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Commentary: Tainted Costs Revisited

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COMMENTARY

Editor's Note: The following comments by Mr. McKinney and Professor Kuhlman are based on their presentations to the St. Louis Bar Association, November 16, 1971. These two experts—one a lawyer, the other an economist—have been engaged in a continuing dialogue on how best to achieve the objectives of the antitrust laws. The precise issue discussed here, the admissibility of cost data in defense of an antitrust conspiracy charge, was the subject of a previous article-response in the Business Lawyer. The primary objective of both the authors and the Quarterly is to promote a continuing dialogue between lawyers and economists.

TAINTED COSTS REVISITED

Luther C. McKinney*

The position I have maintained and continue to maintain in this continuing exchange of views with Dr. Kuhlman is that a defendant in a treble damage price fixing case should be allowed to introduce economic evidence, such as his own contemporaneous costs, to defeat claims being made against him.1 On the other hand, Dr. Kuhlman, a Professor of Economics, disagrees, urging instead that the use of such cost data—as well as other economic information—should not be allowed until adjusted or “detainted” by the defendant to reflect the costs which would have obtained in the absence of the very conspiracy which the defendant denies ever existed.2

The subject of our controversy appears in only a few reported decisions.3 Courts’ rulings on the question are normally rendered in

* Member of the Illinois Bar.
2. Kuhlman, The Reliability of Costs in a Collusive Market: A Comment, 25 Bus. Law. 351 (1969). Indeed it appears that Dr. Kuhlman would urge the same rule as to all economic factors including capacity, capacity utilization, demand, backlogs, orders and the like. Id. at 353.
unreported pretrial conferences. Also, where defendants have been precluded from using this type of evidence in their defense, for the reasons championed by Dr. Kuhlman, they have often chosen to settle the case rather than litigate or appeal the matter.

Our prior exchange of views has already exposed a basic problem. Dr. Kuhlman, a non-lawyer, expressly disclaims an intent to "explore any legal issue which may be involved." Similarly, most members of my profession, including myself, do not purport to be experts in economics. Thus I see a danger of misunderstanding and failure to focus on the real issues if each of us must resort entirely to the jargon of our respective professions. Accordingly, I shall try to point out what in Dr. Kuhlman's thesis bothers me, recognizing that to do so may brand me as a self-proclaimed economist.

First, Dr. Kuhlman's thesis for excluding contemporaneous costs as evidence is premised on an assumption that a conspiracy exists merely because it is charged by the plaintiff. This is clear from his statement that the "basic economic issue in a treble damage action is the estimation of damages. . . ." With this I cannot agree. Except in the very unusual case, the most basic issue—economic or otherwise—is whether there is a conspiracy at all.

Even where a government criminal or civil case precedes the private treble damage case, the issue of conspiracy often remains a central issue for one of several reasons. This may be because a defendant wins the government case. Also, the defendant may have pleaded nolo contendere to the charge. Even where a judgment of guilt has been entered after the taking of testimony in the prior case the government case may have involved a local conspiracy, rather than a much broader regional or national conspiracy alleged in the private complaint.


6. Kuhlman, supra note 2, at 351.

7. Id. at 353.
The use of economic evidence—including cost data—in contesting the issue of conspiracy is not a new or novel one, and the effectiveness of the use of such data to disprove conspiracy has been demonstrated. More than twenty years ago, members of the St. Louis Bar, in *Pevely Dairy Co. v. United States*,\(^8\) successfully demonstrated that all price changes alleged by the government to have resulted from collusion were in fact justified by cost increases or decreases.

The trial court in *Continental Baking Co. v. United States*\(^9\) adopted a rationale analogous to Dr. Kuhlman's and refused to permit defendants in a price fixing case to introduce evidence that their prices resulted from economic factors rather than collusive agreements. On appeal, this ruling was held to be erroneous on the ground that it was for the jury to weigh the evidence of these economic factors against meetings among competitors proven by the government and determine the inference to draw.\(^10\)

Thus my position finds support at the appellate level in the federal courts and has support in economic literature as well. Professor W. Bruce Erickson of the University of Minnesota made this clear when he explained that:

> ... the lines of demarcation among activities reflecting price fixing, various forms of tacit but not legally actionable collusion, and competition are imprecise.

> Under such conditions, cost data become an essential adjunct to price series data. ... Where objective confirmation of the existence and the effects of conspiracy from economic data is required, access to and subsequent use of cost information become of primary importance.\(^11\)

I believe that time will prove wrong Judge Robson's decision to the contrary on this issue in *Commonwealth Edison Co. v. Allis-Chalmers Mfg. Co.*\(^12\) There, the defendant contended that its actual costs were relevant to refute the conspiracy allegations on which the court had previously declined to enter a summary judgment for the plaintiff. The court would not permit the use of defendant's cost data on the theory that this cost evidence might be tainted.

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10. 281 F.2d at 143.
Judge Feinberg in the *Ohio Valley Electric* case expressed what I believe to be the better reasoned position that defendants are permitted to introduce economic data to show that price movements and levels were the result of economic forces rather than conspiracy.\(^\text{13}\) Judge Robson distinguished this case on the ground that it was a bench trial, not a jury trial. However, Judge Bolt in *Washington Public Power System v. American Pipe & Construction*,\(^\text{14}\) a subsequent jury trial, did permit defendants to introduce cost evidence. Thus I believe that the weight of authority is for the admissibility of economic evidence to refute the existence of conspiracy.

The next problem I have with Dr. Kuhlman's thesis is that it would foreclose the use of such evidence to refute the claim that a conspiracy damaged plaintiff in a measurable amount. Dr. Kuhlman states "that there is an *a priori* basis in economics for challenging industry data where that data was generated by the firms in the industry controlled by the price-fixing arrangement."\(^\text{15}\) However, to my knowledge, two of his fellow economists, Professors Richard Leftwich\(^\text{16}\) and Morris A. Adelman,\(^\text{17}\) have taken the position that there is no immutable economic rule that a conspiratorial combination among sellers necessarily or probably has the effect of significantly raising the sellers' costs in such a market.

Neither I, nor I believe Professors Adelman and Leftwich, would argue the obverse of Dr. Kuhlman's position—that conspiracy cannot affect costs; however, I would urge that it should be incumbent upon the plaintiff to come forward and show that costs are in fact inflated. The fact that plaintiffs have done so in prior cases demonstrates that this is not such an impossibility as to warrant shifting the burden to the defendant to prove a negative.\(^\text{18}\)

I would inquire of Dr. Kuhlman (1) whether his "*a priori* basis" is any more than a theoretical possibility and (2) whether it always fol-


\(^{14}\) Civ. No. 6568 (W.D. Wash. 1968).


allows as night the day from his "a priori basis" "that collusive agreements will affect costs." A no answer to either one of these questions would appear to me from a legal point of view to relieve a defendant of any possible burden to detain cost evidence.

Dr. Kuhlman postulates that where price is increased through collusion, the total numbers of units purchased may fall, thus increasing the cost per unit. However, Dr. Kuhlman himself recognizes that this is not an economic rule of universal applicability by acknowledging that it does not apply where the demand for the product is inelastic. He illustrates his general proposition by noting that "the unit costs of 1000 transformers will tend to be higher than unit costs of 2000 transformers." But in a footnote he explains that costs really would not be increased for this reason in the case of transformers because "the demand is relatively inelastic and thus higher price would not result in a proportionate reduction in quantity sold." I would also point out that there is a flaw in the application of Dr. Kuhlman's basic postulate to any antitrust case. He is on record as having said that "[a] necessary condition for the existence of a price fixing ring is an industry demand which permits the participating firms to raise prices without experiencing a proportionate reduction in quantity." Put another way, the demand for the product must be inelastic. Thus, Dr. Kuhlman's prerequisite for an effective conspiracy precludes any increase in costs resulting from an increase in price.

Professor Erickson suggests that an opposite conclusion with respect to Dr. Kuhlman's basic postulate is possible. He has said:

A more persuasive argument is that, if the conspiracy is successful in impeding entry or in encouraging exit, given economies of scale, the net result could be to lower costs.

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20. Id. at 352.
21. Id. at 352 n.2. In an earlier article Dr. Kuhlman noted that "the quantity of transformers sold would not be responsive to changes in price." Kuhlman, Theoretical Issues In the Estimation of Damages In a Private Antitrust Action, 33 Southern Econ. J. 548, 549 (1967).
22. Kuhlman, Theoretical Issues In the Estimation of Damages In a Private Antitrust Action, 33 Southern Econ. J. 548, 551 (1967). Or as stated another way by Dr. Kuhlman, "as the ring raises the price above the noncollusive level, there must not be a relatively large drop in sales volume." Kuhlman, The Nature and Significance of Price Fixing Rings, 2 Antitrust L. and Econ. Rev. 69, 73 (1969).
23. Erickson, supra note 11, at 359 n.27.
Dr. Kuhlman has also speculated that costs will be raised because output will have been allocated by conspiracy rather than competition, thereby siphoning production to inefficient firms. In the first place, this necessarily assumes widely varying efficiencies and cost levels. It presupposes that absent conspiracy, the inefficient firms will go out of business and that their volume can be added to the remaining firms with the effect of every decreasing cost. Depending on a variety of factors, such as capacity, this may not be the fact. Here again, such speculation is a weak reed upon which to ground a rule that contemporaneous costs are presumptively unreliable.

Finally Dr. Kuhlman and I do agree on one point, and I quote: "... there is no generally accepted economic theory or empirical evidence to the effect that collusion dulls the incentive for increased efficiency."\(^24\) However, we part company there because Dr. Kuhlman adds that "it certainly seems reasonable to assume that a firm earning 5 percent on its investment will be somewhat more interested in increased efficiency than the firm which is earning 50 percent or more."\(^25\) It is difficult for me as a lawyer to conceive of a rule which would permit the receipt of evidence if an alleged co-conspirator demonstrated a small return on its investment but which would deny the receipt if an alleged co-conspirator has a larger return.

I submit that defendants' cost data should be treated as any other evidence and should be admissible subject to attack on the same basis. Any limitations on the relevance of cost data should go to their evidentiary weight and not to their admissibility.

I suspect that some courts will not welcome the additional economic evidence due to its time consuming nature. However, I do not see how our adversary system of justice can work in these complex cases if economic data from both sides is not furnished to the trier of fact, whether it be judge or jury. Indeed, I believe, in a price fixing case, jurors expect some cost information. In this connection I am informed that jurors in one antitrust case indicated that adverse inferences were drawn against a defendant because costs were not introduced; in that case such costs had not been introduced because of a ruling which refused to permit the introduction of that evidence. I do not believe that such a result should obtain in our courts.

\(^24\) Kuhlman, supra note 2, at 352.
\(^25\) Id. at 353.