IMPERFECT INFORMATION AND CONSPIRACY CLASS ACTIONS

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A. INTRODUCTION

Imperfect information problems afflict all litigation, but they have some particularly important effects in class action litigation that seeks redress for conspiracies that are unlawful under antitrust law. In this comment, I will outline briefly some of the ways in which the presence of imperfect information can affect the analyses in the excellent articles by Margaret Sanderson and Michael Trebilcock¹ and David Rosenberg and James Sullivan in this collection.² Both articles offer valuable insights into the strengths and drawbacks of reliance on privately initiated class actions for conspiracy. The benefits of such private litigation efforts are that they supplement and serve as a check on sluggish public enforcement, and the costs are the risk of strike suits and over-enforcement. Imperfect information contributes importantly to the benefits and costs of class action litigation about conspiracy, as the articles suggest, but also can affect the proposed solutions to the problem. In this brief comment I discuss the two articles using imperfect information as my frame of analysis. First, I discuss problems of imperfect information in detecting conspiracies; second, I discuss problems of imperfect information in calculating damages resulting from conspiracies.

B. DETECTION

Both articles observe that conspiracy class actions have not often been successful in either Canada or the United States in detecting conspiracies.

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1 Margaret Sanderson & Michael Trebilcock, “Competition Class Actions: An Evaluation of Deterrence, Accountability, and Corrective Justice Rationales.”
For example, Sanderson and Trebilcock observe that there have only been two class actions for conspiracy in Canada, both unsuccessful, that did not follow public enforcement in Canada or the United States, or private litigation in the United States. They conclude that "private enforcers are not uncovering conspiracies that public enforcers have failed to identify."1

The problem of detecting conspiracies, as a general matter, is well known. In the shadow of criminal penalties for collusion, the conspirators will act covertly and direct evidence of conspiracy is difficult to obtain. In addition, observed parallel pricing, and indeed parallel price increases, are consistent with perfectly competitive markets as well as conspiracies, leaving indirect evidence of conspiracy also difficult to gather. Unlike most other crimes, conspiracies may happen without the victim knowing that she has been victimized. There is clearly a problem of imperfect information in detecting covert conspiracies among competitors.

In such a context, it is virtually inevitable that public enforcement will play a leading role in uncovering conspiracies. Public enforcers have a range of important investigation techniques that are unavailable to private enforcers, such as the power to search with a warrant and the authority to grant immunity from criminal prosecution to conspirators that cooperate. These considerations do not suggest that private enforcement does not have a place in uncovering conspiracies. Sometimes private actors may have knowledge of a market that allows them to discover conspiracies more effectively than public enforcers. The option of private litigation also serves as a valuable check on public enforcers. Indeed, at the risk of being Pollyannaish, the rarity of private actions in North America could be explained in part by the discipline of public enforcers that the threat of private litigation creates. But it does imply that any evaluation of the number of truly private class actions must be conducted in light of the considerable obstacles to uncovering conspiracies that private actors face.

In this light, the Canadian record is not as starkly unsuccessful as Sanderson and Trebilcock imply. A fifth of conspiracy class actions to date, two of ten, have resulted from private initiative, while another one of ten followed on similar private litigation in the United States. Given the impediments facing plaintiffs, this might be considered to be a remarkably high percentage of cases. The fact that all three of these conspiracy

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1 Sanderson & Trebilcock, above note 1 in the text following n. 52.
2 Ibid. in the text at n. 53.
proceedings were unsuccessful should also be examined in context. Since major reform of the *Competition Act* in Canada, there have been only four contested merger cases before the Competition Tribunal, and in only one of these has the Commissioner been successful. Yet few would describe merger enforcement activities as having had a trivial effect on business activities in Canada since 1986.

The problems for private parties seeking to uncover information about conspiracies are significant at present, but would be aggravated if Rosenberg and Sullivan’s auction mechanism were adopted. Under their proposal, the right to bring any conspiracy class action would initially vest in public enforcers who would then be compelled to auction the right to bring the action to private enforcers. The private enforcers would bid up to the expected value of the right to sue and the proceeds would be deposited with the court.

While Rosenberg and Sullivan provide valuable food for thought in striking an appropriate balance between too little and too much private enforcement of conspiracy laws, their auction mechanism would significantly undermine privately initiated actions. Under their proposal, a private enforcer that uncovered a conspiracy would not be able to attempt to obtain certification, but rather would only earn the right to bring the action after having won an auction for that right. If information about the conspiracy were costless to obtain, little would be lost by compelling such an auction. However, private enforcers seeking to detect collusion would inevitably have invested time and money in an investigation. By the time the auction arises, of course, these costs are sunk and the discoverer of the conspiracy would bid up to the expected value of the action just as any other bidder would. If bidding in the auction were competitive, the discoverer would lose money: it earns nothing but a competitive return from the auction (whether it wins or loses), and loses the costs of investigating. Just as scholars have suggested that hostile takeover bids resulting in auctions will deter potential bidders from investigating targets, similarly an auction process risks dampening private efforts to discover a valuable cause of action against conspirators.⁶

Rosenberg and Sullivan implicitly acknowledge the auction mechanism’s chilling effect on private efforts to discover conspiracies when they make an observation about strike suits. They suggest that “[h]aving to ante up the expected value of the class action may also inhibit strike and

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⁵ R.S.C. 1985, c. C-34.
nuisance-value litigation.” But the reasons why this is true also imply that the auction mechanism would deter meritorious class actions. Strike suits are unmeritorious actions launched by plaintiffs with the objective of reaching settlement agreements with defendants wishing to avoid costly litigation. Although without legal merit, strike suits have positive net present value to the lawyers that launch them because of their settlement value. This implies that even if strike suits were auctioned off, there ought to be bidders willing to bid for them. The only reason the auction might deter strike suits is that investigating potential strike suits is costly. In such cases, the potential investigator reasons that it will earn only a competitive return on the auction, but will incur the costs of discovering the strike suit; on net, it is better not to investigate potential strike suits. But there is no difference in the deterrence of strike suits and of meritorious actions. Forcing lawyers to purchase the right to bring a proceeding deters unmeritorious litigation, but it also deters meritorious litigation.

The auction mechanism may deter strike suits, but may also deter meritorious actions for the same reasons.

C. THE VALUE OF DAMAGES

Information about the existence of conspiracies is imperfect, but so too is information about the damages resulting from collusion. Imperfect information in this area also has implications for the analysis of conspiracy class actions.

First, consider the difficulties enforcers, public or private, have in determining the total amount of damages resulting from a conspiracy. Sanderson and Trebilcock provide a very helpful summary of the complexities of the question. As they say, the “injured parties may be some (or all) direct purchasers, some (or all) indirect purchasers, or some combination of direct and indirect purchasers.” Information on the mark-ups to direct purchasers, and the extent to which these are passed on to indirect purchasers, must be estimated, which is no easy task, particularly where demand and supply elasticities have to be calculated independently. The calculation is particularly complex in Canada given that indirect purchasers may well be able to claim damages, unlike in the United States under the rule in *Illinois Brick Co. v. Illinois.*

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7 Rosenberg & Sullivan, above note 2, Section E, “Conclusion.”
8 Sanderson & Trebilcock, above note 1 in the text preceding n. 31.
In my view, the complicated process of estimating damages provides a justification for “follow-on” class actions. Both articles are sceptical of the merits of such class actions. For example, Sanderson and Trebilcock express concern that there is a “risk of duplicative public and private enforcement actions and hence over-deterrence, particularly if the private actions are simply follow-on suits that do not uncover new offences …”  

Rosenberg and Sullivan express similar concerns about duplicative litigation and would eliminate follow-on class actions by consolidating all public and private claims into a single class action.

While I agree that the risk of duplicative litigation exists, it is important to appreciate the role that follow-on actions can provide in establishing optimal deterrence. In particular, optimal deterrence implies that the penalties a firm pays for conspiracy should relate to the actual losses that conspiracy creates. If expected fines and damages exceed the expected social costs of collusion, there is over-deterrence; for example, the law could deter socially beneficial forms of horizontal cooperation. If expected fines and damages were less than the social costs of conspiracy, there is under-deterrence. But how are the public authorities to determine actual losses? Follow-on class actions provide an incentive for private plaintiffs to come forward with evidence of the losses that they have suffered. While public enforcers could, of course, ask would-be plaintiffs for such information, incentives for information revelation are clearly stronger where the plaintiffs have something financially to gain. Thus, follow-on class actions may well contribute to optimal deterrence by generating information about losses resulting from a conspiracy.

Similar reasoning suggests that the auction mechanism proposed by Rosenberg and Sullivan has a potentially significant drawback. Again, assume that prospective private plaintiffs have information about damages from price-fixing that is helpful in calculating the losses that a conspiracy has imposed. Under the Rosenberg and Sullivan proposal, the class action lawyer pays up front in an auction for the right to collect damages from the action. The people who have suffered losses do not necessarily collect anything, but rather do so only if the court chooses to dispense some of the auction proceeds to them instead of keeping the money for the court’s budget, which one might surmise to be an attractive option for the court. This system would undermine incentives for would-be plaintiffs to come forward with information about the losses that they have suffered.

10 Sanderson & Trebilcock, above note 1 in the text preceding n. 22.
11 Rosenberg & Sullivan, above note 2 in the text at n. 20.
Information problems about total damages can have another damaging effect on the auction system Rosenberg and Sullivan propose. As discussed, responsibility for the initial investigation into the existence of a conspiracy will predictably fall to public authorities given their relatively expansive investigatory techniques. Suppose that as a result of its investigations, the government has a better idea than private lawyers about the value of the damages to be collected. In such a plausible state of the world, their proposal encounters some problems.

Under Rosenberg and Sullivan's proposal, immediately following the auction of the licence to launch the class action, the government has the option to buy back the licence at the winning bid price. The problem with the option to buy back the claim in the presence of asymmetric information between the government and private lawyers is that an adverse selection problem could result.

To explain, suppose that prospective plaintiff lawyers anticipate that the value of a claim is either $40 or $60 with equal probability. The lawyers would be willing to pay $50 for the claim. The government, in contrast, knows the true value of the claim. On the assumption that the monies paid into the court reduces tax burdens (and attendant inefficient distortions), as Rosenberg and Sullivan suggest, the government would be serving the public interest by refusing to buy back the claim where its value is $40, but should buy it back where its value is $60. The problem with the government's (rational) approach is that lawyers anticipate that the government will systematically buy back the bids when the winning bid is too low, but will not buy them back when the bids are too high. This could dramatically undermine the market for the class action licences.

There are, however, some mitigating considerations. The government may not know more than private lawyers. The government may also take a longer-term view of the public interest and allow low bidders to keep the licence in order to promote future class action auctions. The problem with this latter consideration is that the government may not know whether a low bid is based on imperfect information or is based on higher private costs of litigating than those that the government would incur. As Rosenberg and Sullivan state:

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

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the public enforcer determines that the class claim is more socially valuable in its hands than in those of the private enforcer.¹³

Where, for example, the private lawyer can prosecute the claim at a lower cost, and hence would value the claim more than the government, the government should not buy back the claim; conversely, where the government values the claim more highly because of cost savings relative to a private action, it should buy the claim back. The government may be uncertain of its optimal course of action where it perceives a low bid. Taking a long-term view of the public interest, it should not buy the claim back if the bid is caused by asymmetric information about the value of the action — buying back claims in such circumstances would create an adverse selection problem that would undermine future auctions. On the other hand, a government concerned about the public interest should buy back the claim where the low bid results from the high cost of a private action. But how is the government to distinguish the asymmetric information cases from the high cost cases? Just as troubling, it may be difficult for outside observers to know whether the government is buying back a class action licence to take advantage of superior information or because it genuinely believes that it can more efficiently prosecute the action. Reputation will not significantly constrain the government from opportunistically taking advantage of asymmetric information in buying back claims given the murkiness of the government’s motivation. Whether the government is likely to know more than private plaintiffs about the value of a claim is an empirical question, but where it does, the auction and buyback mechanism will confront challenges resulting from adverse selection.

D. CONCLUSION

Sanderson and Trebilcock and Rosenberg and Sullivan offer excellent analyses of the state of class action conspiracies in North America and offer thought-provoking suggestions for reform. The objective of this comment has been to suggest that fully appreciating the information structure about the value of class actions is essential both to understanding and possibly justifying current practice, particularly the emphasis on follow-on actions, and to understanding the implications of reform to current regimes.

¹³ Rosenberg & Sullivan, above note 2, Section E, "Conclusion."