class certification cases, substantial attention has been devoted to the economic analysis of common proof. At the same time, however, the economic evaluation of conflicts between the members of the putative classes has been relatively overlooked. Class definitions are often crafted quite broadly, encompassing firms that directly compete with one another, firms with different business models, and firms having different relationships with the defendants. As a result, it is not surprising that real and substantial conflicts can exist between putative class members over litigation strategy (or whether to challenge the conduct at issue at all).

An analysis of the economic incentives of putative class members can shed light on potential conflicts that might exist among putative class members. This section describes two cases in which an evaluation of the economic issues proved to be fundamental in the battle over class certification. In the first case, the analysis shows a conflict between those who were harmed by the anticompetitive behavior and those that benefitted. In the second case, there was a conflict between those putative class members that had an incentive to pursue an overcharge theory and those that had an incentive to pursue a lost profits theory.

### A. Valley Drug: *Conflict between Those Benefited and Those Harmed*

Arguably the most fundamental conflict in a class certification case is the conflict between parties that benefited from the challenged conduct and those that were harmed by the challenged conduct. The Eleventh Circuit in *Valley Drug Co. v. Geneva Pharmaceuticals, Inc.*<sup>39</sup> confronted the question of whether it was appropriate to certify a class when it was likely that certain class members not only did not suffer harm, but in fact benefited from the alleged wrongful conduct.

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and damages could be established for this alternative class by common proof. *Id.* at 26–28.

38. Order at 2, *In re K-Dur Antitrust Litig.*, No. 01-1652 (JAG) (D.N.J. Apr. 23, 2008).

39. 350 F.3d 1181 (11th Cir. 2003).

*Valley Drug* involved allegations similar to those in *K-Dur*. Specifically, plaintiffs alleged that a patent settlement agreement between branded and generic pharmaceutical manufacturers delayed generic entry and caused purchasers to pay more for prescription drugs.<sup>40</sup> In *Valley Drug*, two regional pharmaceutical wholesalers brought suit on behalf of a putative class of direct purchasers after defendant Abbott Laboratories (Abbott), a manufacturer of branded pharmaceutical drugs, entered into settlement agreements with generic drug manufacturers Geneva Pharmaceuticals (Geneva) and Zenith Goldline Pharmaceuticals (Zenith).<sup>41</sup> The settlement agreements allegedly preserved Abbott's monopoly position regarding "the drug terazosin hydrochloride by keeping Geneva and Zenith's less expensive generic [drugs] off the market."<sup>42</sup> The plaintiffs claimed that these settlement agreements were in violation of the Sherman and Clayton Acts.<sup>43</sup>

The proposed class in *Valley Drug* was "all entities who purchased Hytrin, also known by the chemical name terazosin hydrochloride, directly from Abbott at any time during the period commencing March 31, 1998, through August 13, 1999."<sup>44</sup> The district court certified this class, and Defendants appealed to the Eleventh Circuit.<sup>45</sup>

The court in *Valley Drug* mainly concerned itself with the adequacy prong of Rule 23. The court stated that "'adequacy of representation' analysis 'encompasses two separate inquiries: (1) whether any substantial conflicts of interest exist between the representatives and the class; and (2) whether the representatives will adequately prosecute the action.'"<sup>46</sup> With respect to the conflict

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40. Whereas *K-Dur* involved final settlement agreements (i.e., settlement agreements that ended the litigation), *Valley Drug* involved an "interim" or "partial" settlement agreement that did not settle the litigation, but under which, Geneva agreed not to launch its generic product until the patent litigation had been resolved. *Schering-Plough Corp. v. FTC*, 402 F.3d 1056, 1061, 1063 (11th Cir. 2005). For a more complete discussion of the economic issues involved in the *Hytrin* case and of "interim" or "partial" settlement agreements more generally, see James Langenfeld & Wenqing Li, *Intellectual Property and Agreements to Settle Patent Disputes: The Case of Settlement Agreements with Payments from Branded to Generic Drug Manufacturers*, 70 ANTITRUST L.J. 777 (2003).

41. *Valley Drug Co.*, 350 F.3d at 1183.

42. *Id.* at 1183–84.

43. *Id.* at 1183; Sherman Act, 15 U.S.C. §§ 1–7 (2006); Clayton Act, 15 U.S.C. §§ 12–27, 29 U.S.C. §§ 52–53 (2006).

44. *Valley Drug Co.*, 350 F.3d at 1184 n.4.

45. *Id.* at 1184.

46. *Id.* at 1189 (quoting *In re HealthSouth Corp. Sec. Litig.*, 213 F.R.D. 447, 460–61 (N.D. Ala. 2003)).

analysis of point (1), the court noted that “the existence of minor conflicts alone will not defeat a party’s claim to class certification: the conflict must be a ‘fundamental’ one going to the specific issues in controversy.”<sup>47</sup> In determining whether a conflict is fundamental, the court found that “[a] fundamental conflict exists where some party members claim to have been harmed by the same conduct that benefited other members of the class.”<sup>48</sup> Tying the first adequacy requirement to the second, the court stated that “[i]n such a situation, the named representatives cannot ‘vigorously prosecute the interests of the class through qualified counsel’ because their interests are actually or potentially antagonistic to, or in conflict with, the interests and objectives of other class members.”<sup>49</sup>

Applying these rules to the facts in *Valley Drug*, the Eleventh Circuit found that the plaintiffs had not met their burden of demonstrating the absence of a fundamental conflict within the class. The defendants argued that the three national pharmaceutical wholesalers, which were the largest members of the putative class, experienced a net gain from the delay in entry of generic terazosin hydrochloride.<sup>50</sup> The rationale was that these three national wholesalers sell their products on a “cost-plus” basis, where they charge a percentage mark-up on both branded and generic drugs.<sup>51</sup> Because of this pricing structure and the fact that drugs such as terazosin hydrochloride were considered “maintenance drugs” (drugs taken continuously to treat a severe chronic condition) with inelastic demand, the national wholesalers arguably made more money on the sale of higher-priced branded products than they would have on lower-priced generic products.<sup>52</sup> The defendants further argued that national wholesalers benefited from the suppression of generic competitors because wholesalers “are often bypassed in the distribution chain for many generic sales, causing them to lose sales.”<sup>53</sup>

The court appears to have been persuaded by these arguments, and the accompanying record supporting them, holding that “[c]lass certification under these circumstances would be inappropriate.”<sup>54</sup> The court made clear that it was not passing judgment on the ultimate legitimacy of the arguments but instead concluded

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47. *Id.*

48. *Id.*

49. *Id.* (quoting *In re HealthSouth*, 213 F.R.D. at 461–63)

50. *Id.* at 1190.

51. *Id.*

52. *Id.* at 1191.

53. *Id.*

54. *Id.*

that the current record provided an inadequate basis to decide the issue.<sup>55</sup>

As a result of the potential benefit that the patent settlement agreements might have afforded to national wholesaler class members, the court held that national wholesalers could “have divergent interests and objectives from the named representatives with respect to the fundamental issues in controversy in this litigation.”<sup>56</sup> In support of its conclusion, the court noted that the class representatives were “two regional wholesalers with relatively small claims who d[id] not sell on a cost-plus basis.”<sup>57</sup> Finally, the court pointed out that “the defendant does not have to show actual antagonistic interest; the potentiality is enough.”<sup>58</sup>

Thus, in *Valley Drug*, an adequacy problem was created because the economic analysis showed that the class representatives would not adequately represent the interests of all putative class members. The problem arose because some of the class members were not injured, and in reality, benefitted from the alleged anticompetitive conduct.

The Eleventh Circuit ruled that, in certifying the class, the district court failed to evaluate the adequacy of representation prong of Rule 23(a) and, therefore, abused its discretion.<sup>59</sup> Specifically, the district court failed to evaluate whether large wholesalers’ alleged gains from the conduct resulted in conflicts of interest between the class representatives and the national wholesalers (AmerisourceBergen, Cardinal, and McKesson).<sup>60</sup> Relying on *Hanover Shoe*<sup>61</sup> and *Illinois Brick*,<sup>62</sup> the district court refused to allow the defendants “downstream” discovery, or discovery on the prices at which wholesalers sold Hytrin and generic terazosin to their customers.<sup>63</sup>

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55. *Id.* at 1191–92. The court determined that the district court, relying on the holdings of *Hanover Shoe, Inc. v. United Shoe Mach. Corp.*, 392 U.S. 481 (1968), and *Illinois Brick Co. v. Illinois*, 431 U.S. 720 (1977), had also abused its discretion by not letting the defendants engage in discovery regarding the wholesalers’ sales practices. *Valley Drug Co.*, 350 F.3d at 1192. However, *Hanover Shoe* and *Illinois Brick* dealt with standing in antitrust suits rather than class certification. *Id.*

56. *Id.* at 1193.

57. *Id.*

58. *Id.* at 1194 (quoting *In re HealthSouth Corp. Sec. Litig.*, 213 F.R.D. 447, 462 (N.D. Ala. 2003)).

59. *Id.* at 1188.

60. *Id.* at 1190–91.

61. *Hanover Shoe, Inc. v. United Shoe Mach. Corp.*, 392 U.S. 481 (1968).

62. *Illinois Brick Co. v. Illinois*, 431 U.S. 720 (1977).

63. *Valley Drug Co.*, 350 F.3d at 1192.

After the remand from the Eleventh Circuit, the district court allowed such discovery with respect to a sample of the largest putative class members. An economic analysis of the data that was produced through this discovery revealed that some sample class members did appear to benefit from delayed generic entry as they earned higher profits on sales of branded Hytrin than they did on sales of generic potassium chloride.<sup>64</sup> In contrast, other sample class members earned higher profits on generic potassium chloride than on branded Hytrin. Based on the analysis of the economist retained by defendants, and on the Eleventh Circuit's decision, the district court denied plaintiffs' motion for class certification.<sup>65</sup>

*B. Bradburn v. 3M: Conflict Over Choice of Damages Theory*

Even if all putative class members were harmed by the challenged conduct, it is quite possible that different groups of class members would have different incentives with respect to which litigation strategy to pursue. For example, while all of the previous discussions have presumed that all putative class members would pursue an overcharge theory of damages, it is possible that some of the putative class members would find it advantageous to pursue a lost profits theory rather than an overcharge theory.

To see why, let  $Q_{it}$  represent the purchases of the  $i$ th individual during time period  $t$ . In assessing impact on lost profits, it is important to account for the possibility that the per-unit impact might be reduced in a lost profits claim if some of the overcharge is passed on in the form of higher prices downstream.

Assuming for simplicity that the pass-through proportion  $1-\lambda$  is the same for all individuals, and recalling that  $\theta_i$  is a measure of the per-unit damage to the  $i$ th direct purchaser, then  $\lambda\theta_i$  will measure the per-unit impact of an alleged conspiracy on the profit of each direct purchaser.<sup>66</sup> In this case, overcharges can be measured (for the conspiracy period) by the following equation:

$$\text{Overcharges} = \sum \theta_i Q_i \quad (4)$$

However, lost profits are measured by the change in the variable profit margin (which is assumed, for simplicity, to be given by  $\lambda\theta_i$ ) aggregated over but-for purchases.<sup>67</sup> In general, but-for purchases

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64. *In re* Terazosin Hydrochloride Antitrust Litig., 223 F.R.D 666, 674 n.18 (S.D. Fla. 2004).

65. *Id.* at 675.

66. Recall that in Equation (1)  $\theta_i$  represents the impact of the conspiracy on the price per-unit of output.

67. This presumes that the alleged conspiracy had no effect on cost.

will be higher than actual purchases, with the difference between but-for and actual purchases being greater the greater the magnitude of the price elasticity of demand for the product.

As a result, for those individuals who are unable to pass-through a substantial part of the overcharge, but for whom the price elasticity of demand is relatively large, lost profits will be greater than overcharges. Those are the individuals who may face a conflict of interest with respect to other putative class members. If the lost profits approach is indeed in the interest of some individuals, even after accounting for possible differences in litigation costs, then those individuals would presumably opt out of the class when given an opportunity to do so.<sup>68</sup>

The *Bradburn v. 3M* cases exemplify such a conflict over damages methodology. The allegations in *Bradburn I*<sup>69</sup> and *Bradburn II*<sup>70</sup> were that 3M, a manufacturer of many products, including invisible and transparent tape, had “unlawfully maintained its monopoly in the transparent tape market through its bundled rebate programs<sup>71</sup> and through exclusive dealing arrangements with various retailers.”<sup>72</sup> This conduct, plaintiffs alleged, was a violation of section 2 of the Sherman Act.<sup>73</sup>

The proposed class in *Bradburn I* included those “who directly purchased invisible and transparent tape from Defendant from October 2, 1998 until the present.”<sup>74</sup>

With respect to the adequacy issue, the court stated that it was important to demonstrate “that the class representatives do not have interests antagonistic to the interests of the class.”<sup>75</sup> The defendant argued that the plaintiff could not demonstrate this and

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68. That opportunity might not come until after the class is certified. While opting out is a possibility as a matter of theory, an early post-certification settlement might never give the “lost-profits plaintiffs” an opportunity to do so.

69. *Bradburn Parent/Teacher Store, Inc. v. 3M*, No. Civ.A. 02-7676, 2004 WL 414047, at \*1 (E.D. Pa. Mar. 1, 2004) [hereinafter *Bradburn I*].

70. *Bradburn Parent/Teacher Store, Inc. v. 3M*, No. Civ.A.02-7676, 2004 WL 1842987, at \*1 (E.D. Pa. Aug. 18, 2004) [hereinafter *Bradburn II*].

71. The bundled rebate program gave significant discounts to purchasers of 3M’s products, but the availability and size of the rebates were dependent on purchasers buying products from multiple product lines. *Bradburn I*, 2004 WL 414047, at \*2 n.1 (citing *LePage’s, Inc. v. 3M*, 324 F.3d 141, 154–55 (3d Cir. 2003)).

72. *Id.* at \*2.

73. *Id.* at \*1. For a discussion of the economic issues underlying this case, see Daniel L. Rubinfeld, *3M’s Bundled Rebates: An Economic Perspective*, 72 U. CHI. L. REV. 243 (2005).

74. *Bradburn I*, 2004 WL 414047, at \*1.

75. *Id.* at \*3 (quoting *In re Linerboard Antitrust Litig.*, 203 F.R.D. 197, 207 (E.D. Pa. 2001)).

that in fact the class representative's interests were in direct conflict with the interests of many of the potential class members.<sup>76</sup>

In further discussing the antagonistic interests prong of the adequacy requirement, the court noted that “the adequacy of representation requirement is not satisfied where ‘the named representative’s interest in maximizing its own recovery provides a strong incentive to minimize the recovery of other class members.’”<sup>77</sup>

The defendant’s challenge to the adequacy of the representative was that the proposed class included large-volume retailers who “occupy a significantly different position in the transparent tape market than [the representative].”<sup>78</sup> The distinction was that the “large-volume retailers purchase[d] significant quantities of ‘private label’ tape from competitors of [the defendant]” whereas Bradburn, the class representative, “never purchased such private label tape itself” nor did it purchase tape from a supplier other than the defendant.<sup>79</sup>

The plaintiffs’ liability theory was that 3M’s bundled rebates induced customers to purchase 3M’s branded tape (Scotch) rather than cheaper private label tape produced by smaller manufacturers such as LePage’s, and that 3M’s bundled discount program prevented the emergence of what would have been very significant competition from private label tape. The proposed class in *Bradburn I* contained companies that were in very different positions with respect to increased competition from private label tape. Bradburn only sold 3M-branded tape and did not sell private label tape. Several other large-volume putative class members, including office superstores such as Staples, sold significant volumes of private label tape.

The defendant argued that the “[class representative] and the large-volume retailers compete with each other in the market for transparent tape by selling different products, thereby creating incentives for [the class representative] and the large-volume retailers to pursue widely differing strategies in order to maximize their potential recovery in this lawsuit.”<sup>80</sup>

The defendant also claimed that the large-volume retailers would argue that, absent the defendant’s anticompetitive conduct,

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76. *Id.*

77. *Id.* (quoting *Yeager’s Fuel v. Pa. Power & Light Co.*, 162 F.R.D. 471, 478 (E.D. Pa. 1995)).

78. *Id.* at \*4.

79. *Id.*

80. *Id.*

private label tape would have gained market share at the expense of the market share enjoyed by [the defendant]'s branded tape, because large volume retailers are in a position to profit from any such shift in market share from [the defendant's] branded tape to private label tape. Utilizing this theory, large-volume retailers could pursue recovery of the unrealized profits that they would have received from their ability to take advantage of the market shift from [the defendant's] branded tape to private label tape.<sup>81</sup>

To put the argument somewhat differently, the large-volume retailers would have an incentive to argue that there would have been a *decrease* in the sales of branded tape because consumers would have switched to private-label tape—on which retailers typically earn significantly higher margins than on branded tape. On the other hand, the class representative would be solely pursuing an overcharge theory of damages and would seek to recover the difference between the price of the defendant's branded tape it purchased during the damages period and the price that such tape would have commanded absent the defendant's anti-competitive conduct. Thus, the class representative would have incentive to minimize the loss in market share that the defendant's branded tape would have suffered absent defendant's anti-competitive conduct. The class representative also would have further incentive to argue that, in order to maintain its market share, defendant would have substantially lowered the prices for the defendant's branded tape. Indeed, the class representative would argue that there would have been an *increase* in the sales of branded tape because of the lower prices and that there would not have been a switch from branded tape to private-label tape.

The plaintiff made several counterarguments. First, the plaintiff responded that the defendant's argument was speculative. Indeed, the court noted that "a conflict between class members must be more than merely speculative or hypothetical before a named representative can be deemed inadequate."<sup>82</sup> However, the court found that the defendant's argument was neither speculative nor hypothetical, because even though the data used were based on hypothetical numbers, the fact that there was no empirical proof that the lost profits theory was preferable to some class members did not render the proposed conflict speculative.<sup>83</sup> The court was appar-

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81. *Id.*

82. *Id.* at \*5 (quoting JAMES WM. MOORE ET AL., MOORE'S FEDERAL PRACTICE ¶ 23.25(4)(b) (3d ed. 2003)).

83. *Id.* at \*6.



ently persuaded by the lack of plaintiffs' evidence contradicting the argument that the lost profits theory would be beneficial for some class members and the evidence presented in a related trial that tended to support the defendant's theory.

Second, the plaintiff argued that the lost profits theory (the theory that the large retailers would pursue the sales of private label transparent tape) rarely produces a greater amount of recovery than an overcharge theory (the theory the class representative would pursue). The court rejected this argument, referring to defendant's example in which a lost profits theory would produce a greater amount of recovery than an overcharge theory.<sup>84</sup>

Third, the class representative argued that the conflict between itself and the large retailer class members was "illusory, because it could have taken advantage of any shift to private label tape in the but-for world by purchasing private label tape itself."<sup>85</sup> The court rejected this argument because there was no support in the record.<sup>86</sup>

The court then further analyzed the economic theories which would lead to a result in which branded tape prices remained the same despite the entry of generic substitutes. The court noted that when generic products enter the market, some economists believe that branded product prices would fall. However, the court also acknowledged that economists also believed that branded products' prices may increase when a generic product enters the market because there would be market segmentation.<sup>87</sup> With market segmentation, there is a group of consumers who are attached to a particular brand of product, i.e., their demand is relatively inelastic. For these consumers, the product will occupy a different and higher-priced niche than for those consumers who are price sensitive. With respect to pharmaceutical pricing, where there is substantial evidence supporting market segmentation, this is consistent with a lower-priced generic and a higher-priced branded product.<sup>88</sup>

Although expert testimony was received on whether the market segmentation theory was applicable in this situation, the court found there was conflicting plausible testimony. Ultimately, however, it did not matter which theory was or was not found to be empirically valid. The court decided that the economic plausibility

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84. *Id.*

85. *Id.* at \*8.

86. *Id.*

87. *Id.* at \*7.

88. See, e.g., Grabowski & Vernon, *Brand Loyalty, Entry, and Price Competition in Pharmaceuticals After the 1984 Drug Act*, *supra* note 33.

of the market segmentation theory itself created a conflict between the class members as to which theory to pursue at trial.<sup>89</sup>

As a final argument in response to the court's inadequacy view, the class representative argued that the conflict would be cured under the opt-out procedure in Rule 23(c)(2).<sup>90</sup> The court rejected this argument by noting Supreme Court precedent requiring the named plaintiff to adequately represent the interests of the absent class members *at all times*.<sup>91</sup>

In the end, the court held that, "because Plaintiff's theory of damages is antagonistic to an alternative theory that many class members will likely wish to pursue, and because Plaintiff is not in a position to pursue this alternative theory itself, Plaintiff's interests are antagonistic to those of other members of the proposed class."<sup>92</sup> For these reasons, the court found that the named plaintiff would not adequately represent the interests of all of the proposed class members and declined to certify the proposed class. As to typicality, the court noted that the requirements were quite similar to the adequacy requirements and held that, because of the conflict described in the adequacy section of its opinion, the typicality requirement also could not be met.<sup>93</sup>

After the motion was denied, plaintiffs' counsel amended their proposed class to exclude those entities that purchased private label tape (and that therefore, under the logic presented by 3M's economist, may have an incentive to pursue a lost-profits theory). These entities were typically the largest purchasers of 3M tape and, therefore, the new putative class was much smaller than the original putative class. Specifically, the new putative class was defined to include:

All persons who directly purchased invisible or transparent tape from 3M Company between October 2, 1998 and the present, who have not purchased, for resale under the class member's own label, any "private label" invisible or transparent tape from 3M Company or any of 3M Company's competitors at any time from October 2, 1988 to the present.<sup>94</sup>

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89. *See Bradburn I*, 2004 WL 414047, at \*7.

90. *Id.* at \*9.

91. *Id.* (quoting *Phillips Petroleum v. Shutts*, 472 U.S. 797, 812 (1985)).

92. *Id.* The Court may have also been influenced by the amicus brief in support of 3M's effort to convince the Supreme Court to grant certiorari filed by Staples, a putative class member.

93. *Id.* Because class certification was denied on adequacy and typicality grounds, the court did not address whether the requirements of Rule 23(b) had been established. *Id.* at \*9-10.

94. *Bradburn II*, 2004 WL 1842987, at \*3.

The plaintiff then intended to “pursue an overcharge theory.”<sup>95</sup> The Court granted plaintiffs’ motion to certify the amended class.

#### IV. CONCLUDING REMARKS

It would be advantageous from a policy perspective if courts were to utilize a more consistent and coherent economic framework in evaluating class certification issues. Currently, the outcomes of class certification claims by plaintiffs are not easily predictable because of the variation in precedents across circuits and the variation in case outcomes within each circuit.<sup>96</sup>

The objectives of this Article are limited in scope. With illustrations based on actual cases, it suggests ways in which courts can move toward the use of a consistent economic framework. The suggested framework takes into account the fact that class certification is rarely defeated only by suggesting that price variation demonstrates that individual elements predominate. In addition, the framework suggests that class certification can (appropriately) be defeated by a deeper analysis of commonality/predominance, and by a close examination of typicality and adequacy. This is consistent with the Third Circuit’s view that courts should acknowledge that class certification investigations must go, to some extent, into the merits on causation and damages. Indeed, courts are beginning to demand that plaintiffs’ economic experts put forward an explicit methodology for evaluating causation and damages on a class-wide basis.

However, note the preliminary nature of the proposed framework. A complete policy analysis of class certification would need to take into account a host of concerns not explicitly discussed here: the goals of private enforcement (deterrence versus compensation), the social costs of Type 1 errors (improperly finding a defendant liable) and Type 2 errors (failing to find liability when there has been a violation), and the public and private costs of litigation. A further analysis would also evaluate class certification issues in mass tort cases and other cases outside the realm of antitrust.<sup>97</sup>

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95. *Id.*

96. For example, the Third Circuit’s *Hydrogren Peroxide* decision contrasts with the D.C. Circuit’s approach in *In re Nifedipine Antitrust Litig.*, No 08-8014, 2009 U.S. App. LEXIS 3643 (D.C. Cir. 2009). For a more general discussion of differences in Courts’ application of Rule 23, see Donald Hawthorne & Margaret Sanderson, *Rigorous Analysis of Economic Evidence on Class Certification in Antitrust Cases*, 24 ANTI-TRUST 55–56 (2009).

97. *See, e.g., Amchem Products, Inc. v. Windsor*, 521 U.S. 591 (1997).

