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COORDINATING PRIVATE CLASS ACTION  
AND PUBLIC AGENCY ENFORCEMENT  
OF ANTITRUST LAW

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## **COORDINATING PRIVATE CLASS ACTION AND PUBLIC AGENCY ENFORCEMENT OF ANTITRUST LAW**

**David Rosenberg<sup>\*</sup> & James P. Sullivan<sup>\*\*</sup>**

### *ABSTRACT*

This essay sketches a new approach to ameliorating the problem of coordinating the use of private class actions and public policing to enforce American antitrust law. Achieving the optimal joint level of enforcement from any system that teams public and private law enforcers requires a coordination mechanism to assure not only that each makes the appropriately motivated and proportionate investment of resources and effort, but also that their respective contributions are properly synchronized and combined. Our proposal addresses this double-sided coordination problem. Its key elements are (i) mandatory-litigation class action; (ii) total enforcement license initially vested with the public enforcer; (iii) auction of private license to enforce class action; (iv) auction proceeds deposited with and distributed by the court for compensatory purposes; and (v) public enforcer option to buy back the private license at the winning bid price. We suggest that our approach is superior to the current practice of judicial coordination (through, for example, statutory interpretation, pre-emption, and class action prerequisites), which suffers from high information costs, and to proposals for reform that give public enforcers the option of “first refusal” or of intervening to take some control over the class action, which regulate only private enforcers.

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## COORDINATING PRIVATE CLASS ACTION AND PUBLIC AGENCY ENFORCEMENT OF ANTITRUST LAW

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### A. INTRODUCTION

But whether antitrust *policy* is sound depends on the enforcement machinery as well as on legal doctrine. It is not enough to have good doctrine; it is also necessary to have enforcement mechanisms that ensure, at reasonable cost, a reasonable degree of compliance with the law.

*Antitrust is deficient in such mechanisms.*<sup>1</sup>

In this essay, we sketch a new approach to ameliorating the problem of coordinating the disparate array of public and private enforcers of American antitrust law.<sup>2</sup> Our focus is on the mainspring of the federal enforcement mechanism: the “tag team” consisting of public policing, conventionally through criminal sanctions and injunctive remedies, by the Federal Trade Commission (FTC) and the Antitrust Division of the Justice Department (DOJ), and of privately litigated class actions primarily seeking treble

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<sup>1</sup> Richard A. Posner, *Antitrust Law*, 2d ed. (Chicago: University of Chicago Press, 2001) at 266 [second emphasis added].

<sup>2</sup> The basic federal antitrust law is comprised of the *Sherman Act*, 15 U.S.C. §§ 1 *et seq.* enacted in 1890; the *Clayton Act*, 15 U.S.C. §§ 12 *et seq.* enacted in 1911 and the *Federal Trade Commission Act*, 15 U.S.C. §§ 41 *et seq.* enacted in 1911. In distinguishing between “public” and “private” enforcers we focus on the salient functional features of the source of enforcement funds and the situs of discretion over the scale, scope, and intensity of enforcement investment and effort. In particular, public enforcers generally rely on public tax and other sources of funding and lodge prosecutorial discretion in government agents. Private enforcers tap private sources of financing civil litigation and determine the scale, scope and intensity of their enforcement investment and effort based on rational choice of the most profitable course of action.

damages.<sup>3</sup> Characteristic of a general American enforcement strategy, the antitrust system enlists the “entrepreneurial” incentives and resources of private enforcers as a counterpoise and a complement to public enforcement efforts. Thus, private antitrust class actions not only provide an efficient means for augmenting and overcoming structural, financial and other operational limits on public enforcement. They also serve as a hedge against the potential (real or perceived) for under-enforcement by public agencies vulnerable to bureaucratic slack and stagnation, political and personal conflicts of interest, and chronic under-funding.<sup>4</sup> However, a basic flaw in this system of checks and balances is its one-sided nature. It not only ignores the danger of deficient private enforcement that results from economic or legal impediments to the effective use of class actions, but it also fails to check the potential for excessive private enforcement.

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<sup>3</sup> See Stephen Calkins, “An Enforcement Official’s Reflections on Antitrust Class Actions” (1997) 39 *Ariz. L. Rev.* 413 at 440. The FTC exclusively enforces the provisions of the *Federal Trade Commission Act* and primarily pursues injunctive remedies. The DOJ is authorized to seek penalties of imprisonment and fines, and also injunctive remedies. The remedial options available to private enforcers include injunctive relief and divestiture as well as treble damages. As Posner points out, policy makers and commentators typically err by analyzing the public and private components of the amalgamated antitrust enforcement mechanism: Posner, *supra* note 1 at 47. The error is to evaluate each component separately. Rather, the enforcement mechanism must be judged and designed in the aggregate. The performance of any system of law enforcement must be considered and shaped functionally according to the way its operation will and properly should affect the behaviour of enforcement targets. In particular, firms “aggregate the expected punishments and discount (multiply) them by the probability of their imposition to determine the expected punishment:” *ibid.* It follows that the effectiveness of the antitrust legal regime must be judged and reformed from an aggregate perspective; that is, in terms of how all of the various public and private pieces can be fit and operated together to achieve the optimal joint level of enforcement.

<sup>4</sup> These conditions can also, by design or effect, produce excessive public enforcement. High-profile prosecutions, especially those that may capture public attention or pander to its fears, can lead to higher budgets and enlarged jurisdiction, promotions within bureaucratic ranks, and political, judicial and private-sector career opportunities. See generally Daryl J. Levinson, “Empire-Building Government in Constitutional Law” (2005) 118 *Harv. L. Rev.* 915. While our proposal does not directly address the coordination problem of overzealous public enforcement, it will, as we note in concluding remarks, likely have a salutary effect on incentives for such personal and bureaucratic “empire-building.”

Indeed, there is significant risk of class actions over-enforcing antitrust laws. A major reason is that many antitrust class actions merely “piggy-back” on public enforcement outcomes and work product.<sup>5</sup> These class actions usually add little or nothing new to the existing public enforcement effort, while their threat of treble damage awards significantly magnifies sanctions.<sup>6</sup> It is an empirical question whether, in any given case or on average, these class actions adequately supplement or grossly overshoot the amount of private enforcement needed to achieve the optimal enforcement level overall. More generally, recent increases in maximum criminal fines and prison terms also may have reduced the need for the supplementary deterrent from trebled class action damages. Supplementation may also be undesirable in many cases as public enforcers place greater reliance on programs and strategies of trading leniency for agreement by firms and individuals to confess, cease and remedy their illegal conduct and to provide evidence and otherwise cooperate in the prosecution of claims against others.<sup>7</sup> Further, as modern economic analyses show, many types of anti-competitive agreements and behaviour can enhance social welfare; for this reason, regulators need to use highly refined,

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<sup>5</sup> See Thomas E. Kauper & Edward A. Snyder, “An Inquiry into the Efficiency of Private Antitrust Enforcement: Follow-on and Independently Initiated Cases Compared” (1986) 74 Geo. L.J. 1163.

<sup>6</sup> The problematic nature of follow-on class actions results in part from the fact that private enforcers often benefit from the presumption, established by section 5(a) of the *Clayton Act*, that mandates treating a final criminal or civil judgment obtained by the United States as “*prima facie* evidence” against the same defendant in a private civil action. In recent years, private enforcers have also been able to invoke offensive collateral estoppel against such a defendant. Compare *Parklane Hosiery Co., Inc. v. Shore*, 439 U.S. 322 (1979). Of course, courts could exert some useful control over unnecessary follow-on class actions by adjusting class counsel fees to reflect the actual social value added by the litigation effort. However, as a practical matter, courts lack the resources needed to carry out this function effectively. The high cost of providing them with relevant information includes determining the optimal investment class counsel should make in relation to the optimal investment the public enforcer should make and did make.

<sup>7</sup> The leniency program used by DOJ to police international cartels is described by the Director of Criminal Enforcement, Antitrust Division, in Scott D. Hammond, “Detecting and Detering Cartel Activity through an Effective Leniency Program” (paper presented to the International Workshop on Cartels, November 2000), online: United States Department of Justice <[www.usdoj.gov/atr/public/speeches/9928.pdf](http://www.usdoj.gov/atr/public/speeches/9928.pdf)>.

discriminating enforcement methods to avoid crushing out the good with the bad.

Prosecuted to maximize private profits from full-bore litigation rather than to optimize social benefit from a finely-tuned economy, antitrust class actions threaten to impose overbearing litigation costs and excessive sanctions that can over-deter and suppress productive business enterprise.

Solving these coordination problems is crucial to the effective enforcement of antitrust laws. To achieve the optimal joint level of enforcement that maximizes social benefit from any system teaming public and private law enforcers, the coordination mechanism must not only assure that each enforcer makes the appropriately motivated and proportionate investment of resources and effort, but also that their respective efforts are properly synchronized and combined. While it is possible, of course, that one or both enforcers could diverge from the optimal path but do so out of phase with one another, so as to “cancel each other out,” the probability and predictability of that outcome seems miniscule. The key, then, is redesigning the antitrust enforcement mechanism to include a double-sided means of coordination. To this point, proposals for reform have not achieved this result.

Most reforms eschew reliance on courts or private enforcers to perform the job of coordination; the former are seen to lack the necessary resources, expertise and information, while the latter are regarded as so profit-motivated as to lack any incentive to maximize social over private benefit. Though some would curtail private resort to

class actions,<sup>8</sup> the general consensus seems to be that the focus should be on controlling the scale, scope, and intensity of class actions on a case-by-case basis, and that this discriminating oversight is best left to public enforcers, principally FTC and DOJ. Thus, Judge Posner proposes to vest public enforcers with “a right of first refusal” analogous to that exercised by the Equal Employment Opportunity Commission over prosecution of employment discrimination claims.<sup>9</sup> But Posner’s solution deals with only one side of the problem. While giving public enforcers the option to check excessive private enforcement, it negates the unfettered private incentive to initiate a class action that serves as a check on deficient public enforcement.

The design puzzle is thus how to enable public enforcers to check excessive private enforcement without sacrificing the prospect of privately initiated class actions, which serve as check against deficient public enforcement. Professor Jill Fisch offers a thought-provoking design to address this conundrum, though it is not specifically tailored for the antitrust context.<sup>10</sup> Fisch argues for establishing a *qui tam*-type process in which public enforcers would have an option to intervene and participate to some degree in litigating the private class action. The utility of this approach, however, depends on the extent of public enforcer involvement in the private class action, an issue that Fisch does not resolve. Resolving the ambiguity, however, is unlikely to solve the coordination problem. If the role of the public enforcer is merely to supply funding and other support,

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<sup>8</sup> See for example Posner, *supra* note 1 at 274-275.

<sup>9</sup> *Ibid.* at 280-283.

<sup>10</sup> Jill E. Fisch, “Class Action Reform, *Qui Tam*, and the Role of the Plaintiff” (1997) 60 *Law & Contemp. Probs.* 167.

then the private check would be preserved, but there would be no public check against socially excessive private enforcement in cases that would otherwise attract too much private investment.<sup>11</sup> Conversely, were public enforcers to take a more authoritative role, for example, invoking the prerogative of dictating limits on the theories of liability or amount of damages the class could assert, then the greater public check on excessive private enforcement would come at the expense of the private enforcer check on deficient public enforcement.

The proposal proffered here aims at the coordination problems presented by both public and private enforcers, while holding constant and given the general substantive and procedural framework of American antitrust law.<sup>12</sup> Essentially, the enforcers cannot be counted on to achieve the socially optimal result on their own. An inevitable danger exists that either or both enforcers will follow a wayward path, possibly from improper or simply insufficient motivation, or possibly, despite their best efforts, because they cannot effectively harmonize and synchronize their respective inputs. Moreover, because the solution to this problem depends on an accurate assessment of the enforcers' aggregate as well as relative contributions to the optimal level of enforcement, reliance on a court or other neutral third party to make and enforce that determination seems out of the

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<sup>11</sup> The *qui tam* approach enables public enforcers to supplement private investment that falls short of the level required for socially optimal enforcement of the class action claim. Our proposal would also provide the means for public supplementation of private investment. In any event, public enforcers already have the option of offering financial and other assistance with no strings attached to private enforcers of class actions, and doubtless in many cases the offer would be accepted.

<sup>12</sup> To be sure, changing the substantive standards defining illegal monopolistic conduct or the enforcement mechanism that incorporates privately litigated class actions could substantially ameliorate these coordination problems. Our proposal, however, is crafted to improve the operations of the mixed public and private enforcement system without implicating the need for further adjustments to the general framework of antitrust law.



question. Even leaving aside the administrative costs of such substantively intensive regulation, any such non-party would labour under a severe disadvantage relative to the public and private enforcers in terms of gathering and processing the necessary information.

We begin from the starting propositions that animate other reform proposals. In particular, we presume that public enforcers are best informed and positioned, and correspondingly that courts and other neutral third parties are comparatively disadvantaged, in performing the coordination function. Beyond that, however, our proposal adopts a markedly different design from the others not only by adopting an auction-buyback system to address the double-sided nature of the coordination problems, but also by incorporating a market mechanism that publicly reveals the enforcers' valuations and allocates enforcement responsibilities accordingly without reliance on less well informed third parties to make those decisions. The key features of our proposal are (i) the mandatory-litigation class action; (ii) a total enforcement license initially vested with the public enforcer; (iii) auction of a private license to enforce class action; (iv) auction proceeds deposited with and distributed by the court for compensatory purposes consistent with primary deterrence objectives; and (v) a public enforcer option to buy back the private license at the winning bid price and, if exercised, to enforce or abandon the class claim at its discretion.

The structure, operational relationship and functions of these elements are summarized below and graphically depicted in Figure 1.

(i) Mandatory-litigation class action: In contrast to other proposals, we argue for strengthening the private enforcement check by founding it on the mandatory-litigation class action. This type of class action, in contrast to the settlement-only version, defaults to a class action trial if the parties fail to achieve class settlement. It is mandatory in requiring courts to certify the case for class action treatment automatically and immediately without assessment of the typical prerequisites of common question predominance, adequacy of representation, and the like. It is also mandatory in barring class members from opting out.

(ii) Total enforcement license vested with the public enforcer: Like Posner, we initially vest the “total enforcement license” with the pertinent public agency (DOJ or FTC). However, our proposal does not give the public enforcer a “right of first refusal” or some other option to pre-empt private enforcement at this stage. The only purpose of vesting the total enforcement license with the public enforcer is to provide it an opportunity, uncomplicated with private enforcement efforts, to investigate, determine and implement public enforcement objectives in the

matter, in particular regarding how much to invest in pursuing conventional public criminal and injunctive remedies and strategies.

(iii) Class action auction: To assure a private class action check against deficient public enforcement, the public enforcer must put the “private enforcement license” up for auction. Specifically, it must submit to auction complete “ownership” and control over the prosecution and recovery from the class action. The highest bidder wins and pays the bid price to the court depository. In the event there are no bidders, the private license reverts to the public enforcer, which can prosecute the class action or not as it sees fit. Auctioning the class action also avoids the costs and contingency of judicial fee-setting, and thereby corrects related distortions in private enforcer incentives that might lead to under-enforcement strategies, notably in the form of a “sweetheart” deal with the defendant, or to over-enforcement through the pursuit of rent-seeking strategies.

(iv) The court receives and distributes auction proceeds: The auction proceeds are deposited with the court automatically to avoid incentive distortions that might result were the proceeds credited to the public enforcer’s budget. The role of the court is to determine the appropriate disposition of the funds, in particular whether they should be distributed as

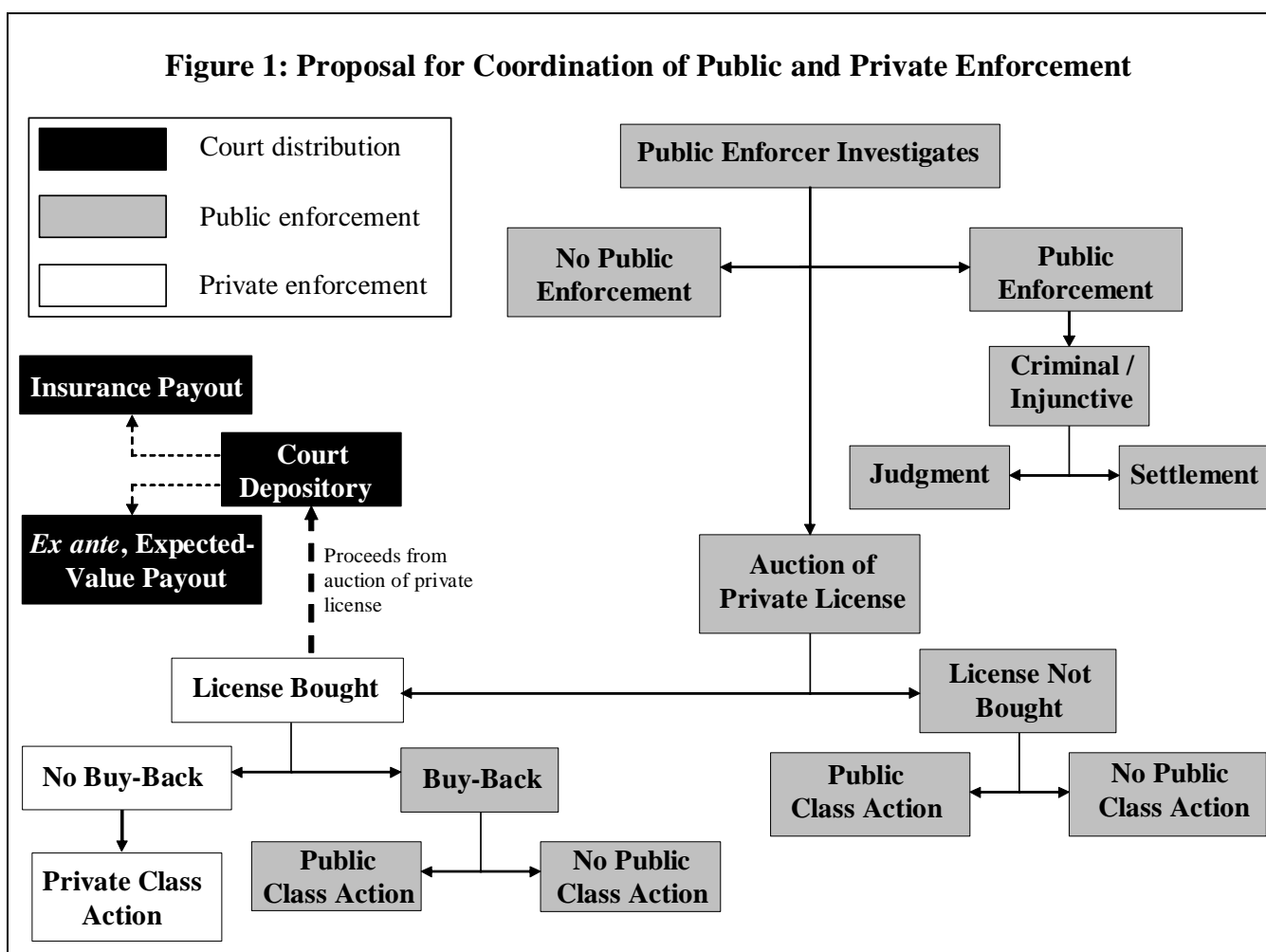
compensation to those who have incurred sanctionable loss or, in the alternative, simply paid to the United States Treasury.<sup>13</sup>

(iv) Public enforcer option to buy back class action at winning bid price:

To address the problem of excessive private enforcement, the proposal provides that the public enforcer can, immediately upon designation of the winning bidder, exercise an option to buy back the private enforcement license, essentially the class action, at the winning bid price. Upon reacquiring the private license, the public enforcer will have normal prosecutorial discretion to press the class claim to whatever degree it deems appropriate. There are several other virtues of the buy-back option, particularly its enabling public enforcers to replace deficient private enforcement and upgrade investment in the class claim, and its deterring public enforcers from making self-serving over-enforcement and under-enforcement decisions by rendering their prosecutorial choices financially and politically transparent and therefore more readily subject to monitoring and discipline.

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<sup>13</sup> Use of a Vickrey-style auction could potentially maximize auction proceeds, which the court can then distribute as compensation (or a form of insurance) to replace sanctionable losses. The Vickrey auction is designed to correct for the “winner’s curse,” which can lead bidders to reduce their offers below their true valuation. See William Vickrey, “Counterspeculation, Auctions, and Competitive Sealed Tenders” (1961) 16 J. Finance 8 at 20.



Part B elaborates the dynamics of the mixed public and private system of antitrust law enforcement and the problems of coordination that can distort this mechanism and prevent its achievement of the optimal joint level of enforcement. Parts C and D develop the basic components of our proposal for improving the coordination of public and private enforcers of antitrust law. We start in Part C on the “private enforcement side” to outline the principal features and functions of a model of mandatory-litigation class action adapted for use in the antitrust context. Attention turns to the “public enforcement side” in Part D. Following a brief discussion of the reasons for vesting the total

enforcement license with the public enforcer, we then focus on the central elements of the class action auction, the receipt and disposition of auction proceeds by courts, and the buyback option. Our discussion addresses the main purposes and workings of these elements, and gauges their effects on public and private enforcement incentives. We also examine the purposes, workings, and functional effects of the various options available to courts in disbursing auction proceeds, and of public enforcers requiring defendants (or otherwise targeted firms or individuals) to bear some or all of the buyback cost or using the buyback option as leverage to acquire control over privately enforced class actions. Part E concludes with a brief evaluation of the cost-effectiveness of our proposal.

## **B. OPTIMAL ENFORCEMENT AND PROBLEMS OF COORDINATION**

We address the problems of coordinating public and private enforcers of antitrust law from the perspective of the social objective of optimal law enforcement. More specifically, the social objective is to optimize the level of law enforcement from the joint investments and efforts of the two public and private sets of enforcers. For present purposes, it is assumed that the optimal joint level of enforcement threatens the imposition of combined public and private sanctions equivalent to the total sanctionable harm resulting from the given antitrust violations.<sup>14</sup> The focus here is on the primary

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<sup>14</sup> This premise subsumes without specific consideration the need for and appropriate use of the treble-damage multiplier to offset dilution of deterrent effects from firms calculating *ex ante* the probability that their antitrust violations will escape detection or otherwise evade the imposition of liability for full sanctionable harm. The term “sanctionable” encompasses harm assessments predicated on either a negligence (unreasonableness) or strict (regardless of reasonableness) test of liability for the agreements or other conduct at issue. “Harm” includes “risk” and for present purposes a threat of liability for

goal of deterrence, as it is generally the case that preventing rather than compensating the violations maximizes social welfare.<sup>15</sup>

Like many other areas of the law,<sup>16</sup> antitrust relies on both public and private enforcers to optimally deter violations.<sup>17</sup> In allocating enforcement power among public and private enforcers, the aim is to have each choose the level of enforcement that will in combination result in the optimal joint level of enforcement. But, if left to their own devices, both private and public enforcers are likely to choose socially inappropriate levels of enforcement. Attempts to remedy such a situation in the status quo are likely to fail. For example, public enforcers, assuming they are well motivated, can cut back on their level of enforcement to offset excesses on the private side. However, cutting back public enforcement goes only so far; it cannot reign in excessive private enforcement that imposes sanctions beyond the total level that should be imposed.<sup>18</sup> Moreover, once we

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sanctionable harm or risk, if imposed prior to accrual of actualized harm, is assumed adequate to achieve optimal deterrence.

<sup>15</sup> The role and implementation of the compensation function is discussed *infra* at Part D. Note the parallel between our assumption and the *Illinois Brick* rule, discussed *infra* at Part C, which prioritizes deterrence over compensation by collectivizing claims for the benefit of direct purchasers and denying standing to indirect purchasers to whom overcharges may have been passed.

<sup>16</sup> The exception, of course, is the criminal offence, the prosecution of which is the exclusive province of the state. For an interesting historical look at why this is the case, see John H. Langbein, *The Origins of Adversary Criminal Trial* (Oxford: Oxford University Press, 2002).

<sup>17</sup> Perhaps more so for antitrust law than for other fields, since the federal statutes regarding antitrust claims authorize treble damages for private plaintiffs to offset the probability that offenders will evade detection or otherwise escape sanctions. The method by which the legislature arrived at its damage multiplier is not readily discernible from the text of the statute or from its legislative history. Important questions arise regarding whether the multiplier should be raised or lowered, or should be fixed or flexible: see for example Posner, *supra* note 1 at 272-273, proposing that the legislature replace treble damages with a “flexible multiple” decided by a jury on a case-by-case basis. Since our analysis of coordination problems holds constant the substance and process of the existing legal framework, these and similar questions relating to reform of that framework lie beyond the scope of this essay.

<sup>18</sup> Consider a simple illustration of the point. Suppose the optimal aggregate enforcement level is ten units, with private enforcers normally providing seven units and public enforcers supplying three units. If

relax the assumption that public enforcers are well motivated, there is evident risk that separate and joint law enforcement efforts will diverge from the optimal, socially appropriate level. Without effective coordination between the enforcers, it is doubtful that by virtue of a favourable “out-of-phase” litigation effort or other fortuitous set of circumstances, the socially appropriate equilibrium will emerge of its own accord.<sup>19</sup>

Even if the resulting level of inefficient litigation is not easy to accurately estimate, one guess will likely ring true – the level of antitrust litigation is rarely, if ever, in accord with the socially optimal joint level.

### 1) Private Enforcement

Differences between private and socially appropriate incentive structures lead private antitrust plaintiffs to choose a level of litigation that is not socially optimal.<sup>20</sup> This failed coincidence of motivation can result in too much litigation or too little, depending on the

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skewed incentives push private enforcement to eight units, the government can respond by scaling back its own enforcement to two units. However, if private enforcement skyrockets to 11 units, there is no reduction strategy available to the government that will achieve the optimal joint level of enforcement; over-enforcement of at least one unit will occur.

<sup>19</sup> If the phase or sine-wave metaphor is unavailing, consider the African fable of the tortoise, the elephant and the hippopotamus. The lowly tortoise challenges each of his fellow creatures to a tug-of-war, then ties the elephant and the hippopotamus to opposite ends of a very long rope, thus preventing either from pulling too far in one direction: see Gilbert Morris Cuthbertson, *Political Myth and Epic* (East Lansing, Mich.: Michigan State University Press, 1975) at 184.

<sup>20</sup> See Steven Shavell, *Foundations of Economic Analysis of Law* (Cambridge, Mass.: Harvard University Press, 2004) at 391-401, which notes “the private incentive to bring suit is fundamentally misaligned with the socially optimal incentive to do so, and *the deviation between them could be in either direction.*” [emphasis added]; Steven Shavell, “The Fundamental Divergence Between the Private and the Social Motive to Use the Legal System” (1997) 26 *J. Legal Stud.* 575 at 577, which notes “The level of litigation is not generally socially correct because there exist what may fairly be called fundamental differences between private and social incentives to use the legal system”. Professor Shavell’s work has stimulated an extensive literature on this topic. See for example Louis Kaplow, “Private Versus Social Costs in Bringing Suit” (1986) 15 *J. Legal Stud.* 371; Peter S. Menell, “A Note on Private Versus Social Incentives to Sue in a Costly Legal System” (1983) 12 *J. Legal Stud.* 41 (1983).



circumstances.<sup>21</sup> The divergence of interests and the corresponding distortion of deterrence effects identified here are not restricted to class actions, but rather apply to all private enforcers and therefore warrant investigation, beyond the scope of our inquiry, into the utility of the treble-damage multiplier, among other features of the enforcement mechanism's private side.

### **a) Over-Deterrence**

The prevalence of private civil actions piggy-backing on public enforcement outcomes and work product poses a significant risk of over-enforcement.<sup>22</sup> Even if follow-on litigation is necessary to promote optimal deterrence, there is no one with authority to determine the appropriate level of such litigation, let alone to keep it within those bounds. Of course, excessive private enforcement may well occur before or even without any public enforcement.<sup>23</sup> Further, as we discuss below, the absence of public enforcement can contribute to the opposite danger of deficient private enforcement since profit motive rather than social benefit dictates the level of private investment and effort.

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<sup>21</sup> It is not our aim to prove that this misalignment cuts one way or the other; it is rather to identify the range of potential problems in the current system.

<sup>22</sup> See for example Christopher R. Leslie, "Trust, Distrust, and Antitrust" (2004) 82 Tex. L. Rev. 515 at 641-642, noting that "The cost of follow-on private suits can be overwhelming. For example, at the conclusion of the criminal cases against the electrical manufacturers convicted of price-fixing, approximately 2,000 private damage suits representing 25,000 separate antitrust claims were filed against the companies. Not surprisingly, the plaintiffs did well at trial."

<sup>23</sup> Posner, *supra* note 1 at 275, warns against taking this prospect lightly: "the plaintiffs' bar cannot be relied upon to exercise reasonable self-restraint.... Students of the antitrust laws have been appalled by the wild and woolly antitrust suits that the private bar has brought – and won. It is felt that many of these would not have been brought by a public agency and that, in short, the influence of the private action on the development of antitrust doctrine has been on the whole a pernicious one."

Characterizations of private enforcers being overly litigious or opportunistic are quite beside the point. The main motivation for private litigation is governed by rational expected value analysis determined largely by incentives created by the basic structural elements of the system. Shavell's structural critique of private litigation makes this evident.<sup>24</sup> In deciding whether to pursue an antitrust claim and the attendant treble damages, private enforcers may well be led to invest beyond the socially appropriate level because the investors are not compelled to internalize the full cost of their choices; in particular, they do not bear the costs of their adversaries' defence and of the public in providing the judicial forum.<sup>25</sup> And, as we have emphasized, the present structure of the system creates the incentives for full-bore litigation, which are compounded by the inexactitude and excessive costs of determining antitrust liability through civil litigation.<sup>26</sup> Courts rarely if ever apply the rules of liability and damages with an eye toward the potential for over-enforcement, and in any event, given their lack of information, expertise and resources, the effort at coordination would likely fail. Indeed, if courts were motivated by these factors to develop restrictive interpretations of what constitutes harmful monopolistic behaviour, they make matters much worse by curtailing the scope of public as well as private enforcement.

## **b) Under-Deterrence**

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<sup>24</sup> See the sources cited *supra* note 20.

<sup>25</sup> Full internalization of these costs, as noted below, can have the opposite effect of decreasing the private investment and effort below the optimal level.

<sup>26</sup> See Posner, *supra* note 1 at 275, noting that “*If antitrust doctrine were pellucid and the courts unerring in applying it to particular disputes, there would be no problem; cases that had merely colorable, and not real, merit would fail and the extortion problem ... would disappear. But these conditions do not obtain.*” [emphasis added].

The danger of deficient private enforcement also exists. This arises partly from defects in the substance and process of the antitrust laws,<sup>27</sup> and from overly restrictive rules governing class actions, notably including the direct purchaser rule from *Illinois Brick Co. v. Illinois*.<sup>28</sup> But it is also the consequence of the basic structure of civil process, as Shavell shows. In particular, private enforcers are indifferent to the positive social consequences, namely the deterrent effects, of their investments. If a low expected recovery renders litigation uneconomical for the investor, then no claim will be brought regardless of its potential deterrent value. With insufficient financial incentive to motivate socially efficient litigant behaviour, certain antitrust claims that should be brought will not be, or their prosecution will be under-funded – a classic instance of positive-externality or public good market failure.

## 2) Public Enforcement

Private litigants are not alone in their failure to achieve optimal litigation levels. Government agents, too, are susceptible to imperfect deterrence strategies. The preceding analysis of the divergence of private interests is not strictly applicable here because, at least in theory, public enforcers are supposed to maximize social rather than personal welfare. Yet it is not entirely irrelevant. Public enforcers too may be prone to

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<sup>27</sup> See for example Robert H. Lande, “Why Antitrust Damage Levels Should Be Raised” (2004) 16 *Loy. Consumer L. Rev.* 329, arguing that treble damages are not sufficient to motivate efficient levels of private antitrust litigation.

<sup>28</sup> 431 U.S. 720 (1977); see *infra* Part C. Because indirect purchasers do not have standing under federal antitrust laws, they must assert claims on the basis of the so-called “state repealer statutes” that recognize such claims as valid. This reliance on state law hampers courts from certifying large-scale, multi-state class actions to prosecute violations that typically cross state boundaries to inflict harm regionally or nationwide.

engage in excessive enforcement because they do not internalize directly the public expense for courts or the costs of defence. Moreover, public enforcers are usually paid a flat salary that does not vary directly with their enforcement effort, and consequently they are prone to slack performance. Moreover, as noted below, there are several other salient factors that can distort the incentive and effort of public enforcers.

**a) Under-Deterrence**

The starting salary at a private law firm specializing in antitrust class actions is likely to exceed starting salaries at the FTC or the DOJ by a factor of nearly three.<sup>29</sup> In light of this fact, the perception that those agencies are understaffed can come as no surprise. The government actors responsible for public enforcement of antitrust claims thus may not have the resources or the personnel to bring as many cases as they should, and so public enforcement is likely to under-deter violations of antitrust laws.<sup>30</sup>

Under-deterrence by public enforcement need not only be attributed to funding decisions by the legislature. Sometimes, the agencies themselves will make choices out of personal interest or due to political pressures that result in deficient enforcement. Certainly there is the public perception, however generated, that government favouritism and possibly

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<sup>29</sup> As an example, compare the following lawyer recruiting information: “Compensation”, online: Susman Godfrey L.L.P. Attorneys at Law <[http://www.susmangodfrey.com/recruit/recruit\\_philosophy.html#compensation](http://www.susmangodfrey.com/recruit/recruit_philosophy.html#compensation)> (last accessed 2 February 2005), noting a first-year associate’s salary of US\$125,000, and “Salary Table 2004-GS”, online: U.S. Office of Personnel Management <<http://www.opm.gov/flsa/oca/04tables/html/gs.asp>> (last accessed 2 February 2005), noting a starting pay-grade of US\$44,136 for GS-11 federal employees such as new FTC lawyers.

<sup>30</sup> Posner, *supra* note 1 at 275-276.

even corruption would let some violators escape full sanctions were there no check on prosecutorial discretion.<sup>31</sup>

### **b) Over-Deterrence**

Given the foregoing description of the government's antitrust enforcement arms as underfunded, it is difficult to make the claim that public enforcement will depart upward from socially optimal levels. But consider for a moment the possibility of "empire-building," the incentive of enforcers to engage in overzealous enforcement efforts for purposes of self-aggrandizement. This behaviour may not be limited to boosting one's self-esteem and social status – it may also serve as a lever in policy- and budget-making quarters to inflate enforcement funding, jurisdiction and power. It may also provide a platform from which to seek promotion and lay the groundwork for a political, judicial or even defence-side legal career.<sup>32</sup>

## **C. PRIVATE ENFORCEMENT: MANDATORY-LITIGATION CLASS ACTIONS**

With these coordination problems in mind, we move to the first plank of our plan. As previously mentioned, our proposal for antitrust reform focuses on optimizing deterrence of anti-competitive behaviour. Those suffering the economic losses that result from antitrust violations usually do not present a need, or even a practical opportunity, for

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<sup>31</sup> As a structural matter, there is no check on agency permissiveness with regard to antitrust violations. Compare Stephen Calkins, "Perspectives on State and Federal Antitrust Enforcement" (2003) 53 Duke L.J. 673 at 701.

<sup>32</sup> See online: Eliot Spitzer 2006 <<http://www.spitzer2006.com/main.cfm>>, promoting Mr. Spitzer's candidacy for governor of the state of New York. See generally Levinson, *supra* note 4.

receiving compensation from civil damage awards. Typically, these losses are diffusely spread across a large population and involve small amounts of money.<sup>33</sup> In such cases, there is no pressing insurance rationale for replacing the losses and the cost of distribution may well exceed the benefits. To maximize social welfare, our coordination proposal effectively decouples the deterrence and compensation functions of civil damages in antitrust cases. The mandatory class action described below effectuates the objective of optimal deterrence, while, as we discuss in Part D, the court can, to the extent that it is cost-effective and functionally useful, distribute the proceeds from auctioning the class action to facilitate compensation goals.<sup>34</sup>

If a primary aim of our coordination proposal is to enable public enforcers to prevent excessive private enforcement, then, one might ask, why bolster the class action? Why eliminate the uncertainties, costs and restrictions entailed by the conventional processes of class certification and judicial fee-setting? Why bar exit, preventing class members from opting out? In short, why not reduce the level of private enforcement by continuing to hobble its most potent weapon, the class action? The answer is that only by enhancing the effectiveness of the class action can private enforcement effectively serve its dual role in relation to public enforcement: complement and check. To be sure, outfitting private enforcement with such a powerful engine can exacerbate the danger of excessive private

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<sup>33</sup> See Posner, *supra* note 1 at 13-14, explaining the economic nature of the societal harm inherent in an antitrust violation in terms of substitution and rent-seeking costs.

<sup>34</sup> It should be apparent that the aggregate price paid at auction to acquire the class action, and consequently the aggregate fund available for purposes of compensation, depends directly on the effectiveness of the private class action in maximizing return for investors. As such, the argument for use of mandatory class action affects the compensation as well as deterrence functions of civil antitrust liability.

enforcement. The auction and buyback features of our proposal, discussed in Part D, address that problem. However, their effectiveness in checking against excessive private enforcement depends in part on the effectiveness of the class action. It must not only spring into action automatically when needed to augment public enforcement. But it also must be sufficiently potent to enable recovery of the full value of the class claim, so as to set a price, which will, of itself or combined with political and public reactions, constrain abuse of the buyback option.

### **1) Mandatory-Litigation Class Action**

Previous scholarly work has advanced an argument favouring use of mandatory-litigation class actions in the context of mass torts.<sup>35</sup> Therefore, only a brief description of this procedural device and explanation of the need and uses for it is in order.

In a system that utilizes the mandatory-litigation class action, all potential and actual claims arising out of an allegedly unlawful practice are automatically aggregated for collectivized adjudication. There is no opportunity for opting out of this process. It is also mandatory in the further sense that the court has no discretion in certifying class action treatment for the case. Moreover, in contrast to the “settlement-only” class action that depends on the defendant’s agreement for certification and defaults to the standard process of separate actions if the court refuses to approve the settlement, our proposal

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<sup>35</sup> For a full treatment of the mandatory-litigation class action in the context of mass tort claims, see David Rosenberg, “Mandatory-Litigation Class Action: The Only Option for Mass Tort Cases” (2002) 115 Harv. L. Rev. 831.

incorporates the litigation class action, which requires the parties to face class action trial in the event that they fail to reach a class-wide settlement or obtain judicial approval of the resulting agreement.

## 2) Need for Collectivization

To achieve the normative goals of optimal deterrence of antitrust violations, collectivization of all claims is imperative. Essentially, collectivization overcomes the asymmetry in litigation scale efficiencies and consequently in litigation power that exists when a firm with a collective “ownership” interest in prosecuting the common defences confronts some number of plaintiffs each possessing only a fractional “ownership” interest in prosecuting the common causes of action. The only way to ameliorate this asymmetry of investment in development of the competing sides of the case is collectivization of the plaintiffs’ claims to afford both parties equivalent opportunity to exploit available litigation scale efficiencies.<sup>36</sup> By aggregating all claims, plaintiffs would be able to exploit the same scale efficiencies that defendants naturally enjoy. Furthermore, the class action mechanism would have the added benefit of motivating

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<sup>36</sup> Of course, the hallmark of mass production cases is that few claims are prosecuted independently, at least when free-riding on the work product of others is taken into account. Rather, even in the absence of a class action, lawyers compete to acquire shares of actual and potential claims, customarily using various formal and informal aggregation measures, ranging from cooperative arrangements for sharing expenses and information to claim inventories, joinder and consolidation. However, such fractional aggregation, short of comprehensive collectivization by a class action or a functional equivalent, never assures the full opportunity to exploit scale efficiencies that would enable plaintiffs to maximize the civil liability benefits of deterrence and insurance. In short, total aggregation is necessary to provide plaintiffs and courts a full opportunity to exploit scale efficiencies in litigation and thus counter the asymmetry in litigation power favouring defendants that results from their ability to exploit *de facto* class action scale efficiencies in the standard separate action process. While it is more realistic to talk in terms of fractional aggregation, and we do so at later points of discussion, it would not change the basics of our present analysis and conclusions.



courts to invest optimally in adjudicating such claims, which typically involve complex matters of fact, law, evidence and policy. Class actions thus offer the only avenue for optimizing both litigant and adjudicative investment in mass production litigation.

Motivated in part by similar concerns, the United States Supreme Court responded to the collectivization problem by developing the direct purchaser rule in *Hanover Shoe, Inc. v. United Shoe Machinery Corp.*<sup>37</sup> and *Illinois Brick Co. v. Illinois*,<sup>38</sup> with the express intent of strengthening the “private attorneys general” conception of antitrust enforcement.<sup>39</sup>

The direct purchaser rule restricts standing in private antitrust actions to those purchasers who are immediately adjacent in the supply chain to the alleged antitrust violator. For example, a wholesaler who purchases a commodity from a manufacturer at an inflated price and passes this overcharge on to consumers is the only party with standing to sue the manufacturer – even if all of the overcharge was borne by the consumers.<sup>40</sup> The direct purchaser is entitled to sue for the entire overcharge, regardless of how that price

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<sup>37</sup> 392 U.S. 481 (1968) at 493-494, rejecting a passing-on defence in part because such a rule would reduce the effectiveness of private treble-damage actions.

<sup>38</sup> *Supra* note 28 [*Illinois Brick*] at 735, asserting that “the antitrust laws will be more effectively enforced by concentrating the full recovery for the overcharge in the direct purchasers rather than allowing every plaintiff potentially affected by the overcharge to sue only for the amount it could show was absorbed by it.” The direct purchaser rule was also a response to the difficulty inherent in determining the extent to which an overcharge has been passed down the supply chain: *ibid.* at 732–33. See also *In re Brand Name Prescription Drugs Antitrust Litigation*, 123 F.3d 599 (7th Cir. 1997) at 605 per Posner J., who observed “Tracing a price hike through successive resales is an example of what is called ‘incidence analysis,’ and is famously difficult”.

<sup>39</sup> *Illinois Brick*, *supra* note 28 at 746: “the legislative purpose in creating a group of ‘private attorneys general’ to enforce the antitrust laws... is better served by holding direct purchasers to be injured to the full extent of the overcharge paid by them than by attempting to apportion the overcharge among all that may have absorbed a part of it.” (citations omitted).

<sup>40</sup> Compare *McCarthy v. Recordex Services, Inc.*, 80 F.3d 842 (3d Cir. 1996) at 855: “The Supreme Court, in [*Kansas v. Utilicorp United, Inc.*, 497 U.S. 199 (1990)], expressly refused to recognize an exception to *Illinois Brick* even where one hundred percent of the cost increases had been passed through to indirect purchasers.”

increase was eventually apportioned. Exceptions to the direct purchaser rule have been greatly restricted in recent years,<sup>41</sup> so *Illinois Brick* almost uniformly operates to collectivize federal claims by aggregating damages dispersed amongst both indirect and direct purchasers and awarding standing to the middlemen. The direct purchaser rule has given rise to a lengthy debate of its merits, the details of which need not be reproduced here. We merely note that our proposal would sidestep the *Illinois Brick* problem and its perceived costs, complexities and other shortcomings. Rather than arbitrarily granting standing to the direct purchaser in every case, our proposal essentially vests the entire collective enforcement license in a single “private attorney general,” who has demonstrated the ability and willingness to prosecute the class-wide claim better than anyone else by bidding and paying the highest price for that license.<sup>42</sup>

#### **a) Optimal Litigant Investment**

When claims are litigated individually or jointly in any fraction of the whole, the defendant automatically gains the “upper hand” due to its greater opportunity to take advantage of efficiencies of litigation scale. Whether the potential recovery of each plaintiff is a hundred, a thousand or a million dollars, the defendant will treat any common issues as a single litigation unit, making a substantial investment to maximize the aggregate return from reduced liability and then spreading the cost of that investment across however many separate actions it confronts or expects to confront. Plaintiffs

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<sup>41</sup> See *Kansas v. Utilicorp United, Inc.*, *ibid.*, holding that exceptions to the direct purchaser rule are proper only where it can be proven that the direct purchaser suffered absolutely no injury.

<sup>42</sup> Our proposal also avoids the problem of tracing the overcharge through the supply chain. Because the license-holder is entitled to all damages resulting from a specific anticompetitive act, it will be sufficient to demonstrate the magnitude (and not the distribution) of the economic harm.

proceeding by way of separate actions are hampered by their inability to similarly exploit available litigation scale efficiencies. The defendant's litigation position is therefore strengthened, not because of anything having to do with the merits of the litigation but solely because the plaintiffs are atomized.<sup>43</sup> With such a disparity in investment, there is little doubt that skewed outcomes will ensue. Class action collectivization is essential to correct this systemic bias that undermines the deterrence function of private enforcement of antitrust laws.

#### **b) Optimal Adjudicative Investment**

To the extent that judges rationally allocate judicial resources, class action scale efficiencies are essential in motivating courts to optimize adjudicative investment, which maximizes the prospect of achieving the social objectives of deterrence.<sup>44</sup> The separate action process forces judges not only to labour under burdens of great administrative pressure and cost, but also to overcome barriers to getting the needed information and perspective imposed by the limits on plaintiffs' investment incentives and insight from the "snapshot" afforded by the fractional set of particular claims being litigated. Courts subject to these constraints are prone to mistaken judgment generally, and are even more so in addressing the factually complex and theoretically and sophisticated issues

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<sup>43</sup> In effect, the defendant is able to use the plaintiffs' numbers against them. Even though tortious harm could reach into the millions of dollars, the defendant may be able to avoid liability altogether so long as it disperses this harm across enough individuals. See Bruce L. Hay & David Rosenberg, "'Sweetheart' and 'Blackmail' Settlements in Class Actions: Reality and Remedy" (2000) 75 Notre Dame L. Rev. 1377 at 1379-1380. See also Randy J. Kozel & David Rosenberg, "Solving the Nuisance-Value Settlement Problem: Mandatory Summary Judgment" (2004) 90 Va. L. Rev. 1849 at 1880.

<sup>44</sup> Although their motivations for investing in the litigation differ from those of the parties, judges, it is not unrealistic to assume, more or less consciously allocate judicial resources to best effectuate the social objectives of the law they make and apply, and therefore, to some extent, exploit the value-enhancing opportunities of class action scale efficiencies.

presented by antitrust litigation. Erroneous decisions in antitrust cases entail potentially high social costs, including reduction and possibly complete preclusion of efficient innovation and other productive business enterprise. These costs of error often justify courts independently developing relevant information, as well as supplementing and verifying the party-created record, to establish a comprehensive and reliable basis for making judgments.<sup>45</sup> Establishing an independent role in the litigation, however, is expensive for courts, given the highly specialized information they must acquire, evaluate and apply to adjudicate antitrust claims. Surely a court is apt to invest much less in developing and using information to decide any fraction of classable claims in the standard process of separate actions than it would were all claims submitted for complete and comprehensive resolution. Class action scale efficiencies are thus necessary to motivate as well as to warrant the judicial investment that maximizes the social value from private enforcement of antitrust law.

### **3) Need for Litigation Class Action**

In contrast to the litigation class action, a settlement-only class action does not result in class action trial should the parties fail to reach, or the court refuse to approve, a class settlement. In the absence of settlement, the class action dissolves by definition, and all claims return for trial through the standard market process of separate actions.<sup>46</sup> Thus, in the settlement-only class action, the threat of trial in a series of independently prosecuted,

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<sup>45</sup> For example, maximizing adjudicative investment may compel courts to appoint neutral experts more frequently. This practice is outlined in Fed. Rules Evid. R. 706 Court Appointed Experts, but it is barely used.

<sup>46</sup> The settlement-only class action received judicial authorization for use in some types of cases in *Amchem Products, Inc. v. Windsor*, 521 U.S. 591 (1997) at 616.

separate actions creates leverage for the plaintiffs and value to settlement for the defendant. By contrast, the litigation class action creates an incentive for the defendant to settle class members' claims by confronting it with the threat of a collectively prosecuted class trial that eliminates the defendant's asymmetric scale advantages, thereby raising settlement values above those generated in the standard market process.<sup>47</sup> This key difference makes settlement-only class actions inferior to litigation class actions. Plaintiffs' bargaining power in settlement-only class actions derives from whatever truncated scale economy and investment opportunities they can marshal through disaggregated litigation in the marketplace of separate actions. Consequently, settlement-only class actions deny plaintiffs the opportunity to exploit investment scale optimally to maximize aggregate benefit from the defendant's mass tort liability. Any settlement in a settlement-only class action thus reflects claim values depressed not only by the plaintiffs' suboptimal investment and other deficient scale incentives, but also by the defendant's superior litigation power. Because the settlement-only class action offers no distinctive benefits to offset its deficiencies, we eliminate it from our repertoire of law enforcement modalities.<sup>48</sup>

#### **4) Need for Mandatory Collectivization**

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<sup>47</sup> Another significant difference is that in the settlement-only class action, the defendant, having final say over whether to settle class-wide or not, exercises complete veto power over who will serve as class counsel, or more accurately, over whether and the extent to which a class action will be certified. In the litigation class action, the defendant has no say over either aspect of the process.

<sup>48</sup> Although settlement-only class actions have become a staple of complex civil litigation, they indeed offer little if any functional advantage over the standard, separate action process and are decidedly inferior to an appropriately designed litigation class action. For a comparative assessment of the functional productivity of settlement-only and litigation class actions, see David Rosenberg, "Adding a Second Opt-out To Rule 23(b)(3) Class Actions: Cost Without Benefit" [2003] U.Chicago Legal F. 19.

The purpose of the mandatory-litigation class action is to maximize deterrence in a way that aligns *ex post* litigation effects with each individual's *ex ante* preference for deterrence.<sup>49</sup> Because optimal deterrence of antitrust behaviour is a public good, there will be a collective action problem in providing that benefit to market participants generally. Free-riding, identifiable in this context as a private party's benefiting from extra deterrence of anti-competitive behaviour but then cashing in on private litigation in the event of personal harm from undeterred behaviour, is inevitable unless all parties pre-commit to a deterrence-maximizing scheme that will foreclose private litigation options once the litigation begins. Class members can often profit by opting out and free-riding on the work product of the class action (to the extent it does not wholly replicate that of the public enforcer). The consequence is lower private investment in the class claim and, indeed, overall, and potential for a significant shortfall in the private enforcement effort.<sup>50</sup> This is where the "mandatory" part of the procedural device makes its presence felt – opting out is not allowed.<sup>51</sup>

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<sup>49</sup> For explanation of the *ex ante* preference for deterrence, see Rosenberg, *supra* note 35 at 840-844.

<sup>50</sup> For a recent study documenting the relatively small fraction of class members who elect to opt-out, see Theodore Eisenberg & Geoffrey P. Miller, "The Role of Opt-Outs and Objectors in Class Action Litigation: Theoretical and Empirical Issues" (2004) 57 Vand. L. Rev. 1529. Low opt-out rates, however, do not contradict our analysis. First, the most likely to exit are claims with relatively higher expected value. See Rosenberg, *ibid.* at 891, n. 119. Second, in the face of a credible threat of opting-out to free-ride, the class action investment will be lowered to reduce the costs and therefore the marginal gain from opting-out for a free-ride.

<sup>51</sup> Mandatory collectivization is already a prominent feature of the mechanism for enforcing antitrust law. As noted earlier, in price-fixing cases the United States Supreme Court has adopted a rule that bars claims by indirect purchasers, whose difficulty in proving individual sanctionable loss dilutes the deterrent effect from threatened liability, and effectively assigned their aggregate litigable interest to wholesalers and other direct purchasers: see *Illinois Brick*, *supra* note 28. Because its deterrent effect would reflect aggregate liability and damages undiluted by impediments to individual loss determinations, the mandatory-litigation class action we propose could fully replace the *Illinois Brick* rule, which is often costly and complicated to apply.

#### **D. PUBLIC ENFORCEMENT: CLASS ACTION AUCTION AND BUYBACK OPTION**

With the mandatory-litigation class action in place on the private enforcement side, we turn to the central design puzzle. Given the risk of excessive private enforcement, there is need for a public enforcer check. Yet given the risk of deficient public enforcement, particularly motivated by public enforcers preferring their own interests to those of society, there is need for a way of preventing them from self-servingly curtailing private prosecution of the class action. Our solution is for the public enforcer to auction off a private license to prosecute the class action while retaining the option of buying it back at the price of the winning bid. This mechanism (“auction-buyback”) should provide the needed check on deficient public enforcement, while at the same time enabling the public enforcer to pre-empt or otherwise confine the class action to the socially appropriate level of private enforcement.

The auction-buyback mechanism operates in four sequentially ordered phases. The process begins with the vesting of the public enforcer with the total license for private as well as public enforcement. In the next phase, the public enforcer, having closed its case, auctions off the private license to prosecute the class action. Following that, the court will receive deposit of the auction proceeds and decide the purpose and method of their disposition consistent with the priority for optimal deterrence. Finally, the public enforcer will choose whether to exercise the class action buyback option and, depending on that choice, either the private or public enforcer will prosecute (including settle or abandon) the class action. In this Part we elaborate and explain the phases of the scheme

we propose for coordinating public and private antitrust enforcers; evaluation of its effectiveness is deferred to concluding remarks in Part E.

### **1) Total Enforcement License Vested with Public Enforcer**

In the first phase all public and private powers of antitrust enforcement (a “total enforcement license”) are initially vested with the public enforcer. This consolidation of enforcement authority is similar to Posner’s “first-refusal” proposal and adopts an approach already in practice in various *qui tam* schemes.<sup>52</sup> However, in specifying that the public enforcer holds the private component of the total enforcement license provisionally, solely in a custodial capacity, our proposal charts a distinctive course. The public enforcer, in this phase, has no authority to pre-empt, appropriate or otherwise dispose of the private class action. The private enforcement license is merely suspended until the close of the public enforcer’s investigation and any ensuing prosecution or other disposition of the alleged antitrust violation.

Temporarily debarring initiation of the class action should promote effective public enforcement efforts. It will reduce the potential for private litigation to interfere with public enforcers investigating the occurrence of conspiratorial and actualized violations, identifying the individual and institutional violators, uncovering and analyzing evidence of the means, instrumentalities and fruits of wrongdoing, and ultimately pursuing the appropriate criminal sanctions, injunctive relief and other formal and informal remedies.

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<sup>52</sup> See for example *False Claims Act*, 31 U.S.C. §§ 3729-3733.



In particular, this hiatus will afford public enforcers added opportunities for maintaining confidentiality, acting with deliberation and gathering substantiating information in conducting investigations and negotiations for plea, settlement and cooperation agreements, and in pressing legal actions against defendants. It will also shield targets and defendants from public and private enforcers attempting to use extortionate and other abusive prosecutorial tactics.<sup>53</sup>

## **2) Public Enforcer Auctions Private License to Prosecute Class Action**

Initially, as explained above, the public enforcer takes only provisional, ministerial control over the private class action. At the closing of any antitrust case, at whatever stage, whether prior to or after an investigation, by settlement or judgment, or otherwise, the public enforcer must divest itself of the private license to prosecute and recover on behalf of the class and assign it to a private enforcer. To accomplish this, we propose that the public enforcer (or court) conduct an auction to determine which cases will become the responsibility of private enforcers.<sup>54</sup> Allocation of the license to prosecute the class

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<sup>53</sup> These include enforcers employing the whipsaw tactic against targets and defendants in settlement and plea negotiations. The strategy involves one enforcer extracting a concession that is then used by the other as the bargaining floor for demanding and wringing out even more from the target or defendant. This process may go on for multiple rounds of bargaining, steadily ratcheting up the total price paid by the defendant or target to resolve its exposure to public and private sanctions. In suspending private enforcement, our proposal also precludes use of the Fifth Amendment dilemma tactic. This ploy involves the private enforcer using civil discovery interrogation to force a target or defendant into the choice between invoking or waiving its Fifth Amendment privilege against self-incrimination. Either course of action carries a high price. Providing incriminating information in civil discovery bolsters not only the private enforcer's case in the class action, but also the public enforcer's case for criminal penalties. However, invocation of the privilege to avoid increasing exposure to criminal prosecution usually comes with a costly sanction on the private enforcement side; typically the court will presume that the discovery response would have been incriminating and admits this as evidence against the privilege-invoking defendant at trial of the class action.

<sup>54</sup> Rather than auctioning many fractionated actions of small value, the government will in most cases be auctioning off large class actions, the "mandatory" nature of which, including preclusion of opt-out, make

action will not be discretionary; the public enforcer must put it on the market and sell it to the bidder offering the highest purchase price.

In the event there are no bids, the private license to litigate the class action reverts to the public enforcer, which can litigate, abandon or otherwise resolve the class claim in its prosecutorial discretion. If the auction attracts bidders, then the winner acquires complete “ownership” control over the prosecution of and recovery from the class action, which includes litigating, settling, abandoning or otherwise seeking to resolve it in the normal course.

We largely incorporate the proposal developed by Professors Jonathan Macey and Geoffrey Miller to auction off the class action claim rather than the position of class counsel.<sup>55</sup> We instead focus briefly on the choice of auction model. For present

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them stable and readily valued assets. See Part B, above. The costs of the auction system are thereby reduced.

<sup>55</sup> Macey and Miller suggest an auction model for large-scale, small-claim class actions: see Jonathan R. Macey & Geoffrey P. Miller, “The Plaintiffs’ Attorney’s Role in Class Action and Derivative Litigation: Economic Analysis and Recommendations for Reform” (1991) 58 U. Chicago L. Rev. 1 at 105-116. See also David Rosenberg, “The Causal Connection in Mass Exposure Cases: A ‘Public Law’ Vision of the Tort System” (1984) 97 Harv. L. Rev. 849 at 914-915 and n. 247. For a thorough examination of the pitfalls to using class counsel auctions, see “Third Circuit Task Force Report: Selection of Class Counsel” (2001), online: Third Judicial Circuit <<http://www.ca3.uscourts.gov/classcounsel/final%20report%20of%20third%20circuit%20task%20force.pdf>> at 17-18. The record of statements and reports submitted to the Task Force are available on the Third Circuit’s website; online: <<http://www.ca3.uscourts.gov>>. See also Lucian A. Bebchuk, “The Questionable Case for Using Auctions to Select Lead Counsel” (2002) 80 Wash. U.L.Q. 889.

For an exchange about the workability of class action auctions, see Randall S. Thomas & Robert G. Hansen, “Auctioning Class Action and Derivative Lawsuits: A Critical Analysis” (1993) 87 Nw. U.L. Rev. 423 at 447-448 and Jonathan R. Macey & Geoffrey P. Miller, “Auctioning Class Action and Derivative Suits: A Rejoinder” (1993) 87 Nw. U.L. Rev. 458 at 460-462. One concern is that in not giving the “first to file” any preference in acquiring the class action, the auction would diminish incentives for private enforcers to ferret out antitrust violations that might otherwise escape the notice of public enforcers. See

purposes, the choice turns on the function of civil liability. The deterrence function comports with virtually any model of auction, even one prone to collusive bid-rigging. In general, there is little reason to be concerned that the winning bidder paid the “correct” amount, the expected value of the class claim minus costs of prosecuting it. Vested with an exclusive proprietary interest in the aggregate return on the class claim, the winner (or a subsequent buyer of the class claim, who being the more effective enforcer values it more than the winner) is motivated to invest optimally in maximizing the expected net recovery and therefore the deterrence benefit from adjudicating the antitrust class action.

While deterrence is the primary function, compensation may be a subsidiary objective in some cases. Consequently there may be greater concern about the ability of the auction to result in a winning bid that approximates the “true” net expected value of the class

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“Developments in the Law – the Paths of Civil Litigation” (2000) 113 Harv. L. Rev. 1827 at 1839. How much private reporting would be lost is an empirical question, but there is reason to believe that the reduction in reporting might not be great. In the antitrust area, there are many market participants, such as competitors injured by illegal predatory pricing, who might benefit sufficiently from public enforcement to “blow the whistle” on violations even without the prospect of acquiring control over ensuing private civil actions. Moreover, public enforcers can pay rewards to promote “whistle blowing.” Further, those who invest in investigating such violations will likely have a significant private-information advantage in valuing the class claim and developing bids accordingly. Bidders may discount their offers somewhat to account for the chance their investigatory and other investments in working up their respective bids will not ultimately yield a winning or profitable bid. This is a normal consequence of any competitive market process and, in any event, may have no functional significance when deterrence is the primary objective. While there are undoubtedly other devils in the details, we leave their exorcism to a later day. For present purposes we proceed on the general evidence of the routine use and social benefit from using auctions to allocate large-scale public and private assets and projects. See for example Evan Kwerel & Walt Strack, “Auctioning Spectrum Rights” (February 20, 2001), online: U.S. Federal Communications Commission <<http://wireless.fcc.gov/auctions/data/papersAndStudies/aucspec.pdf>>; Peter Cramton, “The Efficiency of the FCC Spectrum Auctions” (1998) 41 J.L. & Econ. 727 at 729. See also Martin Shubik, “Auctions, Bidding, and Markets: An Historical Sketch” in Richard Engelbrecht-Wiggans, Martin Shubik & Robert M. Stark, eds., *Auctions, Bidding, and Contracting* (New York: New York University Press, 1983) at 33, reporting that in A.D. 193, the entire Roman Empire was auctioned by the Praetorian Guards to Didius Julianus. Our analysis and intuition strongly suggest that class action auctions will not prove the exception to the general rule.

claim.<sup>56</sup> A problem called the “winner’s curse” can arise to thwart this objective. This condition concerns bidders’ fear of winning, that is, worry that winning signifies that the winning bidder valued the asset not only more than the losing bidders, but by too much more. Consequently, bidders will tend to bid below their true valuations, thereby driving down the winning bid price. To counter this price-deflating strategy, the private license to prosecute the class action could be allocated by way of a sealed-bid, second-price auction, also known as a Vickrey auction.<sup>57</sup> In a Vickrey auction, participants submit a single, non-sequential bid in an attempt to win the item being sold. Participants are not informed about the bidding behaviour of others (“sealed”), and the winning bidder is the one who has submitted the highest offer when the period for accepting bids has ended.<sup>58</sup> The price that the winning bidder must pay is established by the bid of the next-highest bidder (the “second price”). This method is used because it elicits accurate bids from market participants, thus ensuring that the license goes to the party who actually values it the most.<sup>59</sup>

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<sup>56</sup> The reasons for using civil liability as a means of compensation are noted below in connection with discussion of the judicial disposition of proceeds from the class action auction.

<sup>57</sup> This type of auction, the development of which earned Vickrey a Nobel Prize, is described in Vickrey, *supra* note 13.

<sup>58</sup> The computation of a bid in a Vickrey auction involves no estimation of the bidding behaviour of other parties, thus reducing the cost of preparing a bid.

<sup>59</sup> An alternative, modeled on what is called the “English” auction, might also serve the purpose of generating a winning bid that approximates the “correct” net expected value of the class claim. The English auction involves open bidding with the auctioneer soliciting progressively higher bids until only one willing bidder remains to pay the “first price.” See Paul R. Milgrom & Robert J. Weber, “A Theory of Auctions and Competitive Bidding” (1982) 50 *Econometrica* 1089 at 1091. See also Jill E. Fisch, “Lawyers on the Auction Block: Evaluating the Selection of Class Counsel by Auction” (2002) 102 *Colum. L. Rev.* 650 at 664. The version that might best suit the auctioning of class actions would essentially involve a multi-round auction. Each round would proceed with bidders submitting sealed bids, and, at the close of the round, the winning bid being announced and solicitation for the other bidders to submit matching bids. If no matching bids are submitted, the high bidder has bought the class action. If matching bids are submitted, there will be another round of sealed-bid submissions with the minimum bid set equal to the matched bid price established at the close of the preceding round. Only those who submit matching

Whatever the model, the class action auction would be open to any type of bidder, whether dominated by lawyers or not, with the exception of potential defendants or other targets of the public enforcer's investigation. While the participation of a potential defendant would amount to a pre-litigation offer of class settlement, practical considerations suggest that the costs of fostering such a settlement by auction would be needlessly high. The potential defendant would likely possess private information about the value of the class claim, or so it would be supposed by other bidders, and especially in independent, non-follow-on cases the informational asymmetry might depress or even deter bids.<sup>60</sup> However, the potential defendant would seem to have one advantage over other bidders even if everyone were symmetrically informed about the value of the class claim. Because its valuation adds trial costs to the expected judgment, while the other bidders' valuations subtract trial costs from the expected judgment, the potential defendant is generally positioned to outbid the others. This prospect would undermine deterrence, because no one would bid against the potential defendant; rarely would anyone invest in developing a bid that has little or no chance of winning. Predicting that result, the potential defendant will discount the threatened liability from the antitrust class action.

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bids are eligible to participate in the next round. The process continues until a round ends in which no bids are submitted to match the winning bid. This model resembles the one used in FCC spectrum auctions: see Cramton, *supra* note 55.

<sup>60</sup> The result does not follow as a matter of necessity. If the non-defendant bidders were risk-neutral, they might well disregard the presence of a better-informed participant, the potential defendant, given an equal probability that the private information indicates higher or lower value to the class claim than is generally appreciated.

### 3) Court Deposit and Disposition of Auction Proceeds

The winning bidder for the class action pays to the court either the “first price” or, in a Vickrey auction, the “second price.” Payment to the court rather than to the public enforcer avoids distortion of enforcement incentives. Paying the public enforcer might skew prosecutorial decisions to inflate agency budgets and the enforcer’s career opportunities. Because payment into the court’s depository is automatic and unconditional, the prospect of receiving the auction proceeds should have no deleterious effect on the exercise of judicial discretion.

Judicial disbursement of the auction proceeds serves two major purposes in our proposal: optimization of resource allocation and, given risk aversion, reduction of the costs of bearing risk.<sup>61</sup> Normally the court can achieve both goals by conveying the auction proceeds directly to the federal judicial budget, thereby reducing the judiciary’s demand for general tax revenues and presumably lowering the general tax levy accordingly. This should ameliorate the deleterious incentive effects of people being compelled to bear the risk of undeterred and uncompensated loss from antitrust violations. The prospect of lower wealth could lead them to shift expenditures toward less preferred personal and productive uses, including spending more on safeguarding their assets against depredation. When this risk of antitrust loss is borne generally and randomly, these *ex ante* distorting effects can be offset by the corresponding increase in disposable income

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<sup>61</sup> A third function commonly performed in other settings, that of reimbursing and rewarding parties who bear enforcement costs, is absent in our system: the enforcing party will be the winning bidder, whose payoff is the full recovery of class-wide damages.

resulting from a reduction in taxes.<sup>62</sup> Similarly, risk-bearing costs are lowered and risk-averse people are better off when a chancy benefit (or liability) is converted into an immediate, *ex ante* cash payment (or assessment) equal to its expected value. The tax reduction effectively converts the gamble of recovering antitrust losses in litigation into the certain, immediate payment of its expected value.<sup>63</sup>

When the amount of sanctionable loss incurred is large and concentrated, however, the compensatory function of judicial disbursement of the auction proceeds may include not only promoting allocation efficiency. In cases where first-party insurance is otherwise unavailable, the auction proceeds may also be used to reduce risk-bearing costs by providing “civil liability insurance” against the sanctionable loss. As such, direct and individualized distribution of the auction proceeds might be warranted.<sup>64</sup>

#### **4) Public Enforcer Buyback of Private License to Prosecute Class Action**

The buyback option utilizes the market-generated price elicited at auction to avoid the need to transfer the license through costly bargaining, including the potential for holding out, bluffing and other ploys to create impasse and breakdown, between the public

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<sup>62</sup> Compare William M. Landes & Richard A. Posner, “Should Indirect Purchasers Have Standing to Sue Under the Antitrust Laws? An Economic Analysis of the Rule of *Illinois Brick*” (1979) 46 U. Chicago L. Rev. 602 at 605.

<sup>63</sup> It may enhance welfare to individualize this *ex ante* payoff when the risk of illegal loss is not generally and randomly distributed. However, because of the typically small amounts of money involved, prohibitively high administrative cost will often prevent tailoring tax reductions to sanctionable loss.

<sup>64</sup> Given that the auction proceeds equal the aggregate expected value of the class claim, the court might use the funds as a premium for an insurer or other indemnifier to assure payment of the full sanctionable loss as determined by class action judgment or settlement. The court could solicit bids for taking on this contingent insurance obligation, with the winner receiving the auction proceeds as the premium for covering the upside of the litigation gamble.

enforcer and numerous possible would-be private enforcers. Having auctioned the license to prosecute the class action and determined the winning bidder, the public enforcer must immediately either assign the license to the private enforcer or exercise a “buyback” option. If the choice is to exercise the buyback option, the public enforcer acquires (or retains) the license by paying an amount equal to the winning bid price, regardless of whether the winning bidder would have paid that price as the first price or, in a Vickrey auction, paid the second price.<sup>65</sup> This scheme might be modified to require the public enforcer to reimburse the winning bidder for the costs of preparing the bid. Once the public enforcer has exercised the buyback option, it is free to resolve the class claim by litigating or settling any or all of it or otherwise resolving the matter in its prosecutorial discretion.

We briefly consider whether the public enforcer should be allowed to employ the buyback option as “collateral leverage” to bargain for concessions from targets of its investigation and from the winning bidder. Regarding targets, the question is whether the public enforcer should be able to make exercise of the buyback option and of discretion to abandon or curtail prosecution of the class claim conditional on the defendant agreeing to pay some portion of the winning bid price? In our view, there is no reason to prevent this arrangement. It amounts to pre-litigation settlement of the class action based on the

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<sup>65</sup> Whether the public enforcer simply deposits the price with the court or reimburses the auction winner for making such payment seems a detail of no functional significance. In a system employing the reimbursement procedure and a Vickrey auction, the public enforcer pays the winning bidder an amount equal to the second price and pays the balance of the winning bid price to the court.



market valuation of the expected class action judgment.<sup>66</sup> With respect to winning bidders, the question is whether the public enforcer, having exercised the buyback option, should be free to negotiate a resale of the license on condition that the private enforcer scale back the scope of the class action? In return for paying the difference between the winning bid price and the expected judgment from a scaled-back class action, the private enforcer could reacquire the appropriately conditioned private enforcement license. Again, our view is that use of the buyback option for this purpose would promote effective coordination. Once it commits to exercise the option, the public enforcer could itself prosecute a scaled-back version of the class action. There seems to be no reason to preclude the public enforcer from instead accomplishing its enforcement goals by exploiting available additional efficiencies of private enforcement resources and incentives.

## **E. CONCLUSION**

Having laid out the proposal in some detail, we conclude by offering a brief evaluation of its prospects for cost-effectively coordinating the public and private arms of the law to achieve the optimal joint level of antitrust enforcement. We submit that taken as a whole, the combination of requiring the auctioning of a mandatory-litigation class action with the provision for the public enforcer buying it back should significantly ameliorate

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<sup>66</sup> To reduce the variance in such settlements and pre-empt temptation to collude, the arrangement may provide a floor and ceiling bracketing the defendant's ultimate obligation. As such, the prospective defendant would agree to pay a fine equal to the difference between the winning bid price and some specified minimum amount or, on the upside, to pay up to some maximum amount with the public enforcer paying the balance of the winning bid price.

central and pressing coordination problems. They may be termed “central” because they are the very problems that appear to have prompted lawmakers to enact an antitrust enforcement regime using a mixed system of public and private enforcers. In part, this system seems designed to provide some private enforcement check on deficient public enforcement. The pressing nature of the problem is that the private check may frequently operate to excess. There is nothing in the present legal structure that addresses either this aspect of the problem or the further problem of deficient private enforcement.

Our proposal for classing antitrust claims on a mandatory basis – immediately, unconditionally and without possibility of exit – responds to the problem of deficient private enforcement. By correcting a structural bias in the adversarial system, mandatory-litigation class action enables plaintiffs to adopt a collective litigation posture that is similar to that which is naturally enjoyed by defendants. Mandatory collectivization thus produces superior deterrence benefits by threatening defendants with damages equal to the aggregate loss that would result from anti-competitive behaviour. It pools litigation resources and promotes economies of scale that defendants naturally enjoy in single-defendant, multiple-plaintiff situations. Litigants may not be the only parties to antitrust litigation who would expend greater resources in the context of mandatory-litigation class actions. Judges too might make a more productive investment of judicial resources in resolving a large, complex proceeding that features the advocacy of two collectivized parties as well as the aggregate social interest at stake. More productive judicial investment in cases yields more accurate decisions, optimizing

deterrence and strengthening the case law in the field. In clarifying standards of acceptable business behaviour, the courts provide better direction to firms eager to comply with the law and also achieve greater deterrence.

Over-deterrence is also addressed by the mandatory-litigation class action. Because all claims are aggregated, with no opportunity to opt out of the class and free-ride on the work product of the class counsel, this collectivizing device greatly reduces the likelihood of repeat hearings of similar claims. Such duplicative litigation counts as over-enforcement (or at least a social waste of resources) since, by definition, the added costs of adjudication are not necessary to secure the benefits of the litigation. The mandatory-litigation class action also provides a stable backdrop against which courts and public enforcers can work to reform substantive, procedural and other aspects of antitrust law.

The requirement that the public enforcer auction the private license to prosecute the mandatory-litigation class action provides a potent check against deficient public enforcement. The openness of this process provides a further check. One of the overall benefits of our scheme is that it renders the exercise of prosecutorial discretion by private and public enforcers more publicly transparent and therefore politically accountable. The auction requirement provides a salient example. It will be difficult for public enforcers to explain seemingly lax effort in the face of an auction that yields a large number of bidders and a high winning price. At the same time, auctioning the license to prosecute a

class action will curtail excessive private enforcement. Notably, charging the expected recovery value for the license will squeeze out the rents from class counsel free-riding on public agent work-product. Public enforcers are thereby free to invest optimally in developing the antitrust case without concern that it might lead to a follow-on class action, which promises to contribute nothing of value to the overall law enforcement effort. Having to ante up the expected value of the class action may also inhibit strike and nuisance-value litigation.

The buyback option, combined with the auction, affords needed public enforcer power to prevent excessive private enforcement. Given the costs and public notoriety, the option will likely be exercised only when the public enforcer determines that the class claim is more socially valuable in its hands than in those of the private enforcer. While we have not emphasized the coordination problem of constraining excessive public enforcement from “empire-building” or other self-serving motives, it should be noted that our proposal should have salutary effects here too. In addition to subjecting a potentially high cumulative level of enforcement to public scrutiny, the auction may well yield a very low winning bid that would signal that the public enforcers are pressing a weak case, perhaps for self-serving reasons. Moreover, having to pay the winning bid price to buy back the class action would deter public enforcers from attempting to aggrandize themselves by attempting to seize and centralize control of the entire enforcement license. As in the area of eminent domain, where the payment of just compensation for takings constrains public agents from engaging in political favouritism and other self-dealing, public

enforcers operating under our proposal are forced to pay the price of the first bid before regaining control over any antitrust claim.<sup>67</sup>

The success of our plan would depend on a great deal of careful adjustment to account for the particulars of the “real world.” From the running of the actual auction to the political feasibility of mandatory-litigation class actions to the operation of the buyback option, there would be growing pains as this nascent idea evolved into an operational system of antitrust enforcement. Once these details have been ironed out, however, this plan has the potential to ameliorate the coordination problems endemic to the current mechanism for enforcing antitrust laws.

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<sup>67</sup> See for example Louis Kaplow, “An Economic Analysis of Legal Transitions” (1986) 99 Harv. L. Rev. 509 at 602-606; Frank I. Michelman, “Property, Utility, and Fairness: Comments on the Ethical Foundations of ‘Just Compensation’ Law” (1967) 80 Harv. L. Rev. 1165. But see Steve P. Calandrillo, “Eminent Domain Economics: Should ‘Just Compensation’ Be Abolished, and Would ‘Takings Insurance’ Work Instead?” (2003) 64 Ohio St. L.J. 451 at 509-512. Notice that our proposal is far more likely to yield a price that private parties will view as “fair.” Unlike the eminent domain setting, which allows for great variance in the computation of what is “just compensation,” our proposal pegs the government’s buyback price according to bids actually elicited at auction.