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A BRIEF ANALYSIS OF POLICY AND LITIGATION

Hydrogen Peroxide Decision has Important Implications For Class Certification Disputes

Philip B. Nelson

Philip B. Nelson, with Henry B. McFarland and David D. Smith wrote the chapter on class certification in the ABA Section of Antitrust Law's ECONOMETRICS *(2005), which was cited in the Third Circuit's* Hydrogen Peroxide *decision.*

The Third Circuit's recent decision *In re: Hydrogen Peroxide Antitrust Litigation*, No. 07-1689 (3d Cir. Dec. 30, 2008) addresses the type of economic analysis that should be considered in class certification disputes. This decision is part of a trend that has increased the analytical burden that plaintiffs bear when they ask that a class be certified. In particular, courts are increasingly likely to carefully scrutinize expert testimony and to require detailed and rigorous empirical evidence before certifying a class.

The decision sets forth three requirements for certifying a class. First, a court must find by a preponderance of the evidence that each requirement of Rule 23 is met. Second, a court must resolve all factual and legal disputes relevant to class certification, including disputes that touch on the merits of the case. Third, the court must consider all relevant evidence and arguments affecting class certification, including expert testimony.

The decision says that while plaintiffs do not have to prove antitrust impact at the certification stage, they do have to demonstrate that impact can be proven by evidence that is common to the class. Moreover, that demonstration requires substantial empirical support. The Court found that such a demonstration was not made in this case. For example, Plaintiff's expert did not explain how he would show common impact even though some plaintiffs experienced decreasing or constant prices when the proposed class purportedly suffered from increased prices.

The Third Circuit states that while weighing expert testimony may not always be necessary, a court has a duty to resolve disputes between experts concerning Rule 23 requirements. Courts may not refuse to resolve these disputes because they may overlap with a consideration of the merits of the case. Moreover, courts may resolve these disputes only "after considering all relevant evidence submitted by the parties."

The decision furthers the trend toward increased scrutiny of class action allegations. Plaintiffs that are preparing to litigate likely will need to anticipate that courts will seriously evaluate their expert economist's theories relating to class certification. This increased scrutiny should lead all parties to a litigation to increase the economic analysis they employ in support of their motions.

Also In This Issue

Implications of *Energy Capital* for Discounting Lost Profits

Gale Mosteller considers issues raised by one of the few court decisions to discuss the date of discounting and the discount rate for a stream of lost profits. She explains that risk during the prejudgment period affects not only prejudgment profits but also post-judgment profits. As a result, the date of discounting for risk may differ from the date of discounting for inflation and the time value of money. In some cases, using information gained between the violation and the judgment may provide an alternative to discounting for prejudgment risk. Post-breach data can only be used to eliminate prejudgment risk, however, if information learned after the breach largely determines how much profit a venture would realize. Taking prejudgment risk into account can have a significant effect on the size of the damages award.

Comparing China's New Antimonopoly Law and India's Amended Competition Act

Stuart D. Gurrea and Su Sun compare laws recently introduced in China and India to promote competition. Competition laws are particularly significant for these two large emerging economies that have experienced fast economic growth but still have to overcome significant structural obstacles to achieve their full economic potential. China's AML and India's Competition Act will significantly affect how companies conduct business in China and India. These laws take very similar approaches to questions of anticompetitive agreements, dominant firm behavior, and merger policy. Nonetheless, significant differences exist between the laws of the two countries. For example, the two countries treat vertical agreements differently, and there are significant differences in the merger review process.

Implications of *Energy Capital* for Discounting Lost Profits

Gale Mosteller

Gale Mosteller has calculated economic damages in many contexts including breach of contract, fraud, Lanham Act, Sherman Act, and Robinson-Patman Act. She recently analyzed Enron's indemnity policy claim against insurance companies for losses due to employee theft by Mr. Fastow.

Few court decisions discuss the details of discounting damages, but those details can significantly affect the size of the award. In *Energy Capital Corp. v. United States*, 302 F.3d 1314 (2002), the Court of Appeals for the Federal Circuit commented on the date of discounting and the discount rate for a stream of lost profits. This lawsuit arose after the federal government breached its contract and caused Energy Capital to lose a profit stream. The government conceded liability but appealed the amount of lost profit damages awarded.

Discounting with a risk-adjusted discount rate (1) converts dollars earned in later years into equivalent dollars in earlier years by adjusting for inflation and the time value of money and (2) eliminates the expected premium on a risky investment. The Court applied the same date of discounting for inflation and time value of money as for risk, even though the dates need not coincide. The Court's method also ignored risk during the prejudgment period. Failing to consider that risk might inflate the size of the award.

The date of discounting governs how far back to discount damages. The government's method discounted the entire profit stream back to the date of breach. Due to sovereign immunity, the government need not pay prejudgment interest. For this reason, the government did not add interest to bring the damages forward to the date of judgment. By contrast, the plaintiff's method discounted the post-judgment profit stream back to the date of judgment and left prejudgment profits undiscounted. The government argued that plaintiff's method yielded higher damages because it implicitly included prejudgment interest.

The Federal Circuit supported the plaintiff's method and noted that damages should be measured on the dates the plaintiff would have realized the profits, not as of the date of breach. Thus, discounting a profit stream back to the date of breach improperly removes inflation and the time value of money. Contrary to the government's position, prejudgment interest does not accrue before the date of realization.

Although both parties presented experts who discounted future profits using a risk-adjusted discount rate, the plaintiff in post-trial briefing argued for a risk-free discount rate that increased damages. The Court of Federal Claims believed that precedent required using a risk-free rate, but the Federal Circuit found that the choice of discount rate depends on the facts. Because risk could affect post-judgment profits in this case, the Federal Circuit chose a risk-adjusted rate.

The Court discounted post-judgment profits for risk because no one knows on the judgment date to what extent conditions will change profits in the future. Changes in demand, costs, or other factors could alter future profits. Due to the uncertainty of the venture's post-judgment profits, people would trade a larger expected (but uncertain) pay-out stream in the future for a smaller pay-out with certainty on the date of judgment. Put another way, because the plaintiff will not bear the venture's post-judgment risk, it does not receive a risk premium to compensate for bearing that risk.

The same argument might apply to prejudgment profits. When the defendant destroyed the business venture, the entire profit stream became uncertain, not just post-judgment profits. However, rather than discounting for prejudgment risk, the court may reduce uncertainty by incorporating post-breach information in the damages calculation. If the court uses post-breach information to adjust the projected profit stream, the plaintiff has in effect borne risk during the prejudgment period.

Yet using post-breach data cannot always eliminate prejudgment risk. Two kinds of information affect profits: some becomes known between the breach and the judgment, and some would become known only by actually running the business. If information learned after the breach largely determines how much profit a venture would realize, then not discounting prejudgment profits for risk may make sense.

The court did discount prejudgment profits for risk, but not for inflation and the time value of money, in *Franconia Associates v. United States*, 61 Fed. Cl. 718 (2004). An alternative to the Court's discounting method involves multiplying each year's profits by

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Comparing China's New Antimonopoly Law and India's Amended Competition Act

Stuart D. Gurrea and Su Sun

China and India have recently introduced new laws aimed at promoting competition to benefit consumers. Competition laws are particularly significant for these two large emerging economies that have experienced fast economic growth but still have to overcome significant structural obstacles to achieve their full economic potential. In China, the enactment of China's first Antimonopoly Law (AML), which took effect on August 1, 2008, was a significant step towards achieving this potential. Similarly, a key component of India's efforts to foster competition was the enactment in 2002 and subsequent amendment in 2007 of the Competition Act of India (Competition Act). These laws take very similar approaches to questions of anticompetitive agreements, dominant firm behavior, and merger policy. Nonetheless, significant differences exist between the laws of the two countries.

Both laws forbid certain types of agreements. China's AML prohibits horizontal agreements that fix prices or production quantities, allocate markets, restrict the purchase or development of new technology or new products, or jointly boycott a customer or supplier. The AML also has prohibitions on vertical agreements that are generally consistent with the pre-Leegin U.S. doctrine, and the AML may be used against resale price maintenance. The AML allows an agreement that generally would be prohibited if it has an efficient purpose, provided that the agreement does not limit competition substantially and that consumers can share the benefits of the agreement. Exemptions may also apply when firms are in economic hardship or engage in international trade.

India's Competition Act also prohibits certain horizontal agreements, but it remains to be seen how these rules will be interpreted and applied. The Competition Act presumes that cartels are anticompetitive. Vertical agreements are not presumed to harm competition and are subject to the rule of reason. Vertical agreements are generally viewed as procompetitive because they involve complementary activities in the supply chain.

China's AML describes methods to determine dominance and conduct that is prohibited if dominance is found. Several factors are considered in determining dominance, including share of the relevant market,

Stuart D. Gurrea has written on the effect of changes in competition laws in India and China on the technology industry.

Su Sun was actively involved in the consultation process that led to the finalization of China's AML, and has written extensively on such issues in both English and Chinese publications.

ability to control the downstream sales market or an upstream input market, financial and technological strength, and ease of entry. If dominance is found, a firm is prohibited from selling at "unfairly high prices" or buying at "unfairly low prices." It is not clear what prices would be considered as "unfairly high" or "unfairly low." Dominant firms are also generally prohibited from selling below cost, refusing to deal, exclusionary dealing, tying, price discrimination and other abusive conduct as determined by the enforcement agency. Such conduct may be allowed, however, if the firm can present a legitimate justification. The State Administration of Industry and Commerce (SAIC) is responsible for abuse of dominance investigations, except for cases related to pricing, which are the responsibility of the National Development and Reform Commission (NDRC).

India's Competition Act has similar provisions for determining the existence of dominance but somewhat different restrictions on the behavior of dominant firms. Dominance is determined by factors including market share and size, competitors' market shares and sizes, and ease of entry. Dominant firms generally may not engage in predatory pricing, price discrimination, denials of market access, leveraging, or tying. Predatory pricing, however, may be allowed in order to meet competition.

The AML and the Competition Act both establish merger review and control procedures designed to prevent anticompetitive combinations. In China, the AML describes the required documents merging par-

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EI News and Notes

Allied Waste Industries completes its $9 billion merger with Republic Services Inc.

EI economists William P. Hall, Henry B. McFarland and Michael G. Baumann worked with counsel for Allied during a six-month investigation by the Department of Justice into the combination of the second and third largest U.S. waste haulers. Allied was represented by Mayer Brown. The Department allowed the merger to proceed after Allied and Republic agreed to limited divestitures of certain assets.

UnitedHealth Group, and PacifiCare Health win summary judgment.

David A. Argue was the expert witness on liability on behalf of UnitedHealth Group, Inc. and PacifiCare Health Systems. Dr. Argue was assisted by John M. Gale and Kent W Mikkelsen. Plaintiff Omnicare, Inc. alleged that a conspiracy could be inferred between United and PacifiCare. Dr. Argue reasoned that the defendants' conduct was consistent with independent actions, and the U.S. District Court Judge granted summary judgment on the same basis. The defendants were represented by Robins, Kaplan, Miller & Ciresi L.L.P. and Hogan & Hartson.

Australian Competition & Consumer Commission review of the BHP Billiton/Rio Tinto acquisition.

Joseph W. McAnneny was retained by the Australian Competition & Consumer Commission to help with its evaluation of the competitive impact of the proposed BHP Billiton acquisition of Rio Tinto. The transaction affected a number of mining markets, including markets for iron ore. The Commission decided not to oppose the transaction.

Implications of *Energy Capital*

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$(1+rf)^n/(1+ra)^n$, where rf is the risk-free rate, ra is the risk-adjusted rate, and n is the number of years since the breach (assuming constant rates over time). The denominator in this discount factor removes inflation, the time value of money, and the risk premium, while the numerator returns inflation and the time value of money. On net, this method removes the risk premium alone.

Prejudgment risk affects not only prejudgment profits but also post-judgment profits. The risk premium in any year compounds the risk-adjusted discount rate in that year with the rates from previous years. If prejudgment profits are uncertain, then using a risk-adjusted rate to discount post-judgment profits back to the judgment date does not remove the entire risk premium. To remove the prejudgment portion of the risk premium from post-judgment profits, the court would need to apply a factor like the one above where n is the number of years between the breach and the judgment date. This adjustment would have reduced Energy Capital's post-judgment damages by 14% or roughly $1.11 million. This calculation and examples illustrating the different methods of discounting discussed in this article can be found at *www.ei.com/Appendix.pdf*.

In sum, even if damages include no prejudgment profits, risk during the prejudgment period affects damages by affecting post-judgment profits. Discounting or in some cases incorporating post-breach information can adjust for prejudgment risk. The date of discounting for risk can differ from the date of discounting for inflation and the time value of money because the reasons for discounting differ.

China and India

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ties should submit, the review procedure the enforcement agency shall follow, and factors the agency should consider in its review. The Ministry of Commerce (MOFCOM), the enforcement agency responsible for the antitrust review of mergers and acquisitions, has released a number of regulations and guidelines that describe the procedures in more detail. Though MOFCOM published a brief approval notice (with conditions) on the InBev/Anheuser-Busch merger, Coca Cola's proposed acquisition of China's Huiyuan Juice Group is widely considered as the first major test of China's merger regulation regime. MOFCOM's review of this transaction recently moved into a second stage.

The recent amendments to the Competition Act significantly changed India's merger review process. The Act now mandates notification within 30 days for combinations that involve firms that have a certain amount of economic activities in India. Moreover, the Competition Act now defines a review period, a period after filing during which the merger may not be consummated, of at most 210 days. Although the principles behind this process are similar to the Hart-Scott-Rodino (HSR) pre-merger filing and review process in the US, the length and scope of the process may prove very burdensome. Certainly a 210 day review period is longer than those established in most countries, including China. Also, notification of transactions is required where the combined asset value or turnover in India exceeds a certain value whatever the size of the transaction. Basing the threshold only on combined value means that parties to transactions of no economic consequence in India may have to undergo the substantial transaction costs that notification entails. For example, a U.S. manufacturer with large operations in India would have to notify the acquisition of a small U.S. firm, even if the transaction does not affect economic activity in India. Subsequent draft regulations address this problem by defining the local nexus based on assets or turnover of each of at least two of the parties to the combination.

One unique feature of China's AML is its devotion of an entire chapter to the prohibition of undue government intervention that harms competition, particularly government actions that restrict market entry. This feature stems from China's history of a highly planned economy. The first high profile case against a government agency, which involved designating an industry standard in which the agency allegedly held an interest, was dismissed by the court in 2008.

China's AML and India's Competition Act will play a significant role in the development of their respective national economies. The effect of these laws will depend on their interpretation and actual implementation. So far there is little experience with the implementation of the AML and almost no experience with the implementation of the Competition Act. Firms doing business in China and India will have to keep aware of ongoing developments in their antitrust regimes.

Economists
INCORPORATED

OFFICES:

1200 New Hampshire Avenue, NW
Suite 400
Washington, DC 20036
[p] (202) 223-4700
[f] (202) 296-7138

5980 Horton Street
Suite 250
Emeryville, CA 94608
[p] (510) 547-6910
[f] (510) 547-5162

www.ei.com

President
Jonathan L. Walker

Editor
Henry B. McFarland

Layout
Gregory E. Wurz

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