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## 2 'Pass-Through' Hurdles For Indirect Purchaser Plaintiffs

By **Jon Tomlin** (February 14, 2018, 10:24 AM EST)

In numerous recent antitrust class actions, indirect purchaser plaintiffs have alleged a price-fixing conspiracy involving manufacturers several stages “upstream” from the retail level at which they made their purchases. Indirect purchaser plaintiffs in recent antitrust suits include consumers of computers, eggs, drywall, tuna, chicken, automobiles and power tools. In order to establish that any price-fixing overcharges imposed by manufacturers were ultimately “passed-through” to them, these plaintiffs must “find a way to account for the decision-making of a variety of resellers and manufacturers in an intricate distribution chain” leading to their ultimate purchases.[1] As several recent decisions demonstrate, this can be a formidable economic task.



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Courts have recently highlighted two hurdles to indirect purchasers in demonstrating the pass-through of overcharges into the prices they paid. First, indirect purchaser plaintiffs must demonstrate the existence and amount of pass-through through many different levels of the supply chain. Second, many indirect purchaser plaintiffs need to address the fact that retail prices are often set at “price points” (for example, ending in “99” cents or dollars) which retailers may not change in response to relatively small changes in costs. These hurdles can be substantial and several recent courts have determined that plaintiff expert economists did not clear them. Below, I summarize some of the economics of these two challenges and the treatment of them in several recent decisions.

### **Hurdle 1: The Many Stages of Pass-Through**

Over 40 years ago, the U.S. Supreme Court decided to limit damages recoveries to direct purchasers under the Sherman Act and the Clayton Act based, in part, on the complexity inherent in determining the pass-through of overcharges through multiple stages of distribution to indirect purchasers.[2] Since that time, many states have passed “Illinois Brick repealer” legislation. As a result, the question of whether the complexity of calculating pass-through to indirect purchasers can be resolved occupies a prominent place in antitrust class actions. Courts have denied class certification in recent indirect purchaser class actions involving eggs, drywall, transmissions and lithium ion batteries after concluding that the plaintiffs’ expert economist did not adequately address pass-through at some of the multiple levels of distribution between the alleged anti-competitive conduct and the plaintiffs’ ultimate purchases.[3] In December of 2017, the court in *In re Optical Disk Drive Products Antitrust Litigation* granted summary judgment to the defendants after concluding that the plaintiffs’ economic expert report “conveniently theorizes pass-through at every stage in the distribution chain” but did not support this opinion with record evidence that it actually occurred.[4]

As a matter of basic economics, the extent to which a firm passes through any overcharge depends on its costs, the demand it faces, and the competitive conditions it faces.[5] Because of this, pass-through can differ not only at different levels of distribution but between different firms operating at the same level of distribution.

Dozens, and even hundreds, of different manufacturing and distribution paths can exist between a manufacturer allegedly setting anti-competitive prices (e.g., a manufacturer of a DVD drive) and a consumer of a retail good incorporating that manufacturer's product (e.g., a computer containing that DVD drive). Assume, for example, that there are five manufacturers of a product alleged to be subject to anti-competitive pricing, selling to five distributors, who, in turn, sell to five retailers. The indirect purchaser plaintiff consumers make purchases from one of the five retailers. This scenario leads to 125 possible different paths (combinations of manufacturer/distributor/retailer) from the manufacture of the good at issue to a purchase by one of the indirect purchasers.

The presence of multiple levels of distribution is not the only complicating factor. A single firm operating at just one level of the supply chain can have different pass-through rates for different customers, even if it is selling the same product to them. In *In re: Processed Eggs Antitrust Litigation*, for example, the defendants' economic expert pointed out that pricing of eggs (and, therefore, pass-through) differed for the same grocery chain across different geographic locations.[6] Also, several stages of manufacturing (in addition to distribution) can exist between alleged anti-competitive pricing and indirect purchasers. This is commonly the case for electronic components and automotive parts, industries which have both faced multiple indirect purchaser suits. In addition, some manufacturers or distributors sitting "upstream" from an indirect purchaser may not have been subject to any anti-competitive pricing (while other upstream firms were subject to anti-competitive pricing).

Plaintiff economic experts have often faced difficulties in obtaining data sufficient to analyze the numerous levels of manufacturing, distribution and retailing that can exist in the path to an ultimate purchase by an indirect purchaser. In *In re: Cathode Ray Tube (CRT) Antitrust Litigation*, the court certified the class after concluding that the plaintiffs' expert had conducted a pass-through analysis "at each level of the distribution chain." [7] However, other courts have declined to certify a class after concluding that the plaintiffs' economic expert did not utilize data addressing pass-through in one or more parts of the distribution chain for cases involving eggs, drywall, transmissions and lithium ion batteries. [8] If courts require that plaintiff experts show pass-through at each stage of distribution, data requirements will continue to be a substantial hurdle to indirect purchaser plaintiffs.

## **Hurdle 2: Price Points**

Retailers commonly set prices ending in an odd number such as "9" or "5." [9] Some studies of retail pricing have shown that prices ending in a "9" were less likely to change than those not ending in a "9." [10] Firms also can incur "menu costs" for changing their listed price (due to, for example, a need to change packaging or advertising). [11] For both of these reasons, a relatively small increase in cost may not cause a retailer to change its price and, thereby "pass through" a price increase to an indirect purchaser consumer. For example, a computer retailer facing, say, an increase in cost of 10 cents on a computer may not change a retail price listed at "\$999.99" as this would cause the listed price to exceed \$1,000. Recent decisions in cases involving processed eggs, lithium ion batteries and optical disk drives have highlighted the existence of such "price points" in the prices paid by indirect purchasers and concluded that plaintiff economic experts failed to appropriately account for the importance of this in determining pass-through. [12]

Economic experts in *Optical Disk Drives and Lithium Ion Batteries* addressed the issue of price points by opining that firms may pass-through price-fixing overcharges by reducing

the quality of a product, as opposed to necessarily increasing the price. For example, a computer retailer listing a price of \$999 for a computer may “pass-through” a small cost increase not by increasing the price but instead by lowering the quality of one or more of the features on the computer while maintaining the \$999 price point. Under this assessment, indirect purchasers sustain damages by receiving a product that is lower in quality than they would have received “but-for” the alleged price fixing.

Empirically establishing pass-through from a reduction in quality is a difficult hurdle to clear. Although there is a well-established economic literature on calculating pass-through rates of cost changes into prices, there is no such established economic literature on pass-through occurring through quality reductions. Due to the numerous ways in which quality can be adjusted (and the difficulty of attaching a value to each change in quality), calculating pass-through in the form of quality changes will be challenging for plaintiff economic experts. Consistent with this, in granting summary judgment, the court in *Optical Disk Drives* concluded that the plaintiffs did not meet their burden of establishing that any overcharge in optical disk drives resulted in “offsetting with other lower quality components” in the sales of computers.[13] Similarly, the court in *Lithium Ion Batteries* concluded that the plaintiffs’ expert’s opinions on “focal point pricing and adjustments to quality rather than cost were not adequately supported or explained in his pass-through analysis.”[14]

### **The Road Ahead**

Indirect purchaser plaintiffs in multiple recent class actions have faced the economic complexities of the pass-through issue that the U.S. Supreme Court recognized over 40 years ago. Several indirect purchaser plaintiffs have come up short in demonstrating pass-through in dealing with two key issues — the multiple stages of supply between indirect purchasers and the alleged anti-competitive conduct and the existence of established price points. Both issues are commonplace for numerous consumer goods and, therefore, both issues will continue to be hurdles for indirect purchaser plaintiffs.

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### ***DISCLOSURE: Tomlin performed consulting services in In re Optical Disk Drive Products Antitrust Litigation.***

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[1] *In re Static Random Access Memory (SRAM) Antitrust Litig.*, 264 F.R.D. 603, 614 (N.D. Cal. 2009) at 613. See, also, *In re Graphics Processing Units Antitrust Litig.*, 253 F.R.D. 478, 499 (N.D. Cal. July 18, 2008).

[2] *Illinois Brick v. Illinois*, 431 U.S. 720 (1977) at 745.

[3] *In re: Processed Eggs Antitrust Litigation*, No. 08-md-2002, U.S. District Court for the Eastern District of Pennsylvania, *In re: Domestic Drywall Antitrust Litigation*, 2:13-MD-2437, U.S. District Court for the Eastern District of Pennsylvania, *In re: Class 8 Transmission Indirect Purchaser Antitrust Litigation*, case number 1:11-cv-00009, U.S. District Court for the District of Delaware, *In re: Lithium Ion Batteries Antitrust Litigation*, Case No.: 13-MD-2420 YGR, U.S. District Court for the Northern District of California.

[4] *In re Optical Disk Drive Products Antitrust Litigation*, No. 3:10-md-02143 (Dkt. Nos.

2705-08, 2711).

[5] See, e.g., Jonathan T. Tomlin & Dale J. Giali, *Federalism and the Indirect Purchaser Mess*, 11 *Geo. Mason L. Rev.* 157 (2003)

[6] *In re: Processed Eggs Antitrust Litigation*, No. 08-md-2002, U.S. District Court for the Eastern District of Pennsylvania.

[7] *In re: Cathode Ray Tube (CRT) Antitrust Litigation*, MDL No. 1917, Case No. C-07-5944-SC, Order Adopting Special Master's Reports and Recommendations on Defendants' Motion to Exclude Expert Testimony and Indirect-Purchaser Plaintiffs' Motion for Class Certification, filed Sept. 24, 2013 at page 10.

[8] *In re Processed Eggs Antitrust Litigation*, No. 08-md-2002, *In re: Domestic Drywall Antitrust Litigation*, 2:13-MD-2437, *In re: Class 8 Transmission Indirect Purchaser Antitrust Litigation*, case number 1:11-cv-00009, *In re: Lithium Ion Batteries Antitrust Litigation*, Case No.: 13-MD-2420 YGR. The court in *Lithium Ion Batteries* stated that its ruling was "without prejudice to IPPs revising the analysis to cure the defects identified."

[9] See, e.g., Matthew S. Kent, *Odd Prices at Retail Gasoline Stations: Focal Point Pricing and Tacit Collusion*, *Journal of Economics & Management Strategy*, Volume 24, Number 3, 664-685 (2015).

[10] Daniel Levy, Dongwon Lee, Haipeng Lee, Robert Kauffman & Mark Bergin, *Price Points and Price Rigidity*, *Review of Economics and Statistics*, 93, (4) 1417-1431 (2011).

[11] Alexei Alexandrov, *Pass-Through Rates in the Real World: The Effect of Price Points and Menu Costs*, *Antitrust Law Journal*, Volume 79, Issue 1 (2013).

[12] *In re: Processed Eggs Antitrust Litigation*, No. 08-md-2002, *In re: Lithium Ion Batteries Antitrust Litigation*, Case No.: 13-MD-2420 YGR, *In re Optical Disk Drive Products Antitrust Litigation*, No. 3:10-md-02143.

[13] *In re Optical Disk Drive Products Antitrust Litigation*, No. 3:10-md-02143, Order Granting Summary Judgment Against the Indirect Purchaser Plaintiffs filed Dec. 18, 2017 at 15.

[14] *In re: Lithium Ion Batteries*, No. 13-MD-2420 YGR, Order Denying Without Prejudice Motions for Class Certification; Granting in Part and Denying in Part Motions to Strike Expert Reports or Portions Thereof, April 12, 2017 at page 19.