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Apportioning Damages between Direct and Indirect Purchasers in Consolidated Antitrust Suits: ARC America Unravels the Illinois Brick Rule

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APPORTIONING DAMAGES BETWEEN DIRECT AND INDIRECT PURCHASERS IN CONSOLIDATED ANTITRUST SUITS: *ARC AMERICA* UNRAVELS THE *ILLINOIS BRICK* RULE

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I. INTRODUCTION: THE APPLICATION OF THE WRECKING BALL
TO *ILLINOIS BRICK*

IN *California v. ARC America Corp.*¹ the United States Supreme Court held that *Illinois Brick Co. v. Illinois*,² which limits damage recoveries in federal antitrust suits³ to direct purchasers, does not prevent indirect purchasers from recovering damages⁴ under state antitrust law.⁵ Federal antitrust law does not preempt state antitrust law with respect to the damage recovery issue.⁶ However, the *ARC America* decision completely undermines the specific policy rationales that the Court used to justify the simplistic direct purchaser rule in *Illinois Brick*, namely: (1) the threat of duplicate liability, (2) the problem of how to apportion damages among direct and indirect purchasers, and (3) the need for manageable judicial standards to deal with the complicated and theoretical nature of pass-on proof. In addition, the *ARC America* decision resurrects the precise problems the Court thought it had buried twelve years ago when it adopted that rule.⁷ This section elaborates on the divergence between *Illinois Brick* and *ARC America*. The remainder of the article attempts to provide a solution to the problems posed.

The first point to address after *ARC America* is that the decision is virtually certain to result in the filing of state and federal suits against antitrust violators for illegal overcharges by both direct and indirect purchasers. It is also highly likely that both direct and indirect purchasers will be consolidated or joined in one suit, whether in a state or federal court.

Consolidation will occur if a direct purchaser institutes an an-

1. 109 S. Ct. 1661 (1989).

2. 431 U.S. 720 (1977).

3. Section 1 of the Sherman Act, 15 U.S.C. § 1 (1988), provides in pertinent part: "Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal."

4. The *Illinois Brick* rule is limited to damage recoveries and does not prohibit suits by indirect purchasers for injunctions. See, e.g., *In re Beef Indus. Antitrust Litig.*, 600 F.2d 1148, 1167 (5th Cir. 1979) (indirect purchasers entitled to injunctive relief), *cert. denied*, 449 U.S. 905 (1980); *Mid-West Paper Prods. Co. v. Continental Group, Inc.*, 596 F.2d 573, 589-94 (3d Cir. 1979). Therefore, although the policies behind the direct purchaser rule overlap those of rules for standing in that they share remoteness, duplication, and apportionment rationales, the concepts are not coextensive. See *Illinois Brick*, 431 U.S. at 728 n.7; P. AREEDA & H. HOVENKAMP, *ANTITRUST LAW* ¶ 337.2 (Supp. 1989).

5. *ARC America*, 109 S. Ct. at 1667.

6. *Id.*

7. *Illinois Brick*, 431 U.S. at 730-33 & n.12.

trust suit under federal law when contemporaneous indirect purchaser litigation, predicated on the same facts, has been filed in state courts. This results because a federal court is likely to grant a defendant's motion to remove the state suits based upon its diversity⁸ or pendant⁹ jurisdiction after examining the policy considerations underlying multidistrict litigation,¹⁰ which may be applied to state antitrust actions.¹¹

Conversely, if an indirect purchaser institutes an antitrust suit under state law, a state court is likely to grant a defendant's motion for compulsory joinder of direct purchasers because both direct and indirect purchasers have claims to a "common fund." Thus, in order to prevent the potential for duplicate liability in

8. 28 U.S.C. § 1332(a) (1982).

9. *Id.* § 1441.

10. The purpose of 28 U.S.C. § 1407(a) (1982) is to minimize inefficiencies, waste of judicial effort, and contradictory judicial administration occasioned by the existence of similar law suits in diverse jurisdictions. It was enacted in response to the flood of litigation involving private antitrust treble-damage actions against the electrical equipment industry in the early 1960s. H.R. REP. NO. 1130, 90th Cong., 1st Sess. 1-4 (1967). This section provides:

When civil actions involving one or more common questions of fact are pending in different districts, such actions may be transferred to any district for coordinated or consolidated pretrial proceedings. Such transfers shall be made by the judicial panel on multidistrict litigation authorized by this section upon its determination that transfers for such proceedings will be for the convenience of parties and witnesses and will promote the just and efficient conduct of such actions. Each action so transferred shall be remanded by the panel at or before the conclusion of such pretrial proceedings to the district from which it was transferred unless it shall have been previously terminated: provided, however, That the panel may separate any claim, cross-claim, counter claim, or third-party claim and remand any of such claims before the remainder of the action is remanded.

28 U.S.C. § 1407(a) (1982).

11. See Note, *Simultaneous Filing of State and Federal Antitrust Actions: A Jurisdictional Dilemma*, 41 U. PITT. L. REV. 629, 633 (1980) (noting significance of question whether policy considerations underlying multidistrict litigation are of such vital importance that federal jurisdictional requirements should be waived and rules of multidistrict litigation applied to state antitrust actions). *But see ARC America*, 109 S. Ct. 1661. The Supreme Court, ignoring the actual facts in *ARC America* in which state and federal suits were consolidated, stated:

Federal courts have the discretion to decline to exercise pendent jurisdiction over state indirect purchaser claims. . . . Since many state indirect purchaser actions would be heard in state courts, at least when the federal courts determined that hearing those claims would be overly burdensome, any complication of federal direct purchaser actions in federal courts would be minimal.

Id. at 1666 (citation omitted); see also *In re Sugar Antitrust Litig.*, 588 F.2d 1270, 1274 (9th Cir. 1978) (based on consideration of *Illinois Brick*, Ninth Circuit vacated district court's denial of remand back to state court of state antitrust suits that had been removed to federal courts to be heard with consolidated *Sugar* multidistrict litigation cases), *cert. denied*, 441 U.S. 932 (1979).

another suit, state courts will grant compulsory joinder.¹² In fact, state indirect purchaser statutes often direct courts to take the steps necessary to avoid duplicate recovery by means including the transfer and consolidation of suits.¹³

Furthermore, defendants are unlikely to be willing to negotiate a settlement unless they are released from both direct and indirect purchaser claims simultaneously. This occurs because of the defendants' desires to reach settlements that result in "total peace,"¹⁴ a state most easily achieved when all parties are represented in a consolidated action. Finally, in *ARC America* the Ninth Circuit noted that "res judicata principles may require a plaintiff with both direct and indirect claims against a single defendant to bring them together in one lawsuit."¹⁵

This coexistence of both direct and indirect purchaser antitrust suits, especially if the suits are joined or consolidated in a state or federal court, raises a second concern. Litigation by both types of purchasers undermines the three policy rationales behind the United States Supreme Court's rigid *Illinois Brick* rule, which

12. See, e.g., *Union Carbide Corp. v. Superior Court*, 133 Cal. App. 3d 443, 183 Cal. Rptr. 318, 322 (1982) (in dicta court stated that "real parties appear to concede, that [defendant] petitioners cannot be required to pay twice for the same overcharge"), *vacated*, 36 Cal. 3d 15, 679 P.2d 14, 201 Cal. Rptr. 580 (1984).

13. See, e.g., MINN. STAT. § 325D.57 (1981 & Supp. 1990) ("In any subsequent action arising from the same conduct, the court may take any steps necessary to avoid duplicative recovery against a defendant."); R.I. GEN. LAWS § 6-36-12(g) (1985) (excludes relief that would duplicate recovery); S.D. CODIFIED LAWS ANN. § 37-1-33 (1986) ("In any case in which claims are asserted against a defendant by both direct and indirect purchasers the court shall take all steps necessary to avoid duplicate liability for the same injury including transfer and consolidation of all action.")

14. *In re Chicken Antitrust Litig.*, 669 F.2d 228, 238-39 (5th Cir. 1982); *In re Corrugated Container Antitrust Litig.*, 643 F.2d 195, 221-22 (5th Cir. 1981) (release of state law claims was one part of settlement of federal antitrust case); *Oswald v. McGarr*, 620 F.2d 1190, 1197-98 (7th Cir. 1980) (release of future claims was important element of antitrust settlement).

15. *In re Cement & Concrete Antitrust Litig.*, 817 F.2d 1435, 1446 (9th Cir. 1987), *rev'd on other grounds sub nom. California v. ARC America Corp.*, 109 S. Ct. 1661 (1989). On appeal, however, the Supreme Court said that "state indirect purchaser actions will not necessarily be brought in federal court." *ARC America*, 109 S. Ct. at 1666. In this case, the plaintiff states filed both federal and state claims. *In re Corrugated Container* was a post-*Illinois Brick* case in which the Fifth Circuit upheld a settlement that released defendants from both federal and state claims, though the state claims were not pending in federal district court. The court held that in cases where class members were notified that their state law claims might be released before they had to decide whether to opt out of the class, by the weight of authority, a court may release not only those claims alleged in the complaint and before the court, but also claims that could have been alleged by reason of, or in connection with, any matter of fact set forth or referred to in the complaint. *In re Corrugated Container*, 643 F.2d at 221-23.

limits damage recoveries to direct purchasers in federal antitrust suits.

In *Illinois Brick* the Court asserted that a rigid but manageable judicial standard was necessary because proof of whether direct purchasers had passed-on costs to indirect purchasers would be too complex and theoretical for courts to evaluate accurately.¹⁶ After *ARC America*, however, both state courts and federal courts hearing consolidated direct-indirect purchaser antitrust claims will have to deal with complex apportionment and class action issues. *ARC America* therefore undermines the manageable judicial standard rationale for the direct purchaser rule.

Additionally, the *Illinois Brick* rule was supposed to eliminate the risk that defendants would be exposed to multiple liability from inconsistent judgments.¹⁷ Such a risk is significant especially when damage awards are trebled as they are under federal¹⁸ and many state¹⁹ antitrust laws. However, the *ARC America* decision allows the use of the pass-on theory in state suits even though *Illinois Brick* prohibits its use in federal suits, making duplicative and inconsistent recovery for the same injury much more likely.²⁰ Consequently, *ARC America* also undermines the policy

16. *Illinois Brick*, 431 U.S. at 741-42.

17: *Id.* at 730-31 & n.11; *accord* *Associated Gen. Contractors Inc. v. California State Council of Carpenters*, 459 U.S. 519, 534-35 (1983); *Blue Shield v. McCready*, 457 U.S. 465, 474-75 (1982).

18. Section 4 of the Clayton Act provides in part:

Any person who shall be injured in his business or property by reason of anything forbidden in the antitrust laws may sue therefore in any district court of the United States in the district in which the defendant resides or is found or has an agent, without respect to the amount in controversy, and shall recover threefold the damages sustained by him, and the cost of the suit, including a reasonable attorney's fee.

15 U.S.C. § 15(a) (1988).

Circuit Judge Richard Posner has argued that a simple damage remedy is insufficient because many antitrust violations are concealable:

The successful antitrust plaintiff is entitled to a tripling of his compensatory damages, so that two-thirds of every antitrust damage award represents punitive damages [T]his would be sensible if there were a one-third chance of catching the antitrust violator [F]or concealed violations (mainly price-fixing conspiracies) the probability, although lower than one, is not always one-third.

R. POSNER, *ECONOMIC ANALYSIS OF LAW* 293 (3d ed. 1986).

19. *See, e.g.*, LA. REV. STAT. ANN. § 51.137 (West 1987); N.C. GEN. STAT. § 75-16 (1989); OR. REV. STAT. § 646.775 (1989); UTAH CODE ANN. § 76-10-919 (1989); WASH. REV. CODE ANN. § 19.86.090 (1989). *But see* ALA. CODE § 6-5-60(a) (1975) (actual damages); OHIO REV. CODE ANN. § 1331.08 (Baldwin 1989) (twofold damages).

20. After *ARC America* pass-on theory may be used by either plaintiffs or defendants in state suits even though *Illinois Brick* prohibits its use in federal

against duplicate liability that supported the *Illinois Brick* decision.

Moreover, the *Illinois Brick* Court asserted that the dispersion of damage awards between direct and indirect purchasers might, by rendering individual awards smaller and more uncertain, discourage suits and thereby reduce the deterrent value of private antitrust enforcement.²¹ If this assertion is correct, the Court's *ARC America* decision, which allows indirect purchasers to share damage recoveries with direct purchasers in consolidated state and federal antitrust suits surely will exacerbate that tendency.²² The permission of damage apportionment undermines *Illinois Brick's* third policy rationale.²³

Another point to address is whether the deterrence goal will be furthered by the recovery of damages in "tag-along" or "follow-on" suits. If we were concerned merely with suits that follow-on after antitrust suits are initiated by the federal government, the simplicity of a direct purchaser rule would have much to recommend it on deterrence grounds. Indeed, follow-on suits by direct purchasers would probably deter antitrust violations as well as follow-on suits by indirect purchasers.

However, if we are also concerned with encouraging states and private parties to initiate antitrust suits on their own, to perform their statutory role as "private attorneys general,"²⁴ then

suits. *ARC America*, 109 S. Ct. at 1666. For a discussion of the economic theory of pass-on, see *infra* notes 149-63 and accompanying text.

21. *Illinois Brick*, 431 U.S. at 745.

22. Apparently, the *ARC America* Court was not persuaded by this argument: "That direct purchasers may have to share with indirect purchasers is a function of the fact and form of settlement rather than the impermissible operation of state indirect purchaser statutes." *ARC America*, 109 S. Ct. at 1667.

23. Although the *Illinois Brick* Court acknowledged that limiting damage recoveries to direct purchasers would not serve the goal of compensating all parties who were injured by antitrust violations, it asserted that "on balance . . . the legislative purpose in creating a group of 'private attorneys generals' 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." *Illinois Brick*, 431 U.S. at 746 (citation omitted).

24. "Private attorneys general" were envisaged because of the great potential for anticompetitive behavior in the vast American economy in comparison to the limited resources that the Justice Department's Antitrust Division can devote to deter such behavior. See *Hawaii v. Standard Oil Co.*, 405 U.S. 251, 262 (1972); see also *Illinois Brick*, 431 U.S. at 746; *Zenith Radio Corp. v. Hazeltine Research, Inc.*, 395 U.S. 100, 130-33 (1969); cf. *Illinois Brick*, 431 U.S. at 764 n.23 (Brennan, J., dissenting); see generally 15 U.S.C. § 15 (1988) (§ 4 of Clayton Act), reproduced at *supra* note 18. Section 4c of the Clayton Act, 15 U.S.C. § 15c (1988), provides in pertinent part:

(a)(1) Any attorney general of a State may bring a civil action in the name of such State, as *parens patriae* on behalf of natural persons residing in such State, in any district court of the United States having

the right to recover damages should be awarded to the party most likely to investigate and initiate antitrust suits on its own. The deterrence goal favors granting damages to the party, whether direct or indirect purchaser, who is most likely to initiate meritorious antitrust suits independent of the federal government.²⁵ This consideration looms large in indirect purchaser suits brought as consumer class actions or by states in their *parens patriae* capacity.²⁶ Although not mentioned explicitly in *ARC America*, this aspect of the deterrence goal—that of encouraging states and private parties to initiate antitrust suits independent of the Justice Department—probably weighed heavily in the Court's refusal to find federal preemption of state indirect purchaser statutes.

An additional consideration in the wake of *ARC America* is the Court's failure to provide any criteria for coordinating the potentially duplicative and inconsistent damage remedies in consolidated state and federal antitrust suits. Without some criteria for apportioning damages between direct and indirect purchasers in consolidated state and federal antitrust suits, there are currently three unattractive possibilities.

The first involves permitting duplicative and inconsistent direct (federal) and indirect (state) antitrust liability. This is unwise and unlikely on policy grounds because duplicative, treble dam-

jurisdiction of the defendant, to secure monetary relief is provided in this section for injury sustained by such natural persons to their property by reason of any violation of [the Sherman Act]. The court shall exclude from the amount of monetary relief awarded in such action any amount of monetary relief (A) which duplicates amounts which have been awarded for the same injury, or (B) which is properly allocable to (i) natural persons who have excluded their claims pursuant to subsection (b)(2) of this section, and (ii) any business entity.

(2) The court shall award the States as monetary relief threefold the total damage sustained as described in paragraph (1) of this subsection, and the cost of suit, including a reasonable attorney's fee.

Id.

25. See *Illinois Brick*, 431 U.S. at 745-46; *Hawaii v. Standard Oil Co.*, 405 U.S. at 262-63.

26. Cf. CAL. BUS. & PROF. CODE § 16750(d) (West 1988) ("In any antitrust action brought on behalf of the state in which the Attorney General is the class representative of . . . citizens of the state who have been affected by the matters set forth in the complaint, the state shall retain . . . the proceeds . . ."); N.Y. GEN. BUS. LAW § 342 (McKinney 1988) ("The attorney-general may bring an action in the name and in behalf of the people of the state against any person . . . to restrain and prevent the doing in this state of any act herein declared to be illegal. . . . In such an action, the court may award to the plaintiff a sum not in excess of twenty thousand dollars as an additional allowance."); S.D. CODIFIED LAWS ANN. § 37-1-23 (1986) ("The attorney general may bring a civil action in the name of the state, as *parens patriae* on behalf of the natural persons residing in the state.").

ages could result in crushing multiple liability for defendants.²⁷

The second possibility is that direct purchasers could be given the entire damage remedy in consolidated direct-indirect purchaser antitrust suits. Although consistent with *Illinois Brick*, this result would make indirect purchaser suits unremunerative and would in effect preempt state damage recoveries contrary to *ARC America*.

Finally, a de facto, partial repeal of *Illinois Brick* could be fashioned to allow damage apportionment between direct and indirect purchasers. However, with direct purchasers getting the lion's share of damages due to the potentially preemptive power of federal law, this apportionment may not be based upon reasoned principles.²⁸ In cases like *ARC America*, where the antitrust investigation and suit were initiated by indirect purchasers and the direct purchaser suits were mere tag-alongs,²⁹ this result would discourage private antitrust enforcement. Clearly, this would seriously compromise the goal of deterrence.

In order to provide a solution to these problems, it is necessary to develop criteria for damage apportionment between direct and indirect purchasers in consolidated state and federal antitrust suits. Given the *Illinois Brick* rule and the potentially preemptive power of federal law, direct purchasers are likely to be awarded the lion's share of damages in consolidated state and federal cases regardless of the merits or the relevant policy considerations. At the very least, an exception should be made in cases in which the indirect purchasers are the real interested parties, and it is they who have initiated the investigation of the violation and commenced the antitrust suit. This was the case in *ARC America*,

27. Given the *Illinois Brick* rule, which dictates that the direct purchaser is entitled to the entire damage recovery, the problem of duplicate recovery cannot be resolved by consolidating trials of state, indirect purchaser and federal, direct purchaser antitrust suits unless the state law authorizing indirect purchaser liability is rendered null. For example, the South Dakota statute that permits the consolidation of state and federal actions to avoid duplicate liability actions provides in pertinent part: "In any case in which claims are asserted against a defendant by both direct and indirect purchasers the court shall take all steps necessary to avoid duplicate liability for the same injury including transfer and consolidation of all actions." S.D. CODIFIED LAWS ANN. § 37-1-33 (1986); see also *infra* notes 120-24 and accompanying text (discussing Ninth Circuit's analysis of this problem in *ARC America*).

28. See *ARC America*, 109 S. Ct. at 1667 ("That direct purchasers may have to share with indirect purchasers is a function of the fact and form of settlement rather than the impermissible operation of state indirect purchaser statutes.").

29. *Id.* at 1663-64.

where the states, who according to pass-on theory³⁰ were in all probability the most injured of all potential plaintiffs³¹ (*i.e.*, the federal, direct purchaser suits were merely tag-alongs), initiated the antitrust suit. Consequently, when consolidated direct-indirect purchaser suits are initiated under state law, as opposed to consolidated suits initiated by the federal government or direct purchasers, courts should not be required to adhere to federal priorities that favor direct purchasers. Instead, the courts should be free to apportion damages between direct and indirect purchasers so as to accommodate the four, not always consistent, policy goals of antitrust law: compensating injured parties,³² deterring antitrust violations,³³ avoiding multiple liability,³⁴ and employing manageable judicial standards.³⁵

In antitrust suits initiated under state law, these four policies can best be effectuated if courts avoid the extremes of the Court's rigid *Illinois Brick* rule—a complex, theoretical calculation in each case of the exact amount of overcharge a direct purchaser can pass-on to the next level.³⁶ Such a calculation is beyond the technical competence of courts³⁷ because it requires knowledge of the prevailing elasticities³⁸ of supply and demand at each level of production and distribution. If courts could make such measurements, they would be able to measure such attributes as market power directly and decide monopoly and merger cases without the need to define relevant markets and market shares.³⁹

When consolidated state and federal antitrust suits which involve both direct and indirect purchasers are initiated under state

30. For a discussion of the economic theory of pass-on, see *infra* notes 149-63 and accompanying text.

31. For further discussion of this issue, see *infra* notes 165-83 and accompanying text.

32. See *Illinois Brick*, 431 U.S. at 746.

33. *Id.*

34. *Id.* at 730-31 n.11.

35. See *id.* at 737, 741-42; *Hanover Shoe, Inc. v. United Shoe Mach. Corp.*, 392 U.S. 481, 492-93 (1968).

36. See 2 P. AREEDA & D. TURNER, *ANTITRUST LAW* § 337(e) (1978).

37. For the relevant formulas, see Landes & Posner, *Should Indirect Purchasers Have Standing to Sue Under the Antitrust Laws? An Economic Analysis of the Rule of Illinois Brick*, 46 U. CHI. L. REV. 602, 615-25 (1979).

38. Elasticity is defined as the ratio of the percentage change in quantity demanded (or supplied) to the percentage change in price. See W. BAUMOL & A. BLINDER, *ECONOMICS: PRINCIPLES AND POLICY* 379-85 (3d ed. 1985); P. SAMUELSON & W. NORDHAUS, *ECONOMICS* 379-84 (12th ed. 1985). For a discussion of the economic theory of the pass-on problem, see *infra* notes 149-63 and accompanying text.

39. H. HOVENKAMP, *ECONOMICS AND FEDERAL ANTITRUST LAW* 367 (1985).

law,⁴⁰ this article suggests three presumptions for apportioning damages. These presumptions are suggested by economic theory and an analysis of state and federal cases (including federal cases decided before the rigid direct purchaser rule was established in *Illinois Brick*, as well as state and consolidated state and federal cases decided after that case). The presumptions occupy an intermediate position between the extreme of a rigid direct purchaser rule and the other extreme of a complex, theoretical pass-on analysis in each case. They also accommodate the four antitrust policies better than either of the extreme solutions. Congressional legislation may be necessary to reduce the preemptive power of the *Illinois Brick* rule in suits initiated under state law. A more general repeal of *Illinois Brick* would employ the following presumptions in all consolidated direct and indirect purchaser antitrust suits, whether initiated under state or federal law.

Presumption I: In antitrust suits initiated under state laws that involve public or commercial construction contracts, the buyers for whom the projects were constructed, whether direct or indirect purchasers, should be the preferred parties to recover damages for illegal overcharges.

Presumption II: In antitrust suits initiated under state laws that involve products sold without alteration (*i.e.*, final products), consumer class actions or state *parens patriae* suits, whether on behalf of direct or indirect purchasers, should be the preferred means of recovering damages for illegal overcharges.

Presumption III: In antitrust suits initiated under state laws that involve products altered after sale (*i.e.*, intermediate products in a long chain of production and distribution), the party who initiates an antitrust suit independent of the federal government, whether direct or indirect purchaser, should be the preferred party to recover damages for illegal overcharges.

The remainder of this article has been divided into seven sections. Section two contains further analysis of the *Illinois Brick* case, a decision that established the rigid rule that bars indirect purchasers from federal antitrust recoveries.⁴¹ Section three presents a discussion of congressional and state legislative re-

40. A total repeal of *Illinois Brick* would require damage apportionment between direct and indirect purchasers in all consolidated state and federal suits regardless of whether the suits were initiated in state or federal courts.

41. For a discussion of the *Illinois Brick* rule, see *supra* notes 16-23 & *infra* notes 48-79 and accompanying text.

sponses to *Illinois Brick*.⁴² Section four demonstrates that *ARC America* undermines the policy rationales for the rigid direct purchaser rule in consolidated state and federal antitrust suits involving both direct and indirect purchasers.⁴³ Section five presents the argument that presumptions for apportioning damages are preferable to either a rigid rule or a complex theoretical analysis in each case if one's goal is to accommodate the four relevant antitrust policy goals.⁴⁴ Section six presents a discussion of the economic theory of the pass-on problem.⁴⁵ In section seven, both economic theory and an analysis of state and federal cases (including federal cases before the rigid direct purchaser rule was established in *Illinois Brick*, as well as state and consolidated state and federal antitrust cases after that decision) are used to suggest three presumptions for apportioning damages in antitrust suits initiated under state law.⁴⁶ The final section presents concluding thoughts on these issues.⁴⁷

II. THE RATIONALE BEHIND THE RIGID *ILLINOIS BRICK* RULE BARRING INDIRECT PURCHASERS FROM FEDERAL ANTITRUST RECOVERIES

*United States v. United Shoe Machine Corp.*⁴⁸ was an antitrust suit instituted by the federal government in which the defendant was convicted of monopolizing the shoe machinery market.⁴⁹ *Hanover Shoe, Inc. v. United Shoe Machine Corp.*⁵⁰ was a follow-on, treble-damage action brought by a shoe manufacturer.⁵¹ *United Shoe* attempted to defend on the ground that the plaintiff, by virtue of an inelastic demand for its product, had been able to pass-on the illegal overcharge to its customers and therefore had not suffered

42. For a discussion of the legislative response to *Illinois Brick*, see *infra* notes 80-97 and accompanying text.

43. For a discussion of the effect of *ARC America* upon the policy underlying the *Illinois Brick* rule, see *supra* notes 25-35 & *infra* notes 98-138 and accompanying text.

44. For a discussion of why presumptions for apportioning damages appropriately accommodate the antitrust policy goals, see *infra* notes 140-46 and accompanying text.

45. For a discussion of the economic theory underlying the pass-on concept, see *infra* notes 147-63 and accompanying text.

46. For a discussion of the presumptions for apportioning damages, see *infra* notes 164-238 and accompanying text.

47. For the conclusion, see *infra* § VIII.

48. 110 F. Supp. 295 (D. Mass. 1953), *aff'd per curiam*, 347 U.S. 521 (1954).

49. *Id.* at 352.

50. 392 U.S. 481 (1968).

51. *Id.* at 484.

any harm.⁵² The “pass-on theory” refers to the not implausible notion that the party who should be entitled to sue for such an overcharge is the one at the end of the chain of production and distribution.⁵³

In *Hanover Shoe* the Supreme Court rejected the defendant’s attempt to use the pass-on theory defensively for two reasons. First, the Court was unwilling to complicate the “already protracted” antitrust treble-damage actions with theoretical attempts to trace the effects of the illegal overcharge through the chain of production and distribution.⁵⁴ Second, the Court determined

52. *Id.* at 491-92.

53. See Comment, *A Legal and Economic Analysis of the Cost-Plus Contract Exception in Hanover Shoe and Illinois Brick*, 47 U. CHI. L. REV. 743, 745 (1980); Cirace, *Price-fixing, Privity, and the Pass-on Problem in Antitrust Treble-Damages Suits: A Suggested Solution*, 19 WM. & MARY L. REV. 171, 172 (1977) (discussing use of pass-on theory in *Illinois Brick*).

54. See *Hanover Shoe*, 392 U.S. at 492-93. The court stated:

A wide range of factors influence a company’s pricing policies. Normally the impact of a single change in the relevant conditions cannot be measured after the fact. . . . Equally difficult to determine, in the real economic world rather than an economist’s hypothetical model, is what effect a change in a company’s price will have on its total sales. . . . Since establishing the applicability of the passing-on defense would require a convincing showing of . . . virtually unascertainable figures, the task would normally prove insurmountable. On the other hand, . . . if the existence of the defense is generally confirmed, . . . [t]reble damage actions would often require additional long and complicated proceedings involving massive evidence and complicated theories.

Id. (footnote omitted). The Court cited several precedents, arising under the transportation laws, which discussed the relationship between direct purchasers and pass-on theory. *Id.* at 490 & n.8. The first of these was *Southern Pacific Co. v. Darnell-Taenzer Lumber Co.*, 245 U.S. 531 (1918), in which a shipper sought to enforce a reparations order of the Interstate Commerce Commission (ICC) against the defendant railroad. Responding to the defendant’s argument that the plaintiffs had suffered no injury because they had passed-on the overcharge, the Court, through Justice Holmes, stated:

The general tendency of the law, in regard to damages at least, is not to go beyond the first step. As it does not attribute remote consequences to a defendant so it holds him liable if proximately the plaintiff had suffered a loss. . . . If it be said that the whole transaction is one from a business point of view, it is enough to reply that the unity in this case is not sufficient to entitle the purchaser to recover, any more than the ultimate consumer who in turn paid an increased price. *He has no privity with the carrier.* . . . The carrier ought not to be allowed to retain his illegal profit, and the only one who can take it from him is the one that alone was in relation with him. . . . Behind the technical mode of statement is the consideration, well emphasized by the Interstate Commerce Commission, of the endlessness and futility of the effort to follow every transaction to its ultimate result. . . . Probably in the end the public pays the damages in most cases of compensated torts.

Id. at 533-34 (citations omitted, emphasis supplied). In *Darnell-Taenzer* Justice Holmes expressed the notion, later adopted by Justice White in both *Illinois Brick* and *Hanover Shoe*, that the complications inherent in litigating pass-on issues jus-

that allowing direct purchasers to sue would prevent antitrust violators from “retain[ing] the fruits of their illegality.”⁵⁵ In this case the illegal overcharge occurred at an early stage in a long chain of production and distribution.⁵⁶ The Court noted that “ultimate consumers . . . would have only a tiny stake in a lawsuit and little interest in attempting a class action.”⁵⁷ However, the Court recognized a limited exception to its holding: “[T]here might be situations—for instance, when an overcharged buyer has a pre-existing ‘cost-plus’ contract, thus making it easy to prove that he has not been damaged—where the considerations requiring that the passing-on defense not be permitted in this case would not be present.”⁵⁸

Nearly a decade after *Hanover Shoe*, the state of Illinois, on behalf of 700 various governmental entities, initiated a treble-damage action against concrete block manufacturers, alleging price-fixing in violation of the Sherman Act.⁵⁹ The plaintiffs wanted to demonstrate that the illegal overcharge by defendants ultimately passed to them, as indirect purchasers from general contractors who had in turn bought from masonry contractors.⁶⁰ With *Hanover Shoe* already foreclosing the defensive use of “pass-on,”⁶¹ the Court in *Illinois Brick* adopted a rule of symmetry with

tified a rigid privity or direct purchaser rule. *Id.*; see also *Illinois Brick*, 431 U.S. at 741; *Hanover Shoe*, 392 U.S. at 493.

Two other early cases that dealt with the pass-on issue were authored by Justice Brandeis, who did not subscribe to Justice Holmes’ rigid direct purchaser requirement. In *Keogh v. Chicago & N.W. Ry.*, 260 U.S. 156 (1922), a shipper brought an antitrust action against the defendant railroads alleging a conspiracy to set unreasonably high rates. Although the Court affirmed a judgment against the shipper because the ICC had approved the rates as reasonable, the opinion ended with dictum that impliedly acknowledged the pass-on defense: “[N]o court or jury could say that, if the rate had been lower, [the plaintiff] would have enjoyed the difference between the rates or that any other advantage would have accrued to him. The benefit might have gone to his customers, or conceivably, to the ultimate consumer.” *Id.* at 165.

55. *Hanover Shoe*, 392 U.S. at 494.

56. The overcharge occurred when United leased its shoe machinery to Hanover. See *Hanover Shoe, Inc. v. United Shoe Mach. Corp.*, 245 F. Supp. 258, 274 (1965) (effect of United’s leasing practices was extraction of large sums of money in excess of reasonable value of machinery and services provided), *vacated*, 377 F.2d 776 (3d Cir. 1967), *aff’d in part and rev’d in part*, 392 U.S. 481 (1968).

57. *Hanover Shoe*, 392 U.S. at 494.

58. *Id.* For a discussion concerning antitrust suits initiated under state laws that involve component parts in intermediate products in a long chain of production and distribution, see *infra* notes 213-38 and accompanying text.

59. *Illinois Brick*, 431 U.S. at 726-27.

60. *Id.* at 727-28.

61. See *id.* at 728-29. The Court stated:

respect to the offensive use of pass-on by plaintiffs: in a federal antitrust suit, the offensive use of pass-on proof will be denied to a plaintiff if the defensive use of pass-on would be denied to a defendant in the same suit.⁶² The Court held further that only overcharged direct purchasers, and not subsequent indirect purchasers, were persons “injured in [their] business or property” within the meaning of section 4 of the Clayton Act.⁶³ Therefore, the State of Illinois was not entitled to recover under federal law for the portion of the overcharge passed-on to it.⁶⁴

The Court determined that its rigid direct purchaser rule was justified by three policy goals. One of the reasons for the rule was derived from *Hanover Shoe*'s primary conclusion that the proof as to whether costs had been passed-on would be too complex and theoretical for the courts to evaluate accurately.⁶⁵ The nature of the proof precluded either party from relying on pass on theories.⁶⁶ In addition, the Court noted that allowing offensive, but not defensive, use of pass-on would expose defendants to an unacceptable risk of multiple liability.⁶⁷ Moreover, multiple liability

Because *Hanover Shoe* would bar petitioners from using respondents' pass-on theory as a defense to a treble-damages suit by the direct purchasers (the masonry contractors), we are faced with the choice of overruling (or narrowly limiting) *Hanover Shoe* or of applying it to bar respondents' attempt to use this pass-on theory offensively.

Id. (footnote omitted).

62. *Id.* at 728.

63. For the text of the pertinent part of § 4 of the Clayton Act, see *supra* note 18.

64. *Illinois Brick*, 431 U.S. at 726-28; see *In re Sugar Indus. Antitrust Litig.*, 579 F.2d 13, 17-18 (3d Cir. 1978) (*Illinois Brick* does not bar suit by plaintiff who purchases directly from alleged offender but buys product (candy) which incorporates the price-fixed product (sugar) as one of its ingredients). The Court stated that “[t]he difficulty in computation here is not in parceling out damages among entities in the chain, but in isolating the excessive cost of one ingredient that goes into the product purchased by the plaintiff.” *Id.* at 18.

65. *Hanover Shoe*, 392 U.S. at 492-93.

66. The *Illinois Brick* Court stated:

Under an array of simplifying assumptions, economic theory provides a precise formula for calculating how the overcharge is distributed between the overcharged party (passer) and its customers (passees). . . . Even if these assumptions are accepted, there remains a serious problem of measuring the relevant elasticities In view of the difficulties that have been encountered, even in informal adversary proceedings, with the statistical techniques used to estimate these concepts, . . . it is unrealistic to think that elasticity studies introduced by expert witnesses will resolve the pass-on issue.

Illinois Brick, 431 U.S. at 741-42 (footnote omitted).

67. *Id.* at 730-31 & n.11. Multiple liability arises from the fact that the anti-trust defendant may initially be forced to pay damages in excess of three times the illegal overcharge. Because the direct purchaser is presumed to have absorbed the entire overcharge, *id.* at 730, he or she recovers three times that

is less tolerable when awards are trebled than it is in other lawsuits.⁶⁸ The Court also asserted that allowing indirect purchasers to recover damages by using the pass-on theory offensively would reduce the potential recovery of direct purchasers and thereby discourage direct purchaser suits. Further, dispersing the award among the numerous persons involved might discourage suits and necessitate complex class actions.⁶⁹

Although the Court admitted that "direct purchasers sometimes may refrain from bringing a treble-damages suit for fear of disrupting relations with their suppliers,"⁷⁰ it believed that on balance, allowing damage recovery by indirect purchasers would undermine the policy of deterring antitrust violations.⁷¹ (There has been much debate in the courts and academic journals concerning whether the *Illinois Brick* rule has increased or decreased

amount in damages. Any additional recovery by the indirect purchaser then creates liability in excess of treble the overcharge, and the multiple liability concern in *Illinois Brick* arises. *Associated Gen. Contractors, Inc. v. California State Council of Carpenters*, 459 U.S. 519, 534-35 (1983); *Blue Shield v. McCready*, 457 U.S. 465, 474-75 (1982).

68. For references to federal and state treble-damage laws, see *supra* notes 18-19.

69. *Illinois Brick*, 431 U.S. at 745.

70. *Id.* at 746. In addition to the Supreme Court, "[s]everal other courts and commentators have also recognized that a direct purchaser may not be hurt very much as a result of passing-on an overcharge and, thus, may not wish to risk the breach of a long-standing supplier relationship for the chancy potential recovery of windfall damages." *Tip Top Farms, Inc. v. Dairylea Co-op, Inc.*, 114 A.D.2d 12, 23-24, 497 N.Y.S.2d 99, 106 (1985) (citing *In re Western Liquid Asphalt Cases*, 487 F.2d 191, 198 (9th Cir.), *cert. denied sub nom. Standard Oil Co. v. Alaska*, 415 U.S. 919 (1974); *Boshes v. General Motors Corp.*, 59 F.R.D. 589, 598 (N.D. Ill. 1973); *Dunfee, Privity in Antitrust: Illinois Brick v. Illinois*, 16 AM. BUS. L.J. 107, 114 (1978); *Schaefer, Passing-On Theory in Antitrust Treble Damage Actions: An Economic and Legal Analysis*, 16 WM. & MARY L. REV. 883, 913-14 (1975); *Wheeler, Antitrust Treble-Damage Actions: Do They Work?*, 61 CALIF. L. REV. 1319, 1325 (1973); *Note, The Effect of Hanover Shoe on the Offensive Use of the Passing-On Doctrine*, 46 S. CAL. L. REV. 98, 112 (1972); *Note, Illinois Brick: The Death Knell of Ultimate Consumer Antitrust Suits*, 52 ST. JOHN'S L. REV. 421, 453 (1978)), *appeal dismissed*, 67 N.Y.2d 829, 492 N.E.2d 787, 501 N.Y.S.2d 659, *aff'd*, 69 N.Y.2d 625, 503 N.E.2d 692, 511 N.Y.S.2d 227 (1986), *cert. denied*, 481 U.S. 1029 (1987).

71. See *Illinois Brick*, 431 U.S. at 746; see also *Note, State Indirect Purchaser Statutes: The Preemptive Power of Illinois Brick*, 62 B.U.L. REV. 1241, 1242 n.14 (1982). The Court asserted that direct purchasers are more effective antitrust enforcers than indirect purchasers because the former are the more likely plaintiffs. *Id.* (citing *Illinois Brick*, 431 U.S. at 745-46). It said that indirect purchasers, by contrast, are less effective enforcers because they often have too small a stake in the litigation even if allowed to bring suits. The Court was reasserting the concern it expressed in *Hanover Shoe* that antitrust violators not be allowed to escape with the "fruits of their illegality." *Id.* (citing *Illinois Brick*, 431 U.S. at 746 (quoting *Hanover Shoe*, 392 U.S. at 494)).

deterrence.)⁷² The Court recognized that prohibiting the offensive use of pass-on theory would leave concededly injured indirect purchasers uncompensated.⁷³ The Court held, however, that the policies of judicial competence and economy,⁷⁴ avoidance of multiple liability,⁷⁵ and deterrence of antitrust violations⁷⁶ outweighed this concern.

The Court noted two possible exceptions to the direct purchaser rule. The first occurs when the direct purchaser and the indirect purchaser have entered into a pre-existing, fixed quantity,⁷⁷ cost-plus contract, where an overcharge is completely passed-on because it is just another of the direct purchaser's costs, which the indirect purchaser is committed to pay.⁷⁸ The

72. Compare Harris & Sullivan, *Passing on the Monopoly Overcharge: A Comprehensive Policy Analysis*, 128 U. PA. L. REV. 269 (1979) (*Illinois Brick* rule sacrifices goal of compensatory justice and undermines deterrence) with Landes & Posner, *supra* note 37 (*Illinois Brick* rule promotes compensatory and deterrent objectives) and Landes & Posner, *The Economics of Passing On: A Reply to Harris and Sullivan*, 128 U. PA. L. REV. 1274 (1980); see also Harris & Sullivan, *Passing on the Monopoly Overcharge: A Response to Landes and Posner*, 128 U. PA. L. REV. 1280 (1980). Some of the many other participants in the debate are noted in Benston, *Indirect Purchasers' Standing to Claim Damages in Price Fixing Antitrust Actions: A Benefit/Cost Analysis of Proposals to Change the Illinois Brick Rule*, 55 ANTITRUST L.J. 213, 214 nn. 9-10 (1986).

73. *Illinois Brick*, 431 U.S. at 746.

74. *Id.* at 741-42. The Court was concerned with both the protraction of litigation caused by complexities of proof and the capacity of courts to make pass-on determinations. These policies of judicial economy and capacity will collectively be referred to as "judicial economy." *Id.*

75. *Id.* at 730-31 & n.11; *Associated Gen. Contractors, Inc., v. California State Council of Carpenters*, 459 U.S. 519, 534-35 (1983); *Blue Shield v. McCready*, 457 U.S. 465, 474-75 (1982).

76. *Illinois Brick*, 431 U.S. at 746; see Note, *supra* note 71, at 1242 (policies outweigh possibility of noncompensation).

77. *Illinois Brick*, 431 U.S. at 736. *Hanover Shoe* had recognized the pre-existing cost-plus contract exception to the direct purchaser rule. *Hanover Shoe*, 392 U.S. at 494. This exception was further limited in *Illinois Brick* by the requirement that the pre-existing, cost-plus contract be for a fixed quantity (*i.e.*, the pre-existing, fixed quantity, cost-plus contract exception to the direct purchaser rule). *Illinois Brick*, 431 U.S. at 736.

78. *Illinois Brick*, 431 U.S. at 732 n.12 (citing *Hanover Shoe*, 392 U.S. at 494). "[S]everal courts deny the cost-plus exception unless the downstream contract specifies both markup and quantity—a situation one court suggested would be quite rare." P. AREEDA & H. HOVENKAMP, *supra* note 4, at 348; see Phillips v. Crown Central Petroleum Corp., 602 F.2d 616, 633 n.4 (4th Cir. 1979), *cert. denied*, 444 U.S. 1074 (1980); see also *Mid-West Paper Prods. Co. v. Continental Group, Inc.*, 596 F.2d 573, 577 n.9 (3d Cir. 1979); *Fisher v. Wattles*, 639 F. Supp. 7, 8-9 (M.D. Pa. 1985).

A case that possibly would meet this exacting standard is *Illinois v. Borg, Inc.*, 548 F. Supp. 972 (N.D. Ill. 1982). For a discussion of *Borg*, see *infra* notes 176-79 and accompanying text, and see P. AREEDA & H. HOVENKAMP, *supra* note 4, ¶ 337.2c.

second is "where the direct purchaser is owned or controlled by its customer."⁷⁹

III. CONGRESSIONAL AND STATE LEGISLATIVE RESPONSES TO *ILLINOIS BRICK*

Many newspaper editorials criticized the *Illinois Brick* decision as unjust to consumers, who are usually indirect purchasers and who bear the real burden of illegal overcharges that are passed-on.⁸⁰ The decision also provoked many articles in academic and

79. *Illinois Brick*, 431 U.S. at 736 n.16. Otherwise, a firm which contemplated a course of action potentially violative of the antitrust laws might create an intermediate dummy firm to insulate itself from treble-damage suits. See *In re Chicken Antitrust Litig.*, 669 F.2d 228, 239 (5th Cir. 1982); *Royal Printing Co. v. Kimberly Clark Corp.*, 621 F.2d 323, 326 (9th Cir. 1980); *In re Beef Indus. Antitrust Litig.*, 600 F.2d 1148, 1162 (5th Cir. 1979) (dictum suggesting that "credit arrangements" may provide sufficient "control"), *cert. denied*, 449 U.S. 905 (1980); *Mid-West Paper Prods. Co. v. Continental Group, Inc.*, 596 F.2d 573, 589 (3d Cir. 1979); *In re Sugar Indus. Antitrust Litig.*, 579 F.2d 13, 19 (3d Cir. 1978). The direct purchaser and the indirect purchaser may be a single entity. See *Oakland County v. City of Detroit*, 620 F. Supp. 1399 (E.D. Mich. 1985) and 628 F. Supp. 610 (E.D. Mich. 1986) (permitting pass-on defense against direct "purchaser" suit by counties against city because counties were mere "intermediary" or "collection agency" for the fees, which were received by county from smaller municipalities [indirect "purchasers"] and then paid over to defendant), *rev'd*, 866 F.2d 839 (6th Cir. 1989).

Cf. *Perkins v. Standard Oil Co.*, 395 U.S. 642 (1969). *Perkins* involved an allegation of price discrimination in violation of § 2(a) of the Robinson-Patman Act, 15 U.S.C. § 13(a) (1988). The defendant sold gasoline at an illegal discount to a firm that resold gasoline at an illegal discount to a firm that resold the gasoline to a subsidiary. In turn, the latter sold to one of its subsidiaries that competed with the plaintiff, a retail service station operator. The Ninth Circuit had held that because the plaintiff competed with a customer of a customer of a party receiving an illegal discount, his injuries were "fourth level" and unprotected by the Act. *Perkins v. Standard Oil Co.*, 396 F.2d 809 (9th Cir. 1968), *rev'd*, 395 U.S. 642, 647 (1969) (reversed because this reasoning would permit price discriminators to avoid sanctions of Act merely by adding another link in chain of distribution).

80. See *Let Overcharge Victims Sue*, Salt Lake City Desert News, Oct. 9, 1978; *Congress Should Act to Uphold Lawsuits*, Tallahassee Democrat, Sept. 25, 1978; *A Brick Wall of Obstruction*, Boston Globe, Aug. 22, 1978; *Restore the Antitrust Law*, Wisconsin Newspaper Ass'n, Aug. 18, 1978. For a listing of 25 additional newspapers (including the *New York Times* and *Washington Post*) in which similar editorials have appeared, see *Restoring Effective Enforcement of the Antitrust Laws: Hearings on H.R. 2060 and 2204 Before the Subcomm. on Monopolies and Commercial Law of the House Comm. on the Judiciary*, 96th Cong., 1st Sess. 398 (1979).

professional journals, both supporting⁸¹ and criticizing⁸² the decision. The Supreme Court apparently anticipated the controversy its holding would generate because it tacitly encouraged Congress to provide a legislative solution to the practical problems inherent in complex antitrust litigation involving plaintiffs at different points in the chain of production and distribution.⁸³

Congress responded almost immediately with a flurry of bills in the late 1970s designed to override *Illinois Brick*, and extensive hearings were held on these bills in both the House and Senate.⁸⁴ However, none was ever debated on the floor of either chamber of Congress, and the measures failed.⁸⁵ After the initial legislative attempts to override the *Illinois Brick* direct purchaser rule, the controversy lay dormant until July 1982 when another re-

81. Cavanagh, *Illinois Brick Revisited: An Analysis of a Developing Antitrust Jurisprudence*, 17 VAL. U.L. REV. 63 (1983) (*Illinois Brick* rule brings certainty and predictability to antitrust litigation); Landes & Posner, *supra* note 37 (direct-purchaser suits more effective than indirect-purchaser suits at enforcing antitrust policy); Landes & Posner, *supra* note 72 (*Illinois Brick* rule promotes goals of deterrence and compensation); Werden & Schwartz, *Illinois Brick and the Deterrence of Antitrust Violations—An Economic Analysis*, 35 HASTINGS L.J. 629 (1984) (rational basis for *Illinois Brick* rule); Comment, *A Legal and Economic Analysis of the Cost-Plus Contract Exception in Hanover Shoe and Illinois Brick*, 47 U. CHI. L. REV. 743 (1980) (exception should be construed narrowly).

82. Carrafiello, *A Search for Symmetry: The "Pass On" Issue in Quest of Determination*, 24 ANTITRUST BULL. 187 (1979) (Congress, as arbiter of antitrust policy, should act to permit indirect-purchaser suits); Harris & Sullivan, *supra* note 72 (Congress should pass legislation overruling *Illinois Brick* in order to serve policies of deterrence and compensation); Mantel, *Denial of a Forum to Indirect-Purchaser Victims of Price Fixing Conspiracies: A Legal and Economic Analysis of Illinois Brick*, 2 PACE L. REV. 153 (1982) (economic theory understandable and applicable to antitrust cases, therefore reasons for *Illinois Brick* attenuated); Watson, *Bad Economics in the Antitrust Courtroom: Illinois Brick and the 'Pass-On' Problem*, 9 ANTITRUST L. & ECON. REV. 69 (1977) (*Illinois Brick* rule anticompetitive); Note, *Scaling the Illinois Brick Wall: The Future of Indirect Purchasers in Antitrust Litigation*, 63 CORNELL L. REV. 309 (1978) (Court went too far in barring most indirect-purchaser suits).

83. See *Illinois Brick*, 431 U.S. at 746.

84. "While the formulations of the different bills varied widely, the primary thrust of the proposals was to repeat the *Illinois Brick* holding by making it clear that indirect purchasers whose business or property is injured by reason of an antitrust violation shall be entitled to sue for treble damages under § 4 of the Clayton Act." Cavanagh, *The Illinois Brick Dilemma: Is There a Legislative Solution?*, 48 ALB. L. REV. 273, 274 n.10 (1984); see H.R. 9132, 95th Cong., 1st Sess. (1977); H.R. 8517, 95th Cong., 1st Sess. (1977); H.R. 8516, 95th Cong., 1st Sess. (1977); H.R. 8359, 95th Cong., 1st Sess. (1977); S. 1874, 95th Cong., 1st Sess. (1977); H.R. 11942, 95th Cong., 2d Sess. (1978); H.R. 2204, 96th Cong., 1st Sess. (1979); H.R. 2060, 96th Cong., 1st Sess. (1979); S. 1874, 95th Cong., 2d Sess. (1978); S. 300, 96th Cong., 1st Sess. (1979).

85. For a discussion of the congressional response to *Illinois Brick*, see Cavanagh, *supra* note 84, at 294-300.

pealer bill was introduced in the Senate, but no hearings were conducted and ultimately no action was taken on it.⁸⁶ In 1983-84 both the House and Senate considered limited repealer bills.⁸⁷ These bills were designed to allow the federal government, states and their political subdivisions to sue on behalf of indirect purchasers and to direct courts not to permit a plaintiff to recover damages that duplicated the recovery of another plaintiff in any action based upon the same conduct of the defendant.⁸⁸ In 1986

86. S. 2772, 97th Cong., 2d Sess. (1982).

87. S. 915, 98th Cong., 1st Sess. (1983); H.R. 2244, 98th Cong., 1st Sess. (1983).

88. The House bill provided in relevant part:

INDIRECT ACTIONS

SECTION 4(I). (a) A State, a political subdivision of a State, or the United States shall not be barred from bringing an action under section 4, 4A or 4C solely because the injury for which damages are sought did not arise from a sales transaction between the plaintiff (or natural persons on whose behalf the State brings the action) and the defendant.

(b) In any action under section 4, 4A, or 4C, the plaintiff shall not recover for any overcharge paid or underpayment received any amount that duplicates the recovery of another plaintiff in the action or any other action, based upon the same conduct of the defendant, for the overcharge or underpayment.

H.R. 2244, 98th Cong., 1st Sess. (1983).

The Senate bill provided:

SECTION 1. (a) Section 4C(a) of the Clayton Act (15 U.S.C. 15c(a)) is amended—by adding new subsections (2) and (3) as follows:

(2) Whenever any State or political subdivision thereof is injured in its business or property by reason of anything forbidden by section 1 of this title the Attorney General of the State may sue on behalf of the State or any political subdivision thereof in any district court of the United States having jurisdiction of the defendant, to secure monetary relief as provided in this section for injury sustained by such State or political subdivision.

(3) Actions brought pursuant to section 4A of this Act or subsections (a)(1) or (a)(2) of this section may be maintained regardless of whether such natural person, State, political subdivision or the United States has purchased indirectly from the defendant.

(b) Section 4C(a)(4) of the Clayton Act (15 U.S.C. 15c(a)(2)) is redesignated as Section 4C(a)(4) of the Clayton Act (15 U.S.C. 15c(a)(4)) and is amended by inserting in the first sentence after "paragraph (1)" the following: "or paragraph (2)."

SECTION 2. Section 4 of the Clayton Act (15 U.S.C. 15) is amended by adding at the end thereof a new section 4(I) to read as follows:

SECTION 4(I). In any action under sections 4, 4A, or 4C of the Clayton Act, the defendant shall be entitled to prove as a partial or complete defense to a damage action, in order to avoid duplicative liability, that some or all of what otherwise would constitute plaintiff's damages has been passed on to others, who are themselves entitled to maintain an action or on whose behalf the Attorney General of the United States or of any State is entitled to maintain an action under Sections 4A or 4C of this Act. Such defense shall be set forth as an

another limited repealer bill was introduced into the Senate, but it was rejected by the Judiciary Committee.⁸⁹

After the *Illinois Brick* decision, a number of states amended their antitrust laws explicitly to grant indirect purchasers a cause of action.⁹⁰ For example, California amended its statute to allow recovery "regardless of whether such injured person dealt directly or indirectly with the defendant."⁹¹ At present, fourteen states (and the District of Columbia) explicitly authorize indirect purchasers to recover damages in antitrust suits.⁹² Twenty-five states (and Puerto Rico) have antitrust statutes that parallel section 4 of the Clayton Act in providing a remedy to "[a] person who is injured in business or property."⁹³ Therefore, state courts

affirmative defense in any responsive pleading of the defendant. The defendant shall set forth in such pleading, with as much particularity as is reasonable, the identity of those to whom the defendant asserts the plaintiff has passed on some or all of plaintiff's damages. For the purposes of rule 19 of the Federal Rules of Civil Procedure, the Attorney General entitled to represent such person(s) pursuant to section 4A or 4C of this Act shall be deemed an indispensable party.

S. 915, 98th Cong., 1st Sess. (1983).

89. S. 2481, 99th Cong., 2d Sess., 132 CONG. REC. 6352 (1986), was rejected by the Senate Judiciary Committee on June 5, 1986. See Benston, *supra* note 72, at 215 ed.'s n.*.

90. See Note, *Indirect Purchaser Suits Under State Antitrust Laws: A Detour Around the Illinois Brick Wall*, 34 STAN. L. REV. 203, 205-06 (1981).

91. CAL. BUS. & PROF. CODE § 16750(a) (West 1987 & Supp. 1989).

92. See, e.g., ALA. CODE § 6-5-60(a) (1975) (allowing recovery by any person "injured or damaged . . . , direct or indirect"). Other jurisdictions have similar statutes. See COLO. REV. STAT. § 6-4-106 (1973 & Supp. 1988); D.C. CODE ANN. § 28-4509 (1981); KAN. STAT. ANN. § 50-801(b) (1983 & Supp. 1988); MD. COM. LAW CODE ANN. § 11-209 (1983); MICH. COMP. LAWS ANN. § 445.778 (West 1989); MINN. STAT. § 325D.57 (1981 & Supp. 1990); MISS. CODE ANN. § 75-21-9 (1972); N.M. STAT. ANN. § 57-1-3(A) (1987); R.I. GEN. LAWS § 6-36-12(g) (1985); S.D. CODIFIED LAWS ANN. § 37-1-33 (1986); WIS. STAT. ANN. § 133.18 (West 1989).

93. ALASKA STAT. § 45.50.576(a) (1988). The following 25 jurisdictions have similar statutes: ARIZ. REV. STAT. ANN. § 44-1408(B) (1987); CONN. GEN. STAT. ANN. § 35-35 (West 1987); IDAHO CODE § 48-114 (1977); IND. CODE ANN. 24-1-1-5 (West 1980 & Supp. 1989); KY. REV. STAT. ANN. § 365.070 (Michie/Bobbs-Merrill 1987); LA. REV. STAT. ANN. § 51.137 (West 1987); ME. REV. STAT. ANN. tit. 10, § 1104.1 (West 1980 & Supp. 1988); MASS. GEN. LAWS ANN. ch. 93, § 12 (West 1984); NEB. REV. STAT. § 59-1609 (1988); NEV. REV. STAT. ANN. § 59-281 (Michie 1986); N.H. REV. STAT. ANN. § 356:11 (1984); N.Y. GEN. BUS. LAW § 340(5) (McKinney 1988); N.C. GEN. STAT. § 75-16 (1989); N.D. CENT. CODE § 51-08.1-08 (1989); OHIO REV. CODE ANN. § 1331.08 (Baldwin 1989); OKLA. STAT. ANN. tit. 79, § 25 (West 1987); OR. REV. STAT. § 646.775 (1988); P.R. LAWS ANN. tit. 10, § 268 (1978); S.C. CODE ANN. § 39-3-30 (Law. Co-op. 1984); TENN. CODE ANN. § 47-25-309 (1988); TEX. BUS. & COM. CODE ANN. § 15.21 (Vernon 1987); UTAH CODE ANN. § 76-10-919 (1989); VT. STAT. ANN. tit. 9, § 2461 (1984); WASH. REV. CODE ANN. § 19.86.090 (1989); W. VA. CODE § 133.18 (1988). See Note, *supra* note 90, at 206 n.21.

adopting the rationale of the minority in *Illinois Brick* could construe the word "injury" broadly to include indirect purchasers in the class of the injured.⁹⁴ But some state courts, including New York's,⁹⁵ follow *Illinois Brick* and do not allow indirect purchasers to recover damages in antitrust cases. The remaining eleven states either do not have statutes that allow private antitrust actions⁹⁶ or have statutes incorporating language similar to that of Delaware: "[T]his chapter shall be construed in harmony with ruling judicial interpretations of comparable federal antitrust statutes."⁹⁷

IV. *ARC AMERICA* UNDERMINES THE POLICY RATIONALES FOR
THE RIGID *ILLINOIS BRICK* RULE IN CONSOLIDATED
STATE AND FEDERAL ANTITRUST SUITS
INVOLVING BOTH DIRECT AND
INDIRECT PURCHASERS

In the 1970s the Antitrust Division of the Arizona Attorney General's Office uncovered evidence of a national price fixing conspiracy among cement manufacturers.⁹⁸ Beginning in 1976, the states of Alabama, Arizona, California and Minnesota filed complaints alleging a violation of section 1 of the Sherman Act⁹⁹

94. *Illinois Brick*, 431 U.S. at 754-56 (Brennan, J., dissenting).

95. The Appellate Division has not allowed indirect purchasers to use a breach of contract action under state law against direct purchasers as a means of avoiding the *Illinois Brick* rule which New York courts have adopted. See *Tip Top Farms, Inc. v. Dairylea Co-op, Inc.*, 114 A.D.2d 12, 24-25, 497 N.Y.S.2d 99, 106-07 (1985), *appeal dismissed*, 67 N.Y.2d 829, 492 N.E.2d 787, 501 N.Y.S.2d 659, *aff'd*, 69 N.Y.2d 625, 503 N.E.2d 692, 511 N.Y.S.2d 227 (1986), *cert. denied*, 481 U.S. 1029 (1987). The New York County Supreme Court rejected a suit by a class of indirect purchasers. *Russo & Dubin v. Allied Maintenance Corp.*, 95 Misc. 2d 344, 347, 407 N.Y.S.2d 617, 620 (Sup. Ct. 1978) ("[T]he Supreme Court rationale in the *Illinois Brick Company* case is even more compelling under the New York Donnelly Act. Any other result would create serious conflict between enforcement of state and federal antitrust laws which would subject defendants to multiple liability in derogation of due process."); see also *Orange & Rockland Utils., Inc. v. New England Petroleum Corp.*, 60 A.D.2d 233, 237, 400 N.Y.S.2d 79, 82 (1977); cf. *In re Wiring Device Antitrust Litig.*, 498 F. Supp. 79, 86-88 (E.D.N.Y. 1980) (in an alternative holding, construing South Carolina antitrust law to conform to the *Illinois Brick* rule).

96. These states are Arkansas, Florida, Georgia, Montana, Pennsylvania and Wyoming.

97. DEL. CODE ANN. tit. 6, § 2113 (1973 & Supp. 1988). Four other states have similar statutes. See IOWA CODE ANN. § 553.2 (West 1986); MO. ANN. STAT. § 416.141 (Vernon 1979); N.J. STAT. ANN. § 56:9-18 (West 1989); VA. CODE ANN. § 59.1-9.17 (1987).

98. *In re Cement & Concrete Antitrust Litig.*, 437 F. Supp. 750, 750-51 (J.P.M.L. 1977).

99. For the pertinent text of § 1 of the Sherman Act, see *supra* note 3.

against a number of cement manufacturers and their trade association. These states sought damages, injunctive relief, attorney fees and costs.¹⁰⁰ The plaintiffs also alleged violations of each of their state's laws and sought damages based on indirect purchases of cement.¹⁰¹ Private plaintiffs filed "tag-along" complaints based on Arizona's investigation and filing.¹⁰² A total of thirty-five lawsuits were filed in twelve federal district courts.¹⁰³ The federal actions were transferred to the United States District Court for the District of Arizona for coordinated pretrial proceedings.¹⁰⁴ Under the court's pendant jurisdiction, the state law claims were transferred and consolidated with the federal claims.¹⁰⁵

The federal district court certified class actions and established a number of plaintiff classes.¹⁰⁶ Between July 1979 and October 1981, several major defendants settled with the various classes, resulting in a settlement fund exceeding \$32 million.¹⁰⁷ The settlements left distribution of the fund for later resolution, subject to approval by the district court.¹⁰⁸ The court approved a plan for distributing the settlement fund in proportion to the amount of direct purchases of cement, but it refused to allow payments out of the fund for claims based on state indirect purchaser statutes. The court concluded that federal law preempted the state statutes purporting to authorize claims by indirect purchasers because "[s]uch statutes are clear attempts to frustrate the purposes and objectives of Congress, as interpreted by the Supreme Court in *Illinois Brick*."¹⁰⁹

The Ninth Circuit Court of Appeals affirmed, holding that state indirect purchaser statutes impermissibly interfere with the policies behind the federal antitrust laws.¹¹⁰ Therefore, federal law preempts the state statutes.¹¹¹ With respect to those policies,

100. Klitzke, *Can Indirect Purchasers Recover Damages Under State Antitrust Laws?*, 10 *PREVIEW* (ABA) 284, 284 (1989).

101. *In re Cement*, 437 F. Supp. at 750-51.

102. *See id.* at 751.

103. *In re Cement*, 817 F.2d at 1437.

104. *In re Cement*, 437 F. Supp. at 753.

105. Klitzke, *supra* note 100, at 284.

106. *In re Cement*, 817 F.2d at 1437-38.

107. *Id.* at 1438.

108. *ARC America*, 109 S. Ct. at 1664.

109. *Id.* (quoting App. to Juris. Statement at A-31).

110. *In re Cement*, 817 F.2d at 1445-47.

111. *Id.* at 1447. The Ninth Circuit recognized that indirect purchaser claims under state law could be interpreted in two different ways. *Id.* at 1445. Under one interpretation, they prohibit a plaintiff from recovering damages

the Ninth Circuit noted that although indirect purchaser claims theoretically could be brought separately from federal direct purchaser actions, *res judicata* principles may require a plaintiff with both direct and indirect claims against a defendant to bring them together in one suit.¹¹² If so, complications and conflicts between the state and federal statutes are unavoidable.

The Ninth Circuit also noted that indirect purchaser claims under state law could limit the recoveries of direct purchasers, which would reduce their incentives to bring antitrust actions.¹¹³ A defendant's ability and willingness to settle claims by direct purchasers depends in part on the extent of the defendant's other potential obligations to indirect purchaser claimants. "To the extent that indirect purchaser claims have been brought or are threatened, a defendant will reduce any offer to compromise with direct purchasers."¹¹⁴ Moreover, "if antitrust treble damage judgments exhausted a defendant's net assets, then the claims of direct purchasers would have to share the defendant's estate in bankruptcy with the claims of indirect purchasers."¹¹⁵ These possibilities reduce the expected recoveries of direct purchasers and remove the incentives for direct purchasers to bring private damage actions.¹¹⁶

A third concern noted by the Ninth Circuit was the direct conflict with federal policy provoked by indirect purchaser claims under state law—because state law creates the risk of multiple liability for defendants.¹¹⁷ The recognition of these claims would allow both direct and indirect purchasers to recover for the same injury. Although the states had argued that a state cause of action is not preempted solely because it imposes a harsher remedy than

(trebled) greater than the amount of any illegal overcharge that it has absorbed. The Ninth Circuit concluded that under this construction, the state laws directly conflict with federal law. *Id.* The court said that under an alternative interpretation, indirect purchaser statutes permit claims for damages in addition to the claims brought by direct purchasers. The court then discussed its objections, which it considered fatal, to this interpretation. *Id.* at 1445-47.

112. *Id.* at 1446 (citing RESTATEMENT (SECOND) OF JUDGMENTS § 24 (1982) (doctrines of merger and bar extinguish "all rights of the plaintiff to remedies against the defendant with respect to all or any part of the transaction, or series of connected transactions, out of which the action arose")); see also *In re Corrugated Container Antitrust Litig.*, 643 F.2d 195, 221 (5th Cir. 1981) (court may release claims which could have been alleged in complaint by reason of or in connection with any matter or fact set forth or referred to in complaint).

113. *In re Cement*, 817 F.2d at 1446.

114. *Id.*

115. *Id.*

116. *Id.*

117. *Id.*

federal law for conduct that is violative of both federal and state law, the Ninth Circuit concluded that where the Supreme Court has held unequivocally that the policy against multiple liability exists and has made repeated references to it, such a proposition cannot apply.¹¹⁸

The states also presented the related argument that the Supreme Court had determined only that *federal* law does not impose multiple liability.¹¹⁹ They contended that state legislatures, however, are free to impose multiple liability as a matter of *state* law.¹²⁰ The Ninth Circuit, however, determined that if state law claims are generally allowed, the possibility that federal law would impose multiple liability is greatly enhanced.¹²¹

As the Ninth Circuit noted:

If a state indirect purchaser claim is adjudicated or settled before a federal claim by the related direct purchaser, then one of two consequences must follow: either (1) the federal direct purchaser claim is barred, or (2) the direct purchaser can also collect trebled damages based on the full amount of the overcharge, thereby imposing multiple liability on the defendant as a matter of federal law. Either consequence would conflict with express federal policies.¹²²

Finally, the Ninth Circuit discounted Minnesota's argument that its statute avoided any conflict with federal law because express language in the statute requires it to be applied so that defendants are not subject to duplicate liability.¹²³ The court

118. *Id.*; see, e.g., *Illinois Brick*, 431 U.S. at 731 n.11 ("a little slopover on the shoulders of the wrongdoers" is unacceptable); *Associated Gen. Contractors, Inc. v. California State Council of Carpenters*, 459 U.S. 519, 544 (1983); *Blue Shield v. McCready*, 457 U.S. 465, 474-75 (1982).

119. *In re Cement*, 817 F.2d at 1446.

120. *Id.*

121. *Id.*

122. *Id.*

123. *Id.* The Minnesota statute provides: "In any subsequent action arising from the same conduct, the court may take any steps necessary to avoid duplicative recovery against a defendant." MINN. STAT. § 325D.57 (1981 & Supp. 1990).

The Ninth Circuit distinguished the primary cases cited by the states in support of their argument that federal law does not preempt the indirect purchaser claims. In *Silkwood v. Kerr-McGee Corp.*, 464 U.S. 238 (1984), the Supreme Court held that federal law regulating nuclear energy facilities does not preempt an award of punitive damages under state tort law for conduct related to radiation hazards. *Id.* at 256. The Ninth Circuit distinguished *Silkwood* on the grounds that no federal law grants a private cause of action for radiation-related

pointed out that *ARC America* did not involve indirect purchasers who filed a lawsuit after the direct purchaser had failed to bring an action within the statute of limitations period.¹²⁴ Instead, the precise issue concerned whether both direct and indirect purchasers were to share in the distribution of a settlement fund.

Because the court recognized the potential risk of multiple liability, it concluded "that the state law claims in this case based on indirect purchases of cement that do not fall within any exception to the rule of *Illinois Brick* are preempted because they stand 'as an obstacle to the accomplishment of the full purposes and objectives' of federal antitrust law."¹²⁵ Because the *Illinois Brick* rule dictates that direct purchasers are entitled to the entire damage recovery, the problem of duplicate liability cannot be resolved by state statutes that consolidate state and federal antitrust suits involving direct and indirect purchasers unless the state law authorizing indirect purchaser recovery is rendered null.¹²⁶ If both direct and indirect purchasers share in the antitrust settlement, there are only two possibilities. One demands a de facto repeal of the *Illinois Brick* rule that requires the entire damage recovery to go to direct purchasers. The other subjects defendants to duplicate liability if the settlement is larger than that which would be paid to the direct purchasers alone.

The distribution of the settlement fund was the subject of the appeal to the United States Supreme Court.¹²⁷ The appellant states of Alabama, Arizona, California and Minnesota, as indirect purchasers of cement and products containing cement, sought to participate in the settlement fund to recover damages.¹²⁸ The appellee, ARC America Corporation, as a direct purchaser of cement from the defendants, sought to preclude their participation in the settlement.¹²⁹

The United States Supreme Court held that the rule limiting

injuries. *In re Cement*, 817 F.2d at 1447 (citing *Silkwood*, 464 U.S. at 254). Therefore, the court concluded that in *Silkwood*, "state law had no opportunity to conflict with federal policies embodied in a federal law authorizing private damage actions." *Id.*

124. The suit was a class action by direct purchasers that tolled the statute of limitations. *In re Cement*, 817 F.2d at 1447. Thus, the claims presented in the case carried with them a "serious risk of multiple liability." *Id.* (quoting *Illinois Brick*, 431 U.S. at 730).

125. *Id.* (quoting *Silkwood*, 464 U.S. at 248).

126. See, e.g., S.D. CODIFIED LAWS ANN. § 37-1-33 (1986). For the pertinent text of this statute, see *supra* note 27.

127. *ARC America*, 109 S. Ct. at 1664.

128. *Id.*

129. *Id.*

federal antitrust recoveries to direct purchasers does not prevent indirect purchasers from recovering damages flowing from state antitrust law violations.¹³⁰ The Court claimed that state indirect purchaser statutes do not interfere with accomplishing the federal law purposes as identified in *Illinois Brick*.¹³¹ Ignoring the actual facts in *ARC America*, a case involving the consolidation of state and federal suits, the Court deemed it possible to bring state indirect purchaser suits in state court separately from federal direct purchaser suits.¹³² The Court also held that federal courts have discretion to decline to exercise pendant jurisdiction over burdensome state claims.¹³³

In *ARC America* the Court did not examine a number of pressing issues. For example, it did not address the *res judicata* issue raised by the Ninth Circuit. It did not discuss whether defendants would be willing to negotiate a settlement without "total peace," that is, whether they would settle without a simultaneous release from both direct and indirect purchaser claims.¹³⁴ The Court also failed to examine how to prevent the waste of judicial resources that inevitably would result from identical and duplicate trials in state and federal courts.

In *Illinois Brick* the Court maintained that requiring direct and indirect purchasers to apportion the recovery under the federal statute, section 4 of the Clayton Act, would result in no one plaintiff having a sufficient incentive to sue under that statute.¹³⁵ Using tortious logic the *ARC America* Court asserted that state statutes pose no similar risk: "that direct purchasers may have to share with indirect purchasers is a function of the fact and form of settlement rather than the impermissible operation of state indirect purchaser statutes."¹³⁶ By focusing on the form of settlement, the Court in effect concedes that the substance of its argument cannot withstand scrutiny. It is clearly inconsistent to assert that allowing direct and indirect purchasers to share in a

130. *Id.* at 1667.

131. *Id.* at 1666-67.

132. *Id.* at 1666.

133. *Id.*

134. See, e.g., *In re Chicken Antitrust Litig.*, 669 F.2d, 228, 238-39 (5th Cir. 1982); *In re Corrugated Container Antitrust Litig.*, 643 F.2d 195, 221-22 (5th Cir. 1981) (release of state law claims was acceptable part of settlement of federal antitrust case), *cert. denied*, 456 U.S. 1012 (1982); *Oswald v. McGarr*, 620 F.2d 1190, 1197-98 (7th Cir. 1980) (release of future claims was important element of antitrust settlement).

135. See *Illinois Brick*, 431 U.S. at 745 (discussing reduced incentive to sue).

136. *ARC America*, 109 S. Ct. at 1667 (emphasis added).

settlement would result in no one plaintiff having a sufficient incentive to sue when only federal law is involved, but that allowing direct and indirect purchasers to share in the same settlement would not dull the incentive to sue when both state and federal law are involved.

The Court did not agree with the Ninth Circuit's conclusion that state indirect purchaser claims might subject antitrust defendants to multiple liability in contravention of "express federal policy" condemning multiple liability.¹³⁷ The Court noted that "[o]rdinarily, state causes of action are not pre-empted solely because they impose liability over and above that authorized by federal law."¹³⁸ The Court ignored, however, the fact that the additional liability based on state law in *ARC America* is inconsistent with and completely undermines the three specific policy rationales it used to justify the simplistic direct purchaser rule in *Illinois Brick*. Consequently, the Court has once again left the issues of theoretical pass-on proof, multiple liability, manageable judicial standards and effective deterrence unresolved. In sum, the *ARC America* decision resurrected the precise problem—the need to apportion damages between direct and indirect purchasers—that the Supreme Court thought it had buried when it adopted the *Illinois Brick* rule.

V. PRESUMPTIONS ACCOMMODATE THE FOUR ANTITRUST POLICY GOALS BETTER THAN EITHER A RIGID RULE OR A COMPLEX, THEORETICAL, CASE-BY-CASE ANALYSIS

Because *ARC America* permits indirect purchaser antitrust suits under state law and simultaneous direct purchaser suits under federal law, courts cannot avoid adjudicating these suits, balancing the four conflicting antitrust policy goals, and apportioning damage settlements between direct and indirect purchasers. In a potential pass-on situation, it is virtually impossible to accomplish simultaneously all four of the relevant antitrust policy

137. *See In re Concrete*, 817 F.2d at 1446 (citing *Illinois Brick*, 431 U.S. at 731 n.11; *Associated Gen. Contractors, Inc. v. California State Council of Carpenters*, 459 U.S. 519, 544 (1983); *Blue Shield v. McCready*, 457 U.S. 465, 474-75 (1982)). The Supreme Court later said that all these cases construed § 4 of the Clayton Act and that in none of them did the court "identify a federal policy against States imposing liability in addition to that imposed by federal law." *ARC America*, 109 S. Ct. at 1667.

138. *ARC America*, 109 S. Ct. at 1667 (citing *Silkwood v. Kerr-McGee Corp.*, 464 U.S. 238, 257-58 (1984); *California v. Zook*, 336 U.S. 725, 736 (1949)).

goals of compensating injured parties,¹³⁹ deterring antitrust violations,¹⁴⁰ protecting defendants from multiple liability,¹⁴¹ and defining manageable legal standards.¹⁴² Compensating injured parties, for example, is often incompatible with a manageable judicial standard because the theoretical¹⁴³ and practical problems¹⁴⁴ encountered when attempting to place a dollar value on the injury plaintiffs suffer in specific cases is nearly insoluble. In a pass-on situation, this analysis is complicated further because a monopolistic overcharge may have cumulatively larger effects as it occurs farther back in the chain of production and distribution.¹⁴⁵ However, if courts emphasize deterrence, the remedy should be available to the party best able and willing to assert its claim. Consequently, deterrence is not necessarily compatible with compensation. If the protection of defendants from multiple liability and the definition of a manageable judicial standard are primary concerns (*i.e.*, if courts follow a direct purchaser or privity rule),¹⁴⁶ compensation of injured parties assuredly will suffer and deterrence may suffer as well.

Illinois Brick prematurely halted the federal common law development on the issue of damage apportionment between direct and indirect purchasers. Nevertheless, economic theory suggests

139. *Illinois Brick*, 431 U.S. at 737-41.

140. *Id.* at 745-47.

141. *Id.* at 730. After *Hanover Shoe* rejected the defensive use of pass-on theory, many commentators, aware of the potential multiple liability of antitrust defendants, proposed procedural solutions to the problem. See, e.g., P. AREEDA, *ANTITRUST ANALYSIS* 74-76 (2d ed. 1974); McGuire, *The Passing-On Defense and the Right of Remote Purchasers to Recover Treble Damages Under Hanover Shoe*, 33 U. PITT. L. REV. 177, 197-202 (1971); Comment, *Standing to Sue in Antitrust Cases: The Offensive Use of Passing-On*, 123 U. PA. L. REV. 976, 993-98 (1975); see also Note, *The Effect of Hanover Shoe on the Offensive Use of the Passing-On Doctrine*, 46 S. CAL. L. REV. 98, 113-17 (1972).

142. See *Illinois Brick*, 431 U.S. at 731-33; *Hanover Shoe*, 392 U.S. at 492-93.

143. See H. HOVENKAMP, *supra* note 39, at 19-24; F. SCHERER, *INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE* 459-71 (2d ed. 1980) (discussing deficiencies resulting from monopolistic structure and conduct).

144. Calculation of the exact amount of overcharge a direct purchaser can pass-on to the next level is beyond the technical competence of courts because it requires knowledge of the prevailing elasticities of supply and demand. *Illinois Brick*, 431 U.S. at 741-42; *Hanover Shoe*, 392 U.S. at 492-93. For the relevant formulae, see H. HOVENKAMP, *supra* note 39, at 367; Landes & Posner, *supra* note 37, at 615-25.

145. For a discussion of the possible cumulative effects of an illegal overcharge, see *infra* note 161.

146. See *Southern Pac. Co. v. Darnell-Taenzer Lumber Co.*, 245 U.S. 531, 533-34 (1918); *Mid-West Paper Prods. Co. v. Continental Group, Inc.*, 596 F.2d 573, 596 (3d Cir. 1979) (Higginbotham, J., dissenting); see generally Dunfee, *supra* note 70; Cirace, *supra* note 53.

that the conflicts among the several antitrust policies engendered by the issue of how to apportion damages between direct and indirect purchasers can best be resolved by rough rules or presumptions. In antitrust suits initiated under state law, these presumptions are preferable to the Court's absolute rule, which it adopted on grounds of administrative convenience at the expense of the statutory principle that injured parties should recover three times their reasonably provable damages. These presumptions are also preferable to a complex, theoretical calculation in each case of the percentage of overcharge each firm has passed-on to the next level.

VI. THE ECONOMIC THEORY OF THE PASS-ON PROBLEM

The typical consumer product is made in a chain of production and distribution that comprises several vertically related levels. Typically, producers of raw materials sell those materials to intermediate manufacturers, who sell component parts to final product manufacturers. Final product manufacturers sell the finished product to wholesalers, who in turn sell it to retailers. Retailers then sell it to consumers, who may in turn sell to used product buyers. Assume that one of the vertical levels is monopolized or cartelized, and that all other levels have competitive market structures. The economic issue presented by the pass-on problem is whether, and to what extent, one level can pass-on a monopolistic overcharge to the next level and, ultimately, to consumers.¹⁴⁷

A branch of economic analysis known as incidence theory¹⁴⁸ was developed in order to determine whether a tax at one level in the chain of production and distribution could be passed-on to other levels and ultimately to consumers. Using this theory, one can calculate the theoretical percentage of any overcharge that a firm at one level can pass-on to a firm at the next level.¹⁴⁹ The solution to the pass-on problem requires knowledge of the relative elasticities of supply and demand at the several vertical levels.

147. See Cirace, *supra* note 53, at 179-80.

148. See Schaefer, *supra* note 70, at 883-87.

149. See *Illinois Brick*, 431 U.S. at 741 n.25. The illegal overcharge resulting from price-fixing is equivalent to a unit tax and can be analyzed in terms of tax incidence theory. R. MUSGRAVE & P. MUSGRAVE, *PUBLIC FINANCE IN THEORY AND PRACTICE* chs. 19-20 (3d ed. 1980); see W. BAUMOL & A. BLINDER, *supra* note 38, at 605-10; P. SAMUELSON & W. NORDHAUS, *supra* note 38, at 387-88; C. SHOUP, *PUBLIC FINANCE* ch. 10 (1969); Schaefer, *supra* note 70, at 887-89; Cirace, *supra* note 53, at 181-83.

The significance of supply and demand elasticities can be demonstrated by three theoretical cases, two extreme and one intermediate or general case.

For simplicity, assume that there are only three vertical levels: product manufacturers, retail distributors and consumers. Assume further that a cartel of manufacturers engages in price fixing. The precise issue is whether retailers, who are direct purchasers, can pass-on some or all of the illegal overcharge to consumers, who are indirect purchasers, or whether the retailers must absorb some or all of the overcharge themselves. One extreme case exists if the demand of consumers is totally inelastic (Case 1A) or if the supply of retailers is totally elastic (Case 1B).¹⁵⁰ If consumer demand is totally inelastic, as presented in Case 1A, consumers, who are indirect purchasers, will purchase the same quantity regardless of price. This means that the entire monopoly overcharge will be passed-on to them.¹⁵¹ Case 1A is reasonably approximated in the real world by governmental levies of "sin" taxes on alcohol and cigarettes. Acting upon the assumption that consumer demand for these "sinful" products is reasonably inelastic in the relevant price range so that nearly all of the tax will be passed-on to consumers, governments place high taxes on these items. The major object of the tax is to collect revenue; it is only an incident of the tax that it may serve to reduce consumption.¹⁵²

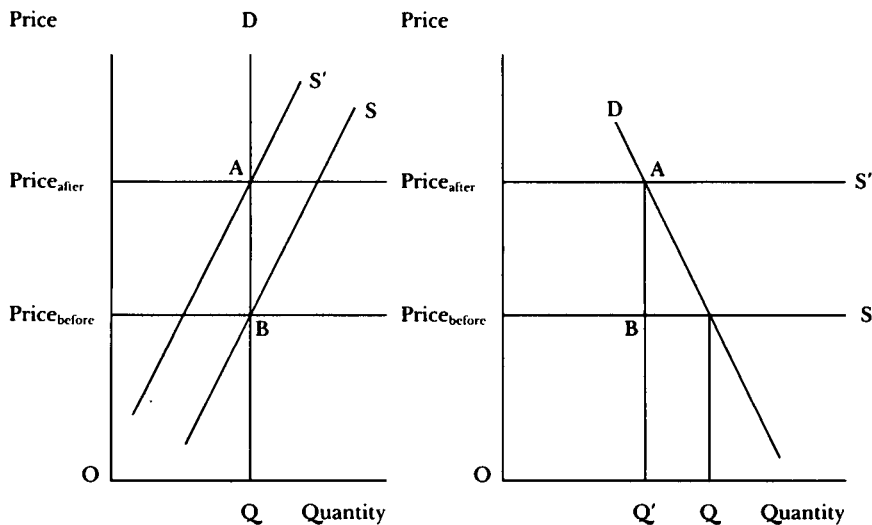
Now consider Case 1B, in which supply is totally elastic.

150. In all figures, supply curve S represents supply prior to the monopoly overcharge and supply curve S' represents supply after the monopoly overcharge is instituted. The effect of the overcharge is to shift the industry supply curve vertically by AB, the amount of the overcharge per unit. When demand (D) for a product is totally inelastic, as in Case 1A, consumers of that product will purchase quantity OQ regardless of price. The price after the overcharge, Price after, is higher than the price before, Price before, by the entire amount of the overcharge, AB, which is passed on to buyers of the product.

If a seller's supply curve is totally elastic, as in Case 1B, the sellers of that product will supply all that the market desires (D) at a price, Price before, and nothing at a lower price. The price rises by the total amount of the overcharge, which therefore is passed-on to the buyers of the product. As discussed in the following text, the reduced quantity sold in Case 1B places a burden on the sellers, unlike Case 1A, where the quantity bought remains the same.

151. It is possible that an amount greater than the overcharge will be passed-on to the next level; this occurs when demand is totally inelastic and the seller sets price on the basis of a markup which is specified in percentage terms. H. HOVENKAMP, *supra* note 39, at 369-70.

152. If a government wanted to use a tax to eliminate consumption rather than raise revenue, it would place a tax on the product that was so large that consumers would no longer be willing or able to buy the product; *i.e.*, demand would become totally elastic rather than inelastic in the relevant price range.



CASE 1A (INELASTIC DEMAND)

CASE 1B (ELASTIC SUPPLY)

Under the reasonable assumption that long-run marginal costs of retailers are approximately constant,¹⁵³ retailers' supply is approximately totally elastic. Retailers will supply all that is demanded at the supply-determined price and will sell nothing at a lower price; therefore, retailers can pass-on the entire overcharge to consumers.¹⁵⁴ In both Cases 1A and 1B, retailers pass-on the entire illegal overcharge to consumers. The only difference between the two scenarios is that in Case 1B (where supply is completely elastic but demand is not completely inelastic), although the entire illegal overcharge will be passed-on to consumers, they will buy fewer units so that the resulting decline in sales volume (from Q to Q') will cause some retailers to leave the industry. Once capacity has adjusted to the new situation, the remaining retailers suffer no further damage. But of course, the retailers driven out of business have been damaged. Therefore, in Case 1B the burden of the overcharge is shared by both distributors and consumers—"the former suffer lost profits, and the latter pay

153. To have an "equilibrium" in a competitive market, we also assume that short-run marginal costs of retailing are rising at current levels of sales.

154. This analysis of a monopoly overcharge can be turned around to determine whether the direct seller bears the brunt of artificially low prices when a buyer exerts monopsony power. A monopsonist is a single buyer rather than a single seller as in a monopoly. H. HOVENKAMP, *supra* note 39, at 17. If supply is perfectly inelastic, so that the seller will supply a constant quantity even though prices fall, the seller bears the entire burden. If supply is perfectly elastic, so that the seller will furnish an unlimited quantity at a given price but nothing at all at any lower price, the burden is entirely passed-on to the indirect seller at the next vertical level.

higher prices.”¹⁵⁵

The opposite theoretical extreme case (Case 2) occurs when consumer demand is totally elastic.¹⁵⁶ In Case 2 consumers will buy as many units of the product as are offered for sale at a demand-determined price and will buy nothing at a higher price. As a result, retailers cannot pass-on any of the illegal overcharge to consumers. This extreme case would be relevant if the monopolized product had a perfect substitute to which buyers could switch instantaneously if sellers of this product attempted to raise the price.¹⁵⁷

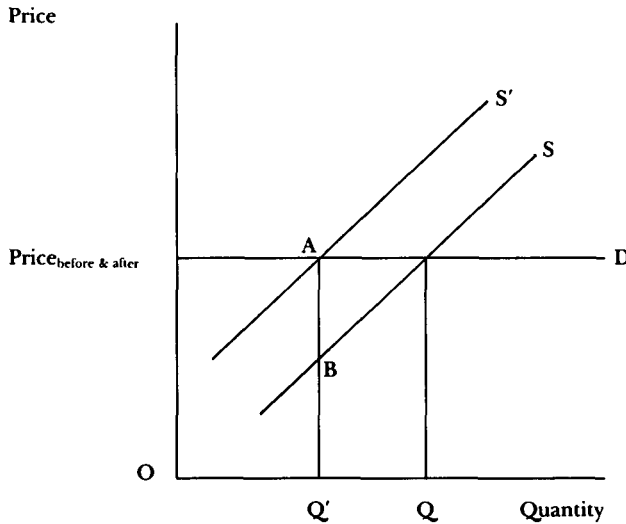
However, when an illegal overcharge occurs in an extended chain of vertically-related levels of production and distribution, the extreme cases (1A, 1B or 2) rarely occur. The general case (Case 3), in which neither demand nor supply are completely elastic or inelastic at any of the production or distribution levels, is more likely.¹⁵⁸ Consider a long chain of production and distribution in which one component part manufacturer has a monopoly. Assume the issue concerns how much of the monopoly overcharge is borne by other intermediate manufacturers who deal with or alter the component, how much is borne by the final product manufacturer, and how much is passed-on to the wholesaler,

155. 2 P. AREEDA & D. TURNER, *supra* note 36, § 337, at 190.

156. In Case 2, assume that the seller's supply curve shifts from S to S' by the amount of the monopoly overcharge, AB. The figure represents a totally elastic demand (D); therefore, buyers will buy all the supply offered at the same price, Price before & after, and nothing at a higher price. Because the price that sellers receive for their product will not reflect the monopoly overcharge, this industry must bear the entire burden of the antitrust violation. In addition to absorbing the entire monopoly overcharge, sellers are also harmed by a reduction in the quantity sold. The resulting decline in sales volume would cause some sellers to leave the industry. Once capacity has adjusted to the new situation, the remaining sellers suffer no further damage.

157. Although many factors influence these elasticities, economists have recognized four principles that determine whether the demand for a component part of a final product will be more inelastic. A monopoly overcharge will be more likely to be passed on: (1) the more inelastic the demand for the final product, (2) the smaller the proportion of the final product's total cost accounted for by that component, (3) the fewer substitutes available for that component, and (4) the more inelastic the supply of substitute components. W. BAUMOL & A. BLINDER, *supra* note 38, at 385-86; A. MARSHALL, *PRINCIPLES OF ECONOMICS* 381-93 (8th ed. 1920).

158. In the general case neither demand (D) nor supply (S, S') are totally elastic or inelastic. Assume that supply shifts from S to S' by the amount of the monopoly overcharge, AB. The per unit price paid buyers after the overcharge, Price after, is higher than the price before, Price before, but only by AC, which is less than the full amount of the monopoly overcharge, AB; the buyers absorb BC of the overcharge.



CASE 2 (ELASTIC DEMAND)

retailer, ultimate consumer, and even a buyer of used products.¹⁵⁹ As in the extreme cases, the burdens allocable to each vertical level will depend on the respective elasticities of supply and demand at each level.¹⁶⁰ After the illegal overcharge, the supply curve of the direct purchaser shifts from *S* to *S'* by the amount of the overcharge, *AB*. However, the per unit price paid by the indirect purchasers at the next vertical level (*P* after) is higher than the price before (*P* before), but only by *AC*, which is less than the full amount of the monopoly overcharge, *AB*. As a result, the indirect buyer must absorb *BC* of the overcharge. The pass-on analysis is repeated at each subsequent level.

A many-leveled pass-on analysis is more complicated than that described above because a monopolistic overcharge may have cumulative effects as it occurs farther back in the chain of production and distribution.¹⁶¹ After passing through several

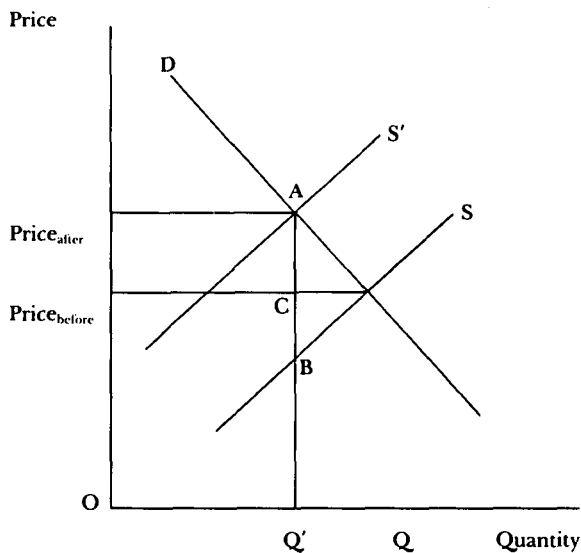
159. See, e.g., *Mangano v. American Radiator & Standard Sanitary Corp.*, 438 F.2d 1187 (3d Cir. 1971), *aff'g per curiam Philadelphia Hous. Auth. v. American Radiator & Standard Sanitary Corp.*, 50 F.R.D. 13 (E.D. Pa. 1970). For a further discussion of *Mangano*, see *infra* notes 214-15 and accompanying text.

160. That is, the indirect purchaser and the middleman (the direct purchaser) will share the overcharge in the following ratio:

$$\frac{\text{buyer's burden}}{\text{seller's burden}} = \frac{\text{elasticity of supply}}{\text{elasticity of demand}}$$

Comment, *supra* note 53, at 746 n.18; see *Illinois Brick*, 431 U.S. at 741; R. MUSGRAVE & P. MUSGRAVE, *supra* note 149, at 452; *Schaefer*, *supra* note 70, at 893.

161. If all the subsequent vertically related levels have totally elastic de-



CASE 3 (THE GENERAL CASE)

levels, depending upon the market structures (*i.e.*, level of competition) and input substitution possibilities at each level, the cumulative effect of the overcharge on price per unit may be less than, equal to, or even greater than the initial overcharge. Unless subsequent stages of production and distribution are perfectly competitive, the loss in the value of output at successive levels¹⁶² is cumulatively larger, with the largest loss at the level selling the

mand curves as in Case 2, the price to consumers will not be higher than before the overcharge. If, however, all the subsequent levels have demand and supply curves that are neither totally elastic nor inelastic, as in Case 3, the price will rise cumulatively as an increase in one industry causes an upward shift in the supply curve and a commensurate rise in the price of the next vertically related level. If the demand curves at subsequent levels are relatively elastic and market imperfections are not large, the cumulative rises in price may amount to less than the initial overcharge per unit. If market imperfections in subsequent levels are substantial, the overcharge per unit that consumers pay will be greater than the initial overcharge per unit. For example, successive monopolies in vertically related levels will cause the final price to be higher and the output lower than if only one monopoly existed in the chain of production and distribution. Nevertheless, monopoly profit will be lower. A single monopoly restricts output and raises prices so as to maximize profit; therefore, a further increase in price caused by a monopoly at a subsequent level unduly restricts output and produces a reduction in the total profit extracted from consumers. The desire to avoid multiple monopolies in the chain of production and distribution provides a powerful incentive for vertical integration. For discussions of the rationale for, and effects of, vertical integration, see O. WILLIAMSON, *MARKETS AND HIERARCHIES: ANALYSIS AND ANTITRUST IMPLICATIONS* ch. 6 (1975); Adelman, *Integration and Antitrust Policy*, 63 HARV. L. REV. 27 (1949); Joskow, *Asset Specificity and the Structure of Vertical Relationships: Empirical Evidence*, 4 J.L. ECON. & ORG. 95 (1988).

162. Value of output can be measured as price times quantity sold. Thus, when demand is completely elastic, as in Case 2, price does not rise; neverthe-

final product.¹⁶³

VII. THREE PRESUMPTIONS FOR APPORTIONING DAMAGES
BETWEEN DIRECT AND INDIRECT PURCHASERS IN
CONSOLIDATED STATE AND FEDERAL
ANTITRUST CASES

If we were merely concerned with damage recovery suits that follow-on after antitrust suits initiated by the federal government, the simplicity of a direct purchaser rule would have much to recommend it on deterrence grounds. Indeed, follow-on suits by direct purchasers would probably deter antitrust violations as well as follow-on suits by indirect purchasers.¹⁶⁴ However, if we are also concerned with encouraging states and private parties to initiate antitrust suits on their own, then the right to recover damages should be awarded to the party most likely to investigate and initiate antitrust suits on its own. That is, the deterrence goal favors granting damages to the party most likely to initiate a meritorious antitrust suit independent of the federal government, whether that is the direct or indirect purchaser. This consideration is important if we wish to encourage indirect purchaser suits brought as consumer class actions or suits by states in their *parens patriae* capacity. Although not mentioned explicitly in *ARC America*, this aspect of the deterrence goal probably weighed heavily in the Court's refusal to find federal preemption of state indirect purchaser statutes.

Both pass-on or incidence theory and an analysis of the decisions of courts in (1) federal cases before *Illinois Brick's* direct purchaser rule, (2) federal cases trying to come under the preexisting, fixed quantity, cost-plus exception to the direct purchaser rule, (3) consolidated state and federal cases after *Illinois Brick* involving direct and indirect purchasers, and (4) state antitrust cases involving indirect purchasers, suggest three presumptions for the apportionment of damages between direct and indirect purchasers in cases initiated under state statutes.

less, the value of output decreases because the overcharge reduces the quantity sold.

163. McKenzie, *Ideal Output and the Interdependence of Firms*, 61 *ECON. J.* 785, 790 (1951); Warren-Boulton, *Vertical Control with Variable Proportions*, 82 *J. POL. ECON.* 783, 788-90 (1974). In addition, the "dead weight" or "welfare loss" resulting from a monopolistic overcharge has cumulatively larger effects as successive stages in the vertical chain of production and distribution.

164. In *Hanover Shoe* the Supreme Court said that allowing direct purchasers to sue would prevent antitrust violators from "retain[ing] the fruits of their illegality." *Hanover Shoe*, 392 U.S. at 494.

A. *Presumption I*

The first presumption is as follows: In antitrust suits initiated under state laws that involve public or commercial construction contracts, the buyers for whom the projects were constructed, whether direct or indirect purchasers, should be the preferred parties to recover damages for illegal overcharges.

The pass-on issue often arises in the context of cases involving public or commercial construction contracts in which subcontractors or their suppliers have engaged in price fixing.¹⁶⁵ In public or commercial construction contracts, price is often determined either explicitly or implicitly on a cost-plus-reasonable-profit basis. Moreover, the quantity bought in order to enable a construction project to comply with detailed specifications is not usually altered due to the overcharge. Public or commercial construction contracts correspond closely to Case 1A of pass-on theory, the inelastic demand case. In these cases, the quantity sold is unlikely to be effected by the overcharge, and the entire overcharge is usually passed-on to the indirect purchaser of the project.¹⁶⁶ Moreover, if the price at which the direct purchaser sells to the indirect purchaser is based on a pre-specified percentage markup, the direct purchaser's profit will increase as a result of the illegal overcharge because he will earn a profit on the illegal overcharge as well as a profit on legal costs.¹⁶⁷ Therefore, in Case 1A, the inelastic demand or fixed quantity, cost-plus case, the direct purchaser has much less incentive to sue than does the indirect purchaser. This is because the direct purchaser usually suffers no injury from the illegal overcharge and may in fact benefit from the overcharge.

In construction cases decided prior to *Illinois Brick*, courts usually allowed the buyer for whom the project was constructed, whether a direct or indirect purchaser, to recover damages.¹⁶⁸ In *Illinois Brick* the Supreme Court confronted a construction case in

165. See Cirace, *supra* note 53, at 189-93.

166. For a discussion of the inelastic demand case, see *supra* notes 150-52 and accompanying text.

167. The increase in profits results because the illegal overcharge increases costs to which the percentage markup is applied. H. HOVENKAMP, *supra* note 39, at 369-70.

168. These decisions, known as the *Electrical Equipment Cases*, were private treble-damage actions brought by utilities against manufacturers who conspired to fix prices of electrical generators. See *Commonwealth Edison Co. v. Allis-Chalmers Mfg. Co.*, 335 F.2d 203 (7th Cir. 1964); *Washington v. General Elec. Co.*, 246 F. Supp. 960 (W.D. Wash. 1965); *Ohio Valley Elec. Corp. v. General Elec. Co.*, 244 F. Supp. 914 (S.D.N.Y. 1965).

which the plaintiffs, who were the pass-on proponents, argued that the cost-plus exception first recognized in *Hanover Shoe* applied to its claim.¹⁶⁹ The demand for the price-fixed concrete blocks was set by contract specifications before the indirect purchasers even accepted bids¹⁷⁰ and was therefore inelastic. In addition, the price allegedly fully reflected the overcharge because it was set by a rule-of-thumb markup.¹⁷¹ In response, the Supreme Court further limited the cost-plus contract exception to fixed quantity, cost-plus contracts,¹⁷² disingenuously asserted that *Illinois Brick* did not come within the still more restricted exception,¹⁷³ and then forthrightly refused to carve out exceptions for particular types of markets.¹⁷⁴ The *Illinois Brick* version of the exception corresponds to Case 1A of pass-on theory, the inelastic demand case, in which the quantity sold is not affected by the overcharge so that the entire overcharge is passed-on to the indirect purchaser. After *Illinois Brick* several courts have denied the cost-plus exception unless the contract with the indirect purchasers specified both markup and quantity—a circumstance one court thought would be quite rare.¹⁷⁵ However, *Illinois v. Borg, Inc.*¹⁷⁶ is a post-*Illinois Brick* construction contract case initiated

169. *Illinois Brick*, 431 U.S. at 743-44; *Hanover Shoe*, 392 U.S. at 494.

170. See *Illinois v. Ampress Brick Co.*, 536 F.2d 1163, 1164 (7th Cir. 1976), *rev'd sub nom. Illinois Brick Co. v. Illinois*, 431 U.S. 720 (1977).

171. One commentator has suggested that the Court should have accepted this situation as analogous to a cost-plus contract because it converted the direct purchasers into mere conduits for the overcharge. Note, *Illinois Brick: The Death Knell of Ultimate Consumer Antitrust Suits*, 52 ST. JOHN'S L. REV. 421, 435 n.57 (1978).

172. See *Illinois Brick*, 431 U.S. at 736. The Court stated that "*Hanover Shoe* indicated the narrow scope it intended for any exception to its rule barring pass-on defenses by citing, as the only example of a situation where the defense might be permitted, a pre-existing cost-plus contract. In such a situation, the purchaser is insulated from any decrease in its sales as a result of attempting to pass on the overcharge, because its customer is committed to buying a *fixed quantity* regardless of price." *Id.* at 735-36 (emphasis added).

173. *Id.* at 736. "The competitive bidding process by which the concrete block involved in this case was incorporated into masonry structures and then into entire buildings can hardly be said to circumvent complex market interactions as would a cost-plus contract." *Id.*

174. *Id.* at 744.

175. See *Phillips v. Crown Cent. Petroleum Corp.*, 602 F.2d 616, 634 n.4 (4th Cir. 1979) (In *Illinois Brick* the Supreme Court "seemingly read *Hanover Shoe* as extending the exception only to rare situations . . ."), *cert. denied*, 444 U.S. 1074 (1980); *Mid-West Paper Prods. Co. v. Continental Group, Inc.*, 596 F.2d 573, 577 n.9 (3d Cir. 1979); *Fisher v. Wattles*, 639 F. Supp. 7, 8-9 (M.D. Pa. 1985); see also P. AREEDA & H. HOVENCAMP, *supra* note 4, ¶ 337.3c, at 357-59; Comment, *supra* note 81.

176. 548 F. Supp. 972 (N.D. Ill. 1982).

under federal law in which both the fixed quantity and cost-plus requirements may have been met. “[T]he plaintiffs, who only dealt directly with general piping contractors, alleged illegal price-fixing by subcontractors.”¹⁷⁷ Further, “[t]he contractors obtained their contracts with the plaintiffs first, and then added on the independently obtained subcontractors’ bids.”¹⁷⁸ Consequently, “both contractual obligation and amount subject to the general contract was established without reference to the price fixing.”¹⁷⁹

After *Illinois Brick* a small number of follow-on, private suits were filed after the relatively large number of criminal antitrust prosecutions initiated by the federal government in highway construction cases.¹⁸⁰ The lack of follow-on damage recovery cases by direct purchasers after federal prosecutions may be explained by the fact that the overcharges on materials can be passed-on to buyers. Additionally, direct purchasers may fear disruption of business relationships or even physical retaliation by antitrust violators in an industry notorious for its relationship with organized crime.¹⁸¹ Consequently, the direct purchaser rule may have significantly reduced deterrence in public and commercial construction cases.

The principal case, *ARC America*, is a public construction case in which states, who were indirect purchasers, initiated the investigation and filed antitrust suits under state law.¹⁸² Consequently, the direct purchasers merely filed tag-along federal suits.¹⁸³ From pass-on theory, one can infer that in industrial and public construction contracts cases, the direct purchasers bear little or none of the burden of the overcharge. Therefore, most if not all of the damage recovery that direct purchasers receive is a wind-fall. If they recover all or the largest share of the settlement in consolidated state and federal antitrust cases involving public and

177. *Id.* at 973-74.

178. *Id.* at 974.

179. *Id.* at 976. “[E]ach general contractor first obtained its contract and then added on the independently sustained subcontractors’ bids on a dollar-for-dollar basis.” *Id.*

180. See Joyce & McGuckin, *Assignments of Rights to Sue Under Illinois Brick: An Empirical Assessment*, 31 ANTITRUST BULL. 235, 258 (1986) (no follow-on activity occurs in nearly half the . . . cases”).

181. One such industry is the concrete industry in New York. See N.Y. Times, Jan. 6, 1987, at A1, col. 2; *Id.*, March 19, 1987, at B1, col. 2; *Id.*, Apr. 30, 1988, at 34, col. 4; *Id.*, July 10, 1988, § 1, at 36, col. 3.

182. *ARC America*, 109 S. Ct. at 1663.

183. *In re Cement & Concrete Antitrust Litig.*, 437 F. Supp. 750, 751 (J.P.M.L. 1977).

commercial construction contracts, indirect purchasers, who are the real injured parties, will have little incentive to initiate such suits independently of the federal government. Moreover, deterrence will almost surely suffer.

B. *Presumption II*

A second presumption is as follows: In antitrust suits initiated under state laws that involve products sold without alteration (final products), consumer class actions or state *parens patriae* suits, whether on behalf of direct or indirect purchasers, should be the preferred means of recovering damages for illegal overcharges.

When price-fixing is engaged in by manufacturers or distributors of products sold without alteration¹⁸⁴ (final products),¹⁸⁵ pass-on theory suggests that ultimate consumers will suffer the greatest injury from the illegal overcharge.¹⁸⁶ Case 1B is the relevant theoretical case: long-run supply curves of distributors (wholesalers and retailers) are generally highly elastic¹⁸⁷ (perfectly elastic at the limit). Therefore, distributors can pass-on most or all of the illegal overcharge to consumers. However, unlike Case 1A in which consumers bear the entire antitrust injury, in Case 1B consumers will buy fewer units at the enhanced price because their demand is not completely inelastic. Distributors are

184. Cf. Beane, *Antitrust: Standing and Passing-On*, 26 BAYLOR L. REV. 331, 351 (1974) ("judicial interpretation . . . has allowed" pass-on in situations where "the product reaches [the ultimate purchaser] in the same form as that sold by the overcharging suppliers"). In *Illinois Brick* the Court seemed to have believed that such an attempt to carve out exceptions would undercut the no pass-on rule by importing back into the judicial process the same complex evidence that the rule was meant to exclude. *Illinois Brick*, 431 U.S. at 744.

185. When measuring the gross national product (GNP), which is the total dollar value of the goods and services produced in an economy during a given period, economists include only "final" products (goods and services) such as apples, bread, automobiles, haircuts and healthcare ultimately bought and used by consumer. "Intermediate products," such as wheat, steel, and hair clippers, are not included so as to avoid overstating the GNP due to "double counting" (e.g., counting the dough and then the bread, the steel and then the automobile). W. BAUMOL & A. BLINDER, *supra* note 38, at 75-79; P. SAMUELSON & W. NORDHAUS, *supra* note 38, at 102-08.

186. "[O]nce recovery [is] concentrated in the hands of the direct purchaser, there is a risk that those purchasers will be unwilling to sue because they can avoid actual injury to themselves by passing-on the added costs to their purchasers and, by suing, they will endanger their source of supply." *Mid-West Paper Prods. Co., v. Continental Group, Inc.*, 596 F.2d 573, 596 (3d Cir. 1979) (Higginbotham, J., dissenting) (citation omitted); see also *Illinois Brick*, 431 U.S. at 746.

187. For a discussion of the case of elastic supply, see *supra* notes 153-57 and accompanying text.

therefore injured to the extent of the profits they lose on reduced volume. The burden of the overcharge is shared by both distributors and consumers—"the former suffer lost profits, and the latter pay higher prices."¹⁸⁸

Even among those who argue that *Illinois Brick* generally has not decreased deterrence, there are those who suspect that the decision may have lessened deterrence against price-fixing conspiracies by final product manufacturers. This is because consumers or their surrogates, who are usually indirect purchasers and who usually bear the burden of the illegal overcharge, have no incentive to initiate investigations and antitrust suits under federal law.¹⁸⁹ One indication of lessened deterrence is that the direct purchaser rule completely insulates the violators from suits by consumers or their surrogates if manufacturers or wholesalers, who engage in antitrust violations, sell to wholesalers or retailers. Another reason is that the *Illinois Brick* rule almost totally emasculates section 4c of the Clayton Act,¹⁹⁰ the federal *parens patriae* statute that authorizes a state to sue on behalf of natural persons residing in that state to recover the damages they suffered as a result of Sherman Act violations.¹⁹¹ After *Illinois Brick* state statutes that allow state *parens patriae* suits on behalf of indirect purchasers are all the more necessary as an avenue for consumer redress. A third indication of the lessening of deterrence is that wholesalers and retailers, if they are not members of powerful chain stores or mass retailers, may lack the resources to initiate investigations of possible antitrust violations, may be reluctant to sue their suppliers because they fear disruption of business relationships, may lack the financial ability to proceed with a major

188. 2 P. AREEDA & D. TURNER, *supra* note 36, at 190.

189. Cavanagh, *supra* note 84, at 288-90; Note, *supra* note 171, at 453; Note, *supra* note 71, at 1243.

190. 90 Stat. 1394 (1976) (codified as amended at 15 U.S.C. § 15c (1988)).

191. Section 4c (reproduced in pertinent part at *supra* note 24) does not say directly whether relief may be awarded on behalf of consumers purchasing through middlemen. There is a provision against any award that "duplicates amounts which have been awarded" or "is properly allocable" to those individuals who opt out of the state suit and to "any business entity." The latter category suggests middlemen, but may simply refer to businesses that were injured by the same injury borne by the natural person included or excluded from the state suit. However, the Senate Committee report states that recovery is authorized on behalf of consumers purchasing through middlemen. S. REP. No. 803, 94th Cong., 2d Sess. 43-43 (1976). In *Illinois Brick* the Court argued that § 4c was intended merely to provide a new procedural device to enforce existing consumer rights and not to create a right where none otherwise existed. *Illinois Brick*, 431 U.S. at 733 n.14.

lawsuit, and may desire to avoid other risks of litigation.¹⁹²

When consolidated state and federal antitrust suits initiated under state law involve illegal overcharges at the final product level, a minimum reform would require that the *Illinois Brick* rule not apply; that damage recoveries by distributors and retailers, who are direct purchasers, be limited to lost profits; and that consumers or their surrogates, whether direct or indirect purchasers, recover damages for the overcharges (under either class actions or state *parens patriae* suits).

Prior to *Illinois Brick*, in the *Oil Jobber Cases*¹⁹³ and in *West Virginia v. Chas. Pfizer & Co.*,¹⁹⁴ courts held that wholesalers and retailers (direct purchasers) pass-on most or all of the illegal overcharges and thus have little claim to antitrust recovery.¹⁹⁵ In

192. Cirace, *supra* note 53, at 195.

193. *Clark Oil Co. v. Phillips Petroleum Co.*, 148 F.2d 580 (8th Cir.), *cert. denied*, 326 U.S. 734 (1945); *Northwestern Oil Co. v. Socony-Vacuum Oil Co.*, 138 F.2d 967 (7th Cir. 1943), *cert. denied*, 321 U.S. 792 (1944); *Twin Ports Oil Co. v. Pure Oil Co.*, 119 F.2d 747 (8th Cir.), *cert. denied*, 314 U.S. 644 (1941); *Leonard v. Socony-Vacuum Oil Co.*, 42 F. Supp. 369 (W.D. Wis.), *appeal dismissed*, 130 F.2d 535 (7th Cir. 1942). The wholesaler plaintiffs were direct buyers whose margins were guaranteed in contracts with defendant oil refiners. Many plaintiffs actually paid wholesale prices tied to the retail price of gasoline. The courts accepted the pass-on defense because plaintiffs were unable to prove injury.

194. 314 F. Supp. 710 (S.D.N.Y. 1970), *aff'd*, 440 F.2d 1079 (2d Cir.), *cert. denied*, 404 U.S. 871 (1971). Among the plaintiffs in this case, a complex multidistrict combination of 66 civil antitrust suits alleging illegal overcharging in the sale of antibiotic drugs, were various state and local governments, wholesale and retail druggists, institutional consumers such as private hospitals and Blue Cross and purchasers of antibiotics for non-human purposes. The federal district court divided the plaintiffs into two classes. The first, which consisted of state and local governments and their agencies with claims arising from direct purchases or welfare payments, was awarded \$60 million. The second class, which consisted of wholesalers, retailers, and individual consumers including claims of states as *parens patriae* on behalf of their citizens, was awarded the remaining \$40 million. The district court approved a settlement which allocated the wholesalers and retailers only \$3 million as "nuisance value," the remainder going to consumers. The court rejected the wholesalers' claims in part because they sold on a cost-plus basis and in part because of the uncertainty in the law after *Hanover Shoe*. *Id.* at 745-46.

195. See *Clark Oil*, 148 F.2d at 582 (because increase in price was passed on to customers of plaintiff, retailer could demonstrate no damages, plaintiff could not recover); *Northwestern Oil*, 138 F.2d at 971 (because plaintiff-retailer demonstrated that increased cost was passed on to ultimate consumer, defendant entitled to directed verdict); *Twin Ports Oil*, 119 F.2d at 750 (because price increase to plaintiff-retailer was immediately reflected in price to other retailers and consumers, plaintiff failed to show damages and reduced margins); *Chas. Pfizer*, 314 F. Supp. at 745-46 (because overcharge was added to cost and collected from consumer, the court found it "difficult to see . . . any real damages to wholesalers or retailers"); *Leonard*, 42 F. Supp. at 370 (because increase may have been passed on to consumers, plaintiff may not have suffered any damage).

*re Chicken Antitrust Litigation*¹⁹⁶ is a case that straddles the pre- and post-*Illinois Brick* eras. It involved an antitrust settlement negotiation between defendant chicken producers and several plaintiff classes that began prior to the *Illinois Brick* decision but was not completed until after the decision.¹⁹⁷ Prior to the decision, the settlement plan called for wholesaler (direct) purchasers to receive only ten percent of the settlement.¹⁹⁸ The relatively small amount allotted to wholesalers was due to the belief that they generally passed-on their increased costs and that ultimate consumers suffered most of the actual injury stemming from the alleged price-fixing.¹⁹⁹ After *Illinois Brick* the wholesalers' share was increased to twenty-five percent to reflect their enhanced bargaining position.²⁰⁰ Over the objections of some wholesalers who argued that they should be entitled to the entire settlement as a result of *Illinois Brick*, the Fifth Circuit approved the adjusted settlement.²⁰¹ The court decided that the defendants would not agree to settle unless both direct and indirect purchasers released their claims against defendants;²⁰² indirect purchasers also had federal remedies in the form of injunctive relief²⁰³ and state law remedies which could be consideration for a settlement.²⁰⁴

In order for consumers or their surrogates, who are indirect purchasers, to recover damages in a federal antitrust suit against manufacturers after *Illinois Brick*, they must prove either a vertical conspiracy between defendant manufacturers and the direct purchasers, who must be joined in the suit,²⁰⁵ that the defendant manufacturers control the direct, retail purchasers,²⁰⁶ or the existence of a preexisting, fixed quantity, cost-plus contract be-

196. 669 F.2d 228 (5th Cir. 1982) (Justice Department sought injunction against continuation of conference call program by which National Broiler Marketing Association allegedly coordinated price-fixing and production decisions of its members and some participating nonmember chicken producers).

197. *Id.* at 234.

198. *Id.* at 233.

199. *Id.* at 233 n.8.

200. *Id.* at 234.

201. *Id.* at 238-40.

202. *Id.* at 238.

203. *Id.* at 238-39.

204. *Id.* (citing *In re Corrugated Container Antitrust Litig.*, 643 F.2d 195, 221-22 (5th Cir. 1981) (release of state law claims was one part of settlement of federal antitrust case), *cert. denied*, 456 U.S. 1012 (1982); *Oswald v. McGarr*, 620 F.2d 1190, 1197-98 (7th Cir. 1980) (release of future claims was important element of antitrust settlement)).

205. *In re Coordinated Pretrial Proceedings in Petroleum Prods. Antitrust Litig.*, 691 F.2d 1335, 1341-42 (9th Cir. 1982), *cert. denied*, 464 U.S. 1068 (1984).

206. *Illinois Brick*, 431 U.S. at 736 n.16.

tween defendant manufacturers and direct retail purchasers.²⁰⁷ Because indirect purchasers have had little success in meeting any of these requirements, *Illinois Brick* all but foreclosed suits by consumers or their surrogates under federal law.

Given the difficulties that indirect consumer plaintiffs must surmount in order to recover damages under federal law, they have turned to state antitrust laws for relief.²⁰⁸ For example, California courts have generally given liberal interpretations to state antitrust statutes authorizing suits by indirect purchasers. One California court of appeals held that out-of-state paper companies that sold containers indirectly to in-state customers were subject to *in personam* jurisdiction under the state's long-arm statute.²⁰⁹ Another held that damages recoverable by consumers as a result of unlawfully fixed milk prices by supermarkets could be had by "fluid class recovery" or "cy pres remedy" distribution methods.²¹⁰ However, one California court of appeals has held that direct purchasers were indispensable parties in a price-fixing action brought by indirect purchasers (end user consumers) against manufacturers of industrial gases since, under a "common fund" theory, there may be conflicting, inconsistent claims to the damage recovery.²¹¹ Another determined that if "the state statute required that all overcharges be paid to indirect consumers, but not direct consumers, there would be a conflict with the federal remedy."²¹²

207. *Id.* at 735-36.

208. See Note, *supra* note 90, at 204-08 (describing state statutes).

209. *St. Joe Paper Co. v. Superior Court*, 120 Cal. App. 3d 991, 996-1000, 175 Cal. Rptr. 94, 97-99 (1981), *cert. denied* 455 U.S. 982 (1982); see Hovenkamp, *State Antitrust in the Federal Scheme*, 58 *IND. L.J.* 375, 393 (1983) (The issue in *St. Joe Paper* was "not the court's personal jurisdiction over the defendants, but rather the state's legislative jurisdiction to condemn price-fixing in remote parts of the country. That issue [was] made more difficult because the plaintiffs were indirect purchasers.").

210. *Bruno v. Superior Court*, 127 Cal. App. 3d 120, 123, 131-34, 179 Cal. Rptr. 342, 343, 348-49 (1981) (petitioners requested that damages be paid on basis of either (1) lowering of milk fluid prices in Orange and Los Angeles Counties by each of the defendants, or (2) depositing damages with State of California, or unit thereof, for limited purposes of being applied to [eleemosynary] purposes benefitting the consuming public in Orange and Los Angeles Counties).

211. *Union Carbide Corp. v. Superior Court*, 133 Cal. App. 3d 443, 183 Cal. Rptr. 318, 322-23 (1982) ("[R]eal parties appear to concede, that [defendant] petitioners cannot be required to pay twice for the same overcharge."), *vacated*, 36 Cal. 3d 15, 679 P.2d 14, 201 Cal. Rptr. 580 (1984).

212. *Crown Oil Corp. v. Superior Court*, 177 Cal. App. 3d 604, 612 n.5, 223 Cal. Rptr. 164, 168 n.5 (1986), *appeal dismissed sub nom. Crown Oil Corp. v. Lapidus Popcorn, Inc.*, 479 U.S. 879 (1986).

C. *Presumption III*

A third presumption is as follows: In antitrust suits initiated under state laws that involve products altered after sale (intermediate products in a long chain of production and distribution), the party who initiates an antitrust suit independently of the federal government, whether direct or indirect purchaser, should be the preferred party to recover damages for illegal overcharges.

In many cases illegal overcharges originate "upstream" in a long chain of production and distribution. This means that after a component part that bears an illegal overcharge is sold from one manufacturer to another, it is usually altered or incorporated into a more complex product.²¹³ *Mangano v. American Radiator & Standard Sanitary Corp.*²¹⁴ is a pre-*Illinois Brick* case that provides a good example of this procedure. It involved an illegal overcharge of \$10 to \$20 on plumbing fixtures that were used in buildings selling for as much as \$30,000.²¹⁵ The vertical chain of production and distribution extended from plumbing fixture manufacturers through plumbing wholesalers, plumbing contractors, general contractors, to either the first, or in some instances, the second, owners of home, apartment, and commercial buildings and their tenants.

When there are illegal overcharges by sellers of intermediate products in a long chain of production and distribution, pass-on theory suggests that the general case (Case 3) is relevant. It also suggests that it is not possible to make practical predictions as to how much of the illegal overcharge is borne by manufacturers, distributors or consumers without knowledge of the specific demand and supply elasticities at each level of production and distribution.²¹⁶ When an illegal overcharge originates below the level of the final product, it is not clear who is the appropriate party to receive compensation.²¹⁷ In this context, if we were merely concerned with damage recovery suits that tag-along or follow-on after antitrust suits initiated by the federal government,

213. For a discussion of the distinction between final and intermediate products (goods and services), see *supra* note 185.

214. 438 F.2d 1187 (3d Cir. 1971), *aff'g per curiam* Philadelphia Hous. Auth. v. American Radiator & Standard Sanitary Corp., 50 F.R.D. 13 (E.D. Pa. 1970).

215. *Id.* at 1188.

216. See *In re Beef Indus. Antitrust Litig.*, 542 F. Supp. 1122, 1140-41 (N.D. Tex. 1982), *aff'd*, 710 F.2d 216 (5th Cir. 1983).

217. As the Supreme Court has correctly pointed out, such knowledge is beyond the technical competence of courts. *Illinois Brick*, 431 U.S. at 741-42; *Hanover Shoe*, 392 U.S. at 492-93.

a rigid direct purchaser rule would have much to recommend it on deterrence grounds. Again, follow-on suits by direct purchasers would probably deter antitrust violations as well as follow-on suits by indirect purchasers.²¹⁸ However, when illegal overcharges originate below the level of the final product, if we are concerned with encouraging private parties to initiate investigations and antitrust suits on their own, the goal of deterrence favors allowing a suit for damages by the party who, independently of the federal government, initiates an investigation and antitrust suit under state law.

In general, we would expect that final product manufacturers or chain retailers would be more likely to institute antitrust suits on their own in response to an illegal overcharge on intermediate products. Intermediate product manufacturers who are direct purchasers will generally be smaller and have less financial resources than final product manufacturers or chain distributors or retailers who are usually indirect purchasers. Therefore, intermediate product manufacturers are less likely to investigate and initiate antitrust suits on their own than are final product manufacturers or chain distributors or retailers. Also, intermediate manufacturers may lack the financial ability to proceed with a major lawsuit, may desire to avoid other risks of litigation, or may fear disruption of business relationships. This deep-pocket rationale for damage recovery by final product manufacturers or chain retailers is analogous to the rationale in products liability law for holding the manufacturer of a final product liable to ultimate consumers for injuries even though the dangerous defect occurred in a component part supplied by an intermediate manufacturer.²¹⁹

Similarly, when an illegal overcharge originates far back in a long chain of production and distribution, individual consumers often have such a small stake in the outcome of an antitrust suit that only complex class actions or *parens patriae* suits would make

218. In *Hanover Shoe* the Supreme Court said that allowing direct purchasers to sue would prevent antitrust violators from "retain[ing] the fruits of their illegality." *Hanover Shoe*, 392 U.S. at 494.

219. See *Union Supply Co. v. Pust*, 196 Colo. 162, 583 P.2d 276 (1978) (takes circumscribed view of holding component manufacturer strictly liable); *Goldberg v. Kollsman Instrument Corp.*, 12 N.Y.2d 432, 191 N.E.2d 81, 240 N.Y.S.2d 592 (1963) (dismissing action against component manufacturer but not airplane manufacturer, despite lack of privity); *Parker v. Warren*, 503 S.W.2d 938 (Tenn. Ct. App. 1974); see also W. KEETON, D. DOBBS, R. KEETON, & D. OWEN, *THE LAW OF TORTS* 705 (5th Ed. 1984) (discussing strict liability of assembler-manufacturers where defect originated with original part).

viable. More importantly, consumers and their surrogates are not well positioned to become aware of or to initiate an investigation into illegal overcharges originating far back in the chain of production and distribution. Therefore, they are unlikely to do so. If state antitrust laws are to further the policy goal of deterrence, the damage recovery should be given to the plaintiff best able and willing to undertake the investigation and initiate an antitrust suit independently of the federal government.

Pre-*Illinois Brick* cases did not evince a consistent policy with respect to who may recover damages for illegal overcharges originated by component part manufacturers in a long chain of production and distribution. In *Carnivale Bag Co. v. Slide-Rite Manufacturing Corp.*,²²⁰ four manufacturers of clothing, plastic bags and carryalls filed a class action to recover treble damages for injuries resulting from a price-fixing conspiracy among zipper slider manufacturers.²²¹ The latter group sold zipper sliders to zipper manufacturers who in turn sold zippers to the plaintiffs.²²² The court granted the final product manufacturers an opportunity to prove losses caused by the antitrust violations of component part manufacturers.²²³ On the other hand, *Mangano*²²⁴ involved a long vertical chain of production and distribution from plumbing fixture manufacturers, plumbing wholesalers, plumbing and general contractors, and owners of buildings.²²⁵ There, the Third Circuit held that *Hanover Shoe* required dismissal as to the owner plaintiffs because of the insuperable burden of proving that the overcharge was passed-on to them.²²⁶ The court also doubted

220. 395 F. Supp. 287 (S.D.N.Y. 1975).

221. *Id.* at 288-89.

222. *Id.* at 288. Denying the defendant's motion to dismiss, the district court concluded that *Hanover Shoe* prohibited only the defensive use of pass-on theory. *Id.* at 291.

223. *Id.* An earlier pre-*Hanover Shoe* case reaching a different result was *Wolfe v. National Lead Co.*, 225 F.2d 427 (9th Cir.), *cert. denied*, 450 U.S. 915 (1955). Paint manufacturers sued the manufacturers of titanium pigment, a component of their paint, for fixing prices and for allocating amounts that paint manufacturers could purchase. Because the defendant's quota system gave preferential treatment to the plaintiff, however, the paint manufacturers could not demonstrate injury. As a result, the Ninth Circuit affirmed the dismissal of the suit. *Id.* at 434. Moreover, in *Wolfe*, which predates *Hanover Shoe*, the court said that the plaintiffs also had the burden of proving that they did not pass-on the overcharge to their customers. *Id.* at 433.

224. *Mangano v. American Radiator & Standard Sanitary Corp.*, 438 F.2d 1187 (3d Cir. 1971).

225. *Id.* at 1188.

226. *Id.*; *cf.* *Balmac, Inc. v. American Metal Prods. Corp.*, 1972 Trade Cas. (CCH) ¶ 74,235 (N.D. Cal. 1972) (heating contractors and building owners denied standing to sue gas vent pipe manufacturers for price-fixing because *Hano-*

that the price of a house would be influenced by the small amount of the overcharges.²²⁷ Despite the objection of some contractors that they did not receive adequate damages, the court later affirmed a settlement approved by the district court.²²⁸

In several post-*Illinois Brick* cases involving illegal overcharges that originated below the level of the final product, indirect purchasers have attempted to employ the pre-existing, fixed quantity, cost-plus contract exception to avoid the direct purchaser rule.²²⁹ In *In re Beef Industry Antitrust Litigation*²³⁰ cattle feeders, who fatten and sell cattle to meat packers, alleged that retail grocery chains conspired to purchase beef from packers at artificially low prices and that the depressed prices were "passed-on." This is a monopsony²³¹ case in which the alleged "illegal undercharge" was "passed-back" upstream in the chain of production. The district court held that the cattle feeders, who were indirect purchasers, could not establish that they fell within the pre-existing fixed quantity cost-plus exception to the direct purchaser rule²³² (or its functional equivalent).²³³ In *Illinois ex rel.*

ver Shoe required privity between plaintiffs and defendants). *But see In re Master Key Antitrust Litig.*, 1973-2 Trade Cas. (CCH) ¶ 74, 680 (D. Conn. 1973) (states, cities, builder-owners and private owners who brought hardware indirectly from price-fixing manufacturers had standing to sue for damages because *Hanover Shoe's* rejection of pass-on defense did not extend to offensive use), *appeal dismissed*, 528 F.2d 5 (2d Cir. 1975).

227. *Mangano*, 438 F.2d at 1188.

228. *Ace Heating & Plumbing Co. v. Crane Co.*, 453 F.2d 30, 34 (3d Cir. 1971), *aff'g* Philadelphia Hous. Auth. v. American Radiator & Standard Sanitary Corp., 322 F. Supp. 834 (E.D. Pa. 1971).

229. For examples of cases in which indirect purchasers had attempted to use the exception, see *supra* note 175.

230. 542 F. Supp. 1122 (N.D. Tex. 1982), *aff'd*, 710 F.2d 216 (5th Cir. 1983).

231. "The mirror image of monopoly is 'monopsony.' A monopsonist is a monopoly buyer rather than seller. Although most antitrust litigation of market power offenses has involved monopoly sellers rather than monopoly buyers, monopsony can impose social costs on society similar to those caused by monopoly." H. HOVENKAMP, *supra* note 39, at 17.

232. *In re Beef Indus.*, 542 F. Supp. at 1139.

233. *Id.* at 1140. In *In re Beef Industry* the district court's decision was on remand after the Fifth Circuit had accepted a "functional equivalent" to the pre-existing, fixed quantity, cost-plus contract exception authorized by the Supreme Court in *Illinois Brick*. *In re Beef Indus. Antitrust Litig.*, 600 F.2d 1148, 1164-65 (5th Cir. 1979), *cert. denied*, 449 U.S. 905 (1980); see also *In re New Mexico Natural Gas Antitrust Litig.*, 1982-1 Trade Cas. (CCH) ¶ 64,685, at 73,721-22 (D.N.M.) ("purchased gas adjustment" clause in plaintiff's purchase contracts required overcharge from alleged price-fixing of wellhead to be passed on; *Illinois Brick* did not apply; contracts did not specify quantity to be purchased).

Other courts have dealt with the cost-plus exception restrictively. See *Jewish Hosp. Ass'n v. Stewart Mechanical Enters.*, 628 F.2d 971, 976-77 (6th Cir. 1980) (*Illinois Brick* bars relief to property owner challenging price-fixing by subcon-

*Hartigan v. Panhandle Eastern Pipeline Co.*²³⁴ the direct purchaser was a price-regulated public utility whose statutory rate structure permitted it to pass-on the entire monopoly overcharge to its customers.²³⁵ The Seventh Circuit held that indirect purchasers could not avail themselves of the pre-existing, fixed quantity, cost-plus contract exception because the statutory scheme under which the utility set its prices specified the percentage markup but not the quantity.²³⁶ Judge Posner, concurring and dissenting, noted that a direct purchaser who is a price-regulated public utility has less incentive to sue than the usual direct purchaser because the public utility commission may force the utility to pass-on to consumers any and all damages that the utility recovers. If so, Judge Posner concluded, the utility will have no incentive to sue²³⁷ and the antitrust violation is likely to go unremedied.²³⁸

In sum, given the varied and complex fact patterns in which illegal overcharges occur upstream in a long chain of production and distribution, if our goal is to encourage private parties to perform their statutory role as private attorneys general in order to deter antitrust violations, then there should be at least a limited repeal of *Illinois Brick*. The limited repeal should presume that those who initiate investigations and antitrust suits under state law independently of the federal government, whether direct or indirect purchasers, will receive the largest share of damages.

VIII. CONCLUSION

In *ARC America* the United States Supreme Court held that *Illinois Brick*, which limits damage recoveries in federal antitrust suits to direct purchasers, does not prevent indirect purchasers from recovering damages under state antitrust law. Four conclusions follow from the uneasy and possibly inconsistent relationship between *Illinois Brick* and *ARC America*.

tractor where owner was not previously obligated to accept general contractor's bid), *cert. denied*, 450 U.S. 966 (1981); *Eastern Air Lines, Inc. v. Atlantic Richfield Co.*, 609 F.2d 497 (Temp. Emer. Ct. App. 1979) (fuel supplier could not use pass-on defense on theory that prices were passed-on according to preset formula because the quantity was unspecified); *see also Merican, Inc. v. Caterpillar Tractor Co.*, 713 F.2d 958, 968 (3d Cir. 1983) (applying similar reasoning), *cert. denied*, 465 U.S. 1024 (1984).

234. 839 F.2d 1206 (7th Cir.), *aff'd in part and rev'd in part*, 852 F.2d 891 (7th Cir.) (en banc), *cert. denied*, 109 S. Ct. 543 (1988).

235. *Id.* at 1207.

236. *Id.* at 1208-10.

237. *Id.* at 1212 (Posner, J., concurring and dissenting).

238. *Id.* at 1214 (Posner, J., concurring and dissenting).

First, after *ARC America* it is virtually certain that both direct and indirect purchasers will file state and federal suits against antitrust violators for illegal overcharges. It is also highly likely that both direct and indirect purchasers will be consolidated or joined in one suit whether in state or federal court. Second, the coexistence of both direct and indirect purchaser antitrust suits, especially if they are joined or consolidated in a state or a federal court, undermines the three policy rationales for the rigid *Illinois Brick* rule, which limits damage recoveries to direct purchasers in federal suits. Third, if we were merely concerned with damage recovery suits that tag-along or follow-on after antitrust suits initiated by the federal government, the simplicity of a direct purchaser rule would have much to recommend it on deterrence grounds because follow-on suits by direct purchasers probably deter antitrust violations to the same extent as follow-on suits by indirect purchasers. However, if we are also concerned with encouraging states and private parties to initiate antitrust suits on their own, then the right to recover damages should be awarded to the party most likely to investigate and to initiate antitrust suits. Fourth, in *ARC America* the Supreme Court failed to provide any criteria for coordinating the potentially duplicative and inconsistent damage remedies in consolidated state and federal suits.

It is necessary to develop criteria for damage apportionment between direct and indirect purchasers in consolidated state and federal antitrust suits. Currently, given the *Illinois Brick* rule and the potentially preemptive power of federal law, direct purchasers will probably get the lion's share of damages in consolidated state and federal antitrust cases regardless of the merits or the relevant policies. However, when consolidated direct-indirect purchaser suits are initiated under state laws as opposed to consolidated suits initiated by the federal government or direct purchasers, courts should not be required to adhere to federal priorities that favor direct purchasers. Instead, the courts should be free to apportion damages between direct and indirect purchasers so as to accommodate the four policy goals of antitrust law: compensating injured parties; deterring antitrust violations; avoiding multiple liability; and employing manageable judicial standards.

This article presents three presumptions, based on pass-on theory and state and federal tax law analysis, for apportioning damages when consolidated state and federal antitrust suits, involving both direct and indirect purchasers are initiated under state law. These presumptions occupy an intermediate position

between one extreme of a rigid direct purchaser rule and the other extreme of a complex, theoretical, case-by-case pass-on analysis. They also attempt to more appropriately accommodate the four antitrust policies. Federal legislation may be necessary to reduce the preemptive power of the *Illinois Brick* rule in suits initiated under state law. A more general repeal of *Illinois Brick* would employ these presumptions in all consolidated state and federal antitrust suits whether initiated under state or federal laws.