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Time to Rebuild The *Illinois Brick* Wall

Ethan Litwin, Hughes Hubbard & Reed LLP

The "indirect purchaser" rule, which denies standing to indirect purchaser plaintiffs[1] in federal antitrust cases, was the product of two remarkable decisions authored by the late Justice Byron White more than 30 years ago: *Hanover Shoe, Inc. v. United Shoe Machinery Corp*.[2] and *Illinois Brick Co. v. Illinois*.[3] Since that time, the indirect purchaser rule has experienced death by a thousand cuts, through both the adoption of so-called "*Illinois Brick* repealer" statutes by state legislatures and the misguided creation of broad exceptions to the rule by the lower federal courts. Originally conceived as a means of simplifying federal antitrust litigation, the indirect purchaser rule has instead contributed to the complexity of modern cases. Reform of the indirect purchaser rule is long overdue.

History of the Indirect Purchaser Rule

The indirect purchaser rule has its roots in Justice White's *Hanover Shoe* opinion of 1968. *Hanover Shoe* was a monopolization case in which the defendant argued that the plaintiff had suffered no injuries under Section 4 of the Clayton Act because the plaintiff had passed any overcharges along to its customers. Writing for an undivided Court,[4] Justice White held that antitrust injury under Section 4 was sustained when the illegal price was paid, regardless of whether the plaintiff had recouped all or part of its loss. *Hanover Shoe* was largely motivated by practical considerations. Displaying a healthy skepticism for econometric modeling, Justice White questioned whether calculation of a pass-on was feasible, given that the plaintiff's downstream prices were the product of numerous factors.

> We are not impressed with the argument that sound laws of economics require recognizing this defense. 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; indeed a businessman may be unable to state whether, had one fact been different (a single supply less expensive, general economic conditions more buoyant, or the labor market tighter, for example), he would have chosen a different price. 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. Finally, costs per unit for a different volume of total sales are hard to estimate. . . . Since establishing the applicability of the passing-on defense would require a convincing showing of each of these virtually unascertainable figures, the task would normally prove insurmountable. . . . Treble-damage actions would often require additional long and complicated proceedings involving massive evidence and complicated theories.[5]

Hanover Shoe was therefore primarily concerned with avoiding litigation complexity. Although the

Court also showed concern for avoiding rules that would reduce the incentives for private plaintiffs to enforce the antitrust laws, Justice White envisioned exceptions to the rule only where application of the pass-on defense would not require complex analyses, such as where the direct purchaser had preexisting cost-plus contracts with its customers, making it "easy to prove that the [direct purchaser] has not been damaged."[6] Justice White's pro-plaintiff, pro-enforcement opinion banning the pass-on defense inspired little controversy upon announcement.

The same cannot be said for Justice White's opinion nine years later in *Illinois Brick.* In *Illinois Brick*, the State of Illinois, on its own behalf and on behalf of local governmental entities, had claimed damages under Section 4 of the Clayton Act for alleged price fixing of concrete block. The State and the local governments, however, had not purchased concrete block directly from defendants, but rather had purchased products or contracted for construction into which the concrete block had been incorporated by an upstream purchaser. The State argued that the prices it and local governments had paid had nonetheless been inflated due to the direct purchasers' passing-on of the overcharge. Because *Hanover Shoe* restricted defendants' ability to limit damages by showing that the direct purchasers had passed-on the overcharge, the *Illinois Brick* defendants were now faced with the prospect of multiple recoveries – for the full amount of the overcharge for concrete blocks by contractors and other direct purchasers and for the passed-on amount by the State and other indirect purchasers. The Court was, in its words, presented with two options – "either we must overrule *Hanover Shoe* . . . or we must preclude [the indirect purchasers] from seeking to recover on their pass-on theory."[7] The Court chose the latter route.[8]

The indirect purchaser rule of *Illinois Brick* was, therefore, the necessary corollary to *Hanover Shoe*: if defendants were to be denied the right to present evidence that the direct purchaser plaintiffs had mitigated their losses, courts would have to deny standing to indirect purchasers to avoid the intractable task of trying to determine how much of an alleged overcharge was paid by the direct purchasers and how much, if any, was passed on to the indirect purchasers. In the Court's words, such an analysis would "complicate treble damage actions with attempts to trace the effects of the overcharge on the purchaser's prices, sales, costs, and profits, and of showing that these variables would have behaved differently without the overcharge."[9] The Court concluded that "[h]owever appealing this attempt to allocate the overcharge might seem in theory, it would add whole new dimensions of complexity to treble-damages suits and seriously undermine their effectiveness."[10] Affirming its intention to keep the complicated proof of pass-on theories out of the courtroom, the Court resolved the issue by establishing a bright line rule that only direct purchasers would have standing under Section 4 of the Clayton Act to seek damages for antitrust violations.[11] The delicate balance struck by the Supreme Court, rejecting both offensive and defensive use of passing-on theory, has now been the rule of federal antitrust law for more than a quarter of a century.

Chipping Away at Illinois Brick

The indirect purchaser rule ignited a political and legal firestorm. Although Congressional attempts to overrule *Illinois Brick* proved unsuccessful, state legislatures, led by California, enacted statutes restricting the effect of *Illinois Brick* to the federal antitrust laws. In 1989, the Supreme Court affirmed the legality of the *Illinois Brick* repealers in *California v. ARC America Corp.*,[12] holding that *Illinois Brick* neither preempts state law nor prevents federal courts from considering indirect purchaser claims when they are raised in cases otherwise within the federal court's subject matter jurisdiction. To date, *Illinois Brick* repealers have been enacted by 25 states and the District of Columbia.[13] The result of *ARC America* was predictable: indirect purchaser claims found their way back to federal court and the promised simplification of federal antitrust litigation envisioned by Justice White went largely unrealized.

Although indirect purchaser litigation had found its way back to federal courts, the Supreme Court did attempt to stem the tide of indirect purchaser litigation under federal law. In *Kansas v. UtiliCorp United Inc.*,[14] the Court was given the opportunity to expand the preexisting cost-plus contract exception to *Illinois Brick*; instead, the Court issued a stunning rebuke of all efforts by the lower federal courts to create exceptions to the indirect purchaser rule. The *UtiliCorp* plaintiffs alleged that they had paid inflated prices for natural gas to a utility, which was the middleman between the antitrust violators and the petitioning consumers. Even though plaintiffs had purchased natural gas pursuant to a fixed markup set by regulators, the Court denied plaintiffs standing because the utility had not sold gas to customers under "a preexisting cost-plus contract,"[15] thereby holding plaintiffs to the precise language of *Illinois Brick*. Writing for the majority, the recently appointed Justice Anthony Kennedy rejected all attempts to circumvent the indirect purchaser rule:

> The rationales underlying *Hanover Shoe* and *Illinois Brick* will not apply with equal force in all cases. We nonetheless believe that ample justification exists for our stated decision not to "carve out exceptions to the [indirect purchaser] rule for particular types of markets." The possibility of allowing an exception, even in rather meritorious circumstances, would undermine the rule . . . .
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> In sum, even assuming that any economic assumptions underlying the *Illinois Brick* rule might be disproved in a specific case, we think it an unwarranted and counterproductive exercise to litigate a series of exceptions. Having stated the rule in *Hanover Shoe*, and adhered to it in *Illinois Brick*, we stand by our interpretation of § 4.[16]

Perhaps surprisingly, Justice White found himself writing the dissent for the now dwindling group of former *Illinois Brick* dissenters. Although Justice White regretted that the Court's "rigid and expansive holding" would not "promote the twin antitrust goals of ensuring recompense for injured parties and encouraging the diligent prosecution of antitrust claims,"[17] the dissent also made clear that the ongoing debate over compensation versus deterrence had been, and continues to be, misplaced.

> *Illinois Brick* barred indirect purchaser suits chiefly because we feared that permitting the use of pass-on theories under § 4 would transform these treble-damages actions into massive and inconclusive efforts to apportion the recovery among all potential plaintiffs that could have absorbed part of the overcharge – from direct purchasers to middlemen to ultimate consumers.[18]

The point of distinction separating the *UtiliCorp* majority from the dissenters was therefore exceedingly narrow: the dissenters would entrust district court judges with determining whether the pass-on amount can be easily proven, while the majority forbade district courts from that determination altogether. Following *UtiliCorp*, exceptions to the indirect purchaser rule would be extremely rare: the opinion provides merely for the "possibility" of exceptions to the indirect purchaser rule.[19]

The lower federal courts have largely disregarded the Court's intention to create a bright line rule denying indirect purchasers standing to pursue claims under the federal antitrust laws. For example, the ink was barely dry on the *Illinois Brick* opinion when the Third Circuit, in *In re Sugar Industry Antitrust Litigation* allowed indirect purchasers to bring antitrust claims where the direct purchaser (i) was a subsidiary or division of the defendant (ii) had sold to plaintiffs a product that incorporated the allegedly price-fixed product, *and* (iii) had sourced the allegedly price-fixed product internally.[20] The *Sugar* plaintiffs alleged that defendants had conspired to fix the price of

refined sugar. Plaintiff Stotter, however, did not purchase sugar directly from any of the defendants; rather, Stotter purchased candy from two defendants, Borden and SuCrest. Stotter alleged that the price it paid for the candy was inflated as a result of the sugar conspiracy in which Borden and SuCrest had allegedly participated. The Third Circuit remanded the case for further proceedings against these two defendants, holding that *Illinois Brick* did not bar suits against alleged antitrust offenders who directly sell to plaintiffs products that incorporate the allegedly price-fixed product.

There are good reasons to believe that *Sugar* and its progeny did not survive *UtiliCorp.* As discussed above, the touchstone in the Supreme Court's jurisprudence on the indirect purchaser rule has been an attempt to limit litigation complexity. The Third Circuit's *Sugar* opinion is virtually silent in this regard; instead, focusing solely on deterrence, the Third Circuit reasoned that if plaintiffs lacked standing, the antitrust laws could be evaded by either incorporating the price-fixed ingredient into another product or inserting a subsidiary between the alleged violator and the first non-controlled purchaser.[21] Ultimately, this logic fails. As the Third Circuit acknowledged, the candy sold by defendants did not compete with refined sugar, but with, at a minimum, other forms of candy.[22] Moreover, the Third Circuit also agreed that several factors other than the price of sugar determined the price of the candy sold by Borden and SuCrest to Stotter.[23] Ignoring the obvious differences between the sugar and candy markets, and without conducting any analyses of competition in the candy market, the Third Circuit pithily assumed that "just as the sugar sweetened the candy, the price-fixing enhanced the profits of the candy manufacturers."[24] Logic did not compel that assumption, which would be false, for example, if the sugar conspirators did not wield market power in candy sales, or, absent an agreement to fix the price of candy, manufacturers chose to compete in the candy market and recoup profits elsewhere. In short, determining the pass-on in the sugar/candy context, if anything, would have been more complex than for indirect purchasers of the refined sugar itself. This is exactly the result that *UtiliCorp* sought to prevent.

Taking the flawed logic of *Sugar* one step further, the Ninth Circuit created what amounted to a co-conspirator exception to the indirect purchaser rule seemingly from whole cloth.[25] *Royal Printing v. Kimberly-Clark Corp.*[26] concerned an alleged conspiracy to fix the price of paper products. Defendants distributed their products largely through owned and independent wholesalers. Plaintiff Royal Printing purchased paper from the subsidiary of a defendant, although the paper itself had been manufactured by a different defendant. Reasoning that the wholesaler would not sue the manufacturer (as this would expose the conspiracy between the manufacturer and the wholesaler's corporate parent), the Ninth Circuit allowed the claims to proceed. In that regard, *Royal Printing* aligns itself with *Sugar* – both cases reasoning that if plaintiffs lack standing, the transactions at issue "would be immune from private antitrust enforcement."[27] As such, *Royal Printing*, like *Sugar*, ignores that the central motivation behind *Illinois Brick* and *Hanover Shoe* was to avoid the complex and largely impossible task of apportioning the alleged overcharge through multiple layers of distribution.[28] *Royal Printing* wrongly trumps concerns about complexity with concerns about enforcement.

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The reasoning of the *UtiliCorp* majority remains sound today. Economists are still unable to trace overcharges through the chain of distribution without employing gross assumptions that are largely inapplicable to real world business decisions. As predicted by Justice White, consideration of pass-on theories has significantly complicated class certification and summary judgment proceedings, while at the same time complicating settlement efforts. Indeed, the risk of collateral estoppel makes it virtually impossible to go to trial, especially given the extremely limited protection against multiple recoveries in overlapping federal and state court

trials. Against these complexities and risks, the benefits of permitting indirect purchaser suits to proceed appear to be relatively slim. Enforcement of the antitrust laws is not dependent on indirect purchaser claims: direct purchasers routinely sue alleged price-fixers, often following-on public announcements of government investigations. Moreover, indirect purchaser suits generally yield paltry compensation to individual consumers or otherwise take the form of vouchers or coupons of limited utility.

The Supreme Court has not opined on the indirect purchaser rule since *UtiliCorp* was decided twenty years ago. Since that time, indirect purchaser lawsuits are routinely considered by federal courts, either under state law or pursuant to one of the "recognized" exceptions to *Illinois Brick*. For example, in the ongoing litigation over allegations of pricing fixing of TFT-LCD panels, two classes of plaintiffs seek certification. The first class of plaintiffs purchased TFT-LCD panels as part of finished TVs and monitors. The second class of plaintiffs is comprised of the first class's customers. Both classes present indirect claims absent evidence of a price-fixing conspiracy concerning TVs and monitors, although their respective suits are premised on substantially different notions of standing. The parties, should these claims survive, will need to produce sophisticated analyses concerning the passing-on of the alleged overcharge and the court, presided over by the prevailing advocate in the *Royal Printing* case, will be faced with equally difficult decisions regarding class certification, liability, and damages. This is precisely the sort of complex analysis Justice White sought to preclude from federal courts. Perhaps it is time for the Supreme Court to take another look at the indirect purchaser rule.

Ethan Litwin is a Partner in Hughes Hubbard & Reed LLP's antitrust group. Mr. Litwin has litigated antitrust cases in federal and state courts across the U.S. and has represented companies in criminal and civil investigations before regulators in the U.S., the EU, and elsewhere. Mr. Litwin has represented clients in the pharmaceutical, transportation, entertainment, electronics, petrochemicals, agriculture, spirits, and container manufacturing industries. He has also advised leading private equity firms and hedge funds.

For more information on this topic, please contact Ethan Litwin at litwin@hugheshubbard.com or 212-837-6540. For further information about Hughes Hubbard & Reed LLP, please visit www.hugheshubbard.com.

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[1] Antitrust jurisprudence distinguishes direct purchasers, *e.g.*, those plaintiffs who purchased the allegedly price-fixed product directly from the alleged antitrust violator, and indirect purchasers, *e.g.*, those plaintiffs who purchased the allegedly priced-fixed product from either a direct purchaser or other indirect purchasers further downstream.

[2] 392 U.S. 481 (1968).

[3] 431 U.S. 720 (1977).

[4] Justice Marshall did not participate in the decision and Justice Stewart's lone dissent did not discuss the pass-on defense.

[5] 392 U.S. at 492-93.

[6] *Id.* at 494.

[7] *Illinois Brick*, 431 U.S. at 736.

[8] Recent scholarship suggests that the Court initially was prepared to permit indirect purchaser suits by a 6-3 vote. It was only through the efforts of Justice White, who argued that symmetrical application of passing-on theory was supported by the doctrine of *stare decisis* (reversal of *Hanover Shoe* should be reserved for Congress), the need to reduce the complexity of and contain massive antitrust litigations, as well as the importance of minimizing the risk of multiple recoveries, that the indirect purchaser bar was eventually adopted. *See* Andrew I. Gavil, *Change in the Supreme Court: Assessing the Powell Papers,* Third Annual Midwest Antitrust Colloquium (April 11, 2003).

[9] *Illinois Brick,* 431 U.S. at 725.

[10] *Id.* at 737.

[11] *Id.* at 730-31.

[12] 490 U.S. 93 (1989).

[13] Several other states permit indirect purchaser claims to proceed under judicial decisions interpreting

state antitrust laws to provide for indirect purchaser standing, even in the absence of a repealer provision.

[14] 497 U.S. 199, 211-12 (1990).

[15] *Id.* at 218.

[16] *Id.* at 216-17.

[17] *Id.* at 226.

[18] *Id.* at 221.

[19] *Id.* at 218.

[20] *In re Sugar Industry Antitrust Litig.*, 579 F.2d 13, 19 (3d Cir. 1978) (citing *Illinois Brick*, 431 U.S. at 736 n. 16). Federal courts in several circuits have subsequently construed this exception narrowly to apply only when the defendant had either "functional unity" with the intermediary sellers or sufficient ownership interest in or control over the intermediary sellers to set prices along the chain of distribution. *See In re Brand Name Prescription Drugs Antitrust Litig.*, 123 F.3d 599, 605-06 (7th Cir. 1997); *Jewish Hospital Assoc. v. Stewart Mechanical Enterprises, Inc.*, 628 F.2d 971, 975 (6th Cir. 1980). The Third Circuit itself subsequently narrowed the *Sugar* holding to instances where the parent's domination of the subsidiary caused the subsidiary's prices to be determined in accordance with the general price-fixing conspiracy. *See Mid-West Paper Prods. v. Continental Group*, 596 F.2d 573, 589 (3d Cir. 1979).

[21] *In re Sugar*, 579 F.2d at 18-19.

[22] *Id.* at 17.

[23] *Id.*

[24] *Id.* at 18.

[25] Importantly, the Third Circuit had declined to extend the owned/controlled exception to cover co-conspirators. On its argument for rehearing, Borden argued that the candy that it had sold to plaintiffs did not incorporate sugar that Borden itself had refined. The court instructed Borden to raise that issue, which was not on appeal, on remand along with other defenses (*e.g.*, that it did not engage in price fixing or that the plaintiff suffered no damage).

[26] 621 F.2d 323 (1980). The Ninth Circuit subsequently expressly found a co-conspirator exception to the indirect purchaser rule in *Arizona v. Shamrock Foods*, 729 F.2d 1208, 1212-14 (9th Cir. 1984). Since then, the Eighth and Eleventh Circuits have followed suit. *See Campos v. Ticketmaster Corp.*, 140 F.3d 1166, 1171 n.4 (8th Cir. 1998) and *Lowell v. Am. Cyanamid Co.*, 177 F.3d 1228, 1233 (11th Cir. 1999).

[27] 621 F.2d at 326-27 n. 7.

[28] Royal Printing at least purchased the price-fixed product itself and therefore avoids the sort of market structure questions that arise after a careful analysis of *Sugar*. Nonetheless, *Royal Printing* is properly seen as the sort of case implicitly overruled by *UtiliCorp*. Notwithstanding the fact that the economic assumptions underlying *Illinois Brick* may not apply in *Royal Printing*, the Court counseled the lower federal courts to avoid litigating exceptions to the indirect purchaser rule for fear of undermining the rule itself. *UtiliCorp*, 490 U.S. at 217.