No. 14-1091

IN THE
Supreme Court of the United States

THE DOW CHEMICAL COMPANY,
Petitioner,
v.

INDUSTRIAL POLYMERS, INC., QUABAUG CORPORATION, AND SEEGOTT HOLDINGS, INC., INDIVIDUALLY AND ON BEHALF OF ALL OTHERS SIMILARLY SITUATED,
Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Tenth Circuit

BRIEF OF PROFESSORS KEVIN M. MURPHY, JERRY HAUSMAN, BENJAMIN KLEIN, EDWARD A. SNYDER, AND ROBERT H. TOPEL AS *AMICI CURIAE* IN SUPPORT OF PETITIONER

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Pursuant to this Court's Rule 37.2, *amici curiae* respectfully file this brief in support of the petition for a writ of certiorari.[1]

INTEREST OF *AMICI CURIAE*

Amici are economists who are concerned about the use (and misuse) of economics in the courtroom. *Amici* file this brief to underscore how faulty economic reasoning can lead to faulty class-certification decisions and hence to faulty (and grossly inflated) class-action judgments.

Amicus Kevin M. Murphy is the George J. Stigler Distinguished Service Professor of Economics at The University of Chicago Department of Economics and the Booth School of Business. Professor Murphy is a fellow of the Econometric Society and an elected member of the American Academy of Arts & Sciences, and a 2005 MacArthur Fellow. Professor Murphy was first exposed to this case when he was retained by petitioner to consult in a non-testifying role on economic methods used by an economic expert in a related case. He had no access to any confidential information in that role, has no further relationship with petitioner in this matter, and is not

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[1] Pursuant to this Court's Rule 37.6, *amici* represent that no counsel for a party authored this brief in whole or in part, and no person or entity other than *amici* or their counsel made a monetary contribution intended to fund the preparation or submission of this brief. Pursuant to this Court's Rule 37.2(a), *amici* represent that all parties were provided notice of *amici*'s intention to file this brief at least 10 days before its due date, and all parties have provided blanket consent to the filing of *amicus* briefs on behalf of either party or neither party.

receiving any compensation for his involvement in this *amicus* brief.

Amicus Jerry A. Hausman is the John and Jennie S. MacDonald Professor of Economics at MIT, where he has taught for 30 years. He is also Director of the MIT Telecommunications Economics Research Program. Professor Hausman received the John Bates Clark Award from the American Economics Association in 1985 for the most outstanding contributions to economics by an economist under 40 years of age, as well as the Frisch Medal from the Econometric Society. Professor Hausman is a fellow of the Econometric Society and an elected member of the American Academy of Arts & Sciences, and a Distinguished Fellow of the American Economic Association.

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INTRODUCTION AND SUMMARY OF ARGUMENT

This is one of those cases at the intersection of law and economics, where bad economics makes bad law. The Tenth Circuit here affirmed an antitrust price-fixing judgment of more than a *billion* dollars in favor of a nationwide class of industrial purchasers of polyurethane products. But buying polyurethane from a chemical manufacturer is not like buying a candy bar from the corner store. It is undisputed that many of the industrial purchasers that make up the plaintiff class *individually* negotiate their purchase prices, and those prices thus vary greatly according to the relative bargaining power and incentives of both the buyer and the seller in each particular transaction. Under such conditions, as a matter of economics, there is no basis to conclude that an alleged conspiracy among manufacturers to fix *list* prices for polyurethanes invariably affected the *actual* price paid by every buyer.

The Tenth Circuit concluded otherwise only by holding that the alleged price-fixing conspiracy "artificially inflated the *baseline* for price negotiations." Pet. App. 13a (emphasis added). According to the court, that higher "baseline" allowed the district court to make a "finding" that "price-

fixing would have affected the entire market," regardless of the actual prices that individual buyers ended up paying. *Id.* at 14a. And, the appellate court held, "[b]ased on the reasonableness of *this finding*, the [district] judge had the discretion to treat impact as a common question that was capable of class-wide proof." *Id.* (emphasis added); *see also id.* ("The district judge certified a class based on the plaintiffs' evidence of an artificially inflated baseline."). The Tenth Circuit's ratification of class certification in this case, in other words, hinges on the validity of the economic assumption that a conspiracy among sellers to fix *list* prices necessarily affects all buyers—regardless of whether the parties individually negotiated their *actual* prices—because "it artificially inflate[s] the baseline for price negotiations." *Id.* at 13a.

That assumption defies basic principles of economics. A buyer and a seller reach a purchase price based on their individual economic positions and incentives in negotiations, and thus the actual price they negotiate is by no means invariably affected by some arbitrary list-price "baseline." There is no basis, in short, to conclude that the actual prices that every individual buyer and seller negotiated in light of the alleged conspiracy differed from the price they would have reached in the absence of that alleged conspiracy. To the contrary, a conspiracy to fix list prices, especially in the absence of customer allocation, may raise prices for some buyers but can create incentives to compete for the business of, and thus lower prices for, other buyers (for example, as a way of making use of excess capacity).

And whether or not it is true that the alleged list-price conspiracy resulted in the *average* actual prices paid by buyers being increased (or maintained) above competitive levels does not reveal whether any (much less every) individual buyer was injured. Focusing on *average* actual prices reveals nothing about the actual prices for *individual* buyers. It is thus entirely possible for average actual prices to exceed competitive levels while actual prices for many individual buyers remain at or even below those levels. The class certification decision in this case precluded petitioner from trying to prove that any particular member of the class (much less every member) was not injured by the alleged conspiracy—and thus does not have a successful antitrust claim—based on the individual business relationship between petitioner and that class member. That is neither good economics nor good law.

ARGUMENT

An Alleged Conspiracy To Fix *List* Prices Does Not Invariably Affect All Buyers Where *Actual* Prices Are Individually Negotiated.

The judgment below is based on a manifestly erroneous economic premise: that "price-fixing affects all market participants, creating an inference of class-wide impact even when prices are individually negotiated," because it "artificially inflate[s] the *baseline* for price negotiations." Pet. App. 13a (emphasis added). The Tenth Circuit, in other words, affirmed the classwide liability judgment on the theory that every class member was injured by the alleged antitrust conspiracy because price negotiations necessarily *started* at a supracompetitive level, regardless of where actual prices ended up. *See id.* at 13-14a.

That theory has no basis in economics, and thus should have no basis in law. Even assuming that the alleged supracompetitive conspiracy price served as a "baseline" for individual negotiations, not every negotiation travels a fixed distance from such a baseline. To the contrary, as an economic matter, where negotiations start may have no bearing on where they end up—it all depends on the dynamics of the particular negotiations and the parties' varying incentives to reach a deal. Anyone who has ever haggled at a flea market knows this point: if a buyer is only willing to pay $100 for a particular item, the seller may well agree to sell at that price regardless of whether the seller gave $200, $500, or $1,000 as his starting price. The same is true whether the seller claims to be running a sale or offering "special deals." The notion that the actual price negotiated by a buyer and seller is invariably affected by the starting price has no basis in economics.

The Tenth Circuit misunderstood this basic point, holding that "evidence of an artificially inflated baseline" is enough to justify class certification, because such evidence would prove the requisite classwide antitrust injury. Pet. App. 13a; *see also id.* at 14a ("The district judge could reasonably weigh the evidence and conclude that price-fixing would have affected the entire market, raising the baseline prices for all buyers. *Based on the reasonableness of this finding*, the judge had the discretion to treat impact as a common question that was capable of class-wide proof.") (emphasis added); *see also id.* ("The district judge certified a class based on the plaintiffs' evidence of an artificially inflated baseline.").

This Court should grant review to make clear that a "finding" of an artificially inflated baseline is insufficient to establish classwide antitrust injury. Such a "finding" is meaningless because, by definition, a baseline is the *starting* point, not the *ending* point, of a dynamic process. There is no way to know, without individualized inquiry, whether the baseline had any effect on the actual price negotiated by a buyer and a seller in individualized negotiations.

As an example, consider a buyer who is especially knowledgeable about industry supply and demand conditions and engages in negotiations with one or more sellers. In this situation, the list price is unlikely to affect what this buyer actually pays. Using its knowledge of supply and demand fundamentals, such a buyer likely will negotiate a price independent of a "list" or published price.

This is especially true if the alleged conspiracy has raised (or maintained) average prices and reduced aggregate sales relative to a competitive benchmark—which it must if the conspiracy is successful—because sellers then will have excess capacity. The very success of an alleged conspiracy that raises prices to some buyers may actually reduce the prices paid by others. By definition, buyers paying lower prices are not harmed, but rather benefit from the fact that a conspiracy to fix list prices was effective in increasing actual prices paid by some buyers, thereby causing them to purchase less and creating incentives for conspirators to lower prices to other buyers.

It is not inconsistent for the average price paid by the class as a whole (much less some subset of buyers) to increase as a result of a conspiracy, while

prices paid by many individual class members remain flat or even decline. Thus, focusing on average actual prices in the aggregate reveals nothing about the actual prices paid by any individual buyers. The basic laws of supply and demand teach that a conspiratorial increase in price to some buyers would lead those buyers to purchase less of the product. The lower sales to those buyers generated by the higher price would result in unutilized production capacity, and give the conspirators a strong incentive to use that capacity to make sales to other potential buyers. The enhanced incentive of suppliers to sell to other customers would have the economic effect of putting those targeted buyers in an enhanced bargaining position, enabling them to negotiate more favorable prices despite (indeed because of) the inflated list prices. Economic incentives to lower prices to some buyers as a consequence of a conspiracy to set prices for other buyers above competitive levels are especially strong when buyers are differentially situated in ways that make it easier to raise prices to some or switch sales to others.

Similarly, the "baseline" may have no impact on a buyer who is a repeat purchaser from a particular seller, and who uses its past negotiated transaction price as the "baseline" from which it negotiates a new purchase agreement and price. This will be especially true when repeat buyers are valued customers of a seller—the seller would have a strong incentive to maintain the long-term and profitable relationship, and thus to insulate the customer from any effects of artificially inflated list prices.

Where, as here, actual prices are negotiated and thus are not transparent to other class members or

other alleged conspirators, it is especially easy for an alleged conspirator to profitably "cheat" by offering lower actual prices, and for a buyer with strong bargaining power to avoid an overcharge. As explained above, the buyer may even benefit, obtaining a lower price than would have been paid in the absence of a conspiracy. Identifying buyers that avoided an overcharge or paid lower prices because of the alleged conspirators' incentive to cheat requires individualized inquiry.

Economics thus teaches that individual buyers may suffer no injury, and may even benefit, from an alleged price-fixing conspiracy. Such a conspiracy, especially in the absence of customer allocation, capacity reduction, and restriction of output, may raise (or maintain) prices above competitive levels for some buyers but can create incentives to compete for the business of, and lower prices to, other buyers.

It follows that the Tenth Circuit's rationale for affirming the classwide judgment is not consistent with economic reality. An individual buyer could not demonstrate that it was injured by an alleged conspiracy to fix list prices by simply proving that a conspiracy exists and that list prices exceeded competitive levels. Rather, an individual buyer could demonstrate that it was harmed *only* by showing that the alleged conspiracy inflated the actual price it paid. It follows that a putative class of buyers cannot start and stop its proof of antitrust injury with evidence that list prices exceeded competitive levels. Because of this, as a matter of basic economics, certifying a class based only on an alleged list-price conspiracy is bad economics and bad law.

CONCLUSION

For the foregoing reasons, this Court should grant a writ of certiorari and reverse the judgment.

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Respectfully submitted,

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