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Antitrust Law – Standing to Sue – Prices – Consumers are Precluded from Showing "Injury" within the Meaning of Section 4 of the Clayton Act by Establishing that they Paid Higher Prices for Goods Because of Illegal Price-Fixing of a Manufacturer with Whom they Did Not Deal Directly – Illinois Brick Co. v. Illinois, 431 U.S. 720 (1977)

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ANTITRUST LAW—STANDING TO SUE—PRICES—CONSUMERS ARE PRECLUDED FROM SHOWING "INJURY" WITHIN THE MEANING OF SECTION 4 OF THE CLAYTON ACT BY ESTABLISHING THAT THEY PAID HIGHER PRICES FOR GOODS BECAUSE OF ILLEGAL PRICE-FIXING OF A MANUFACTURER WITH WHOM THEY DID NOT DEAL DIRECTLY.—*Illinois Brick Co. v. Illinois*, 431 U.S. 720 (1977).

The State of Illinois,[1] in a treble-damage civil antitrust action under section 4 of the Clayton Act,[2] accused concrete block manufacturers of conspiring to fix prices of blocks used in the construction of public buildings in violation of section 1 of the Sherman Act.[3] Illinois alleged that the blocks were sold at artificially high prices to various general and specific contractors, who in turn overcharged the State.[4]

The United States District Court for the Northern District of Illinois granted the defendants' motion for partial summary judgment, finding that only direct purchasers could sue for the alleged overcharge.[5] The United States Court of Appeals for the Seventh Circuit reversed, holding that indirect purchasers could recover treble-damages for an illegal overcharge if they could prove that the overcharge was passed on to them through the intermediate distribution channels.[6] On appeal to the United States Supreme Court, *held*: Reversed. Consumers are precluded from showing "injury" within the meaning of section 4 of the Clayton Act by establishing that they paid higher prices for goods because of illegal price-fixing of a manufacturer with whom they did not deal directly.[7]

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1. The suit was brought by the State on behalf of itself and 700 local governmental entities in the greater Chicago area. Illinois Brick Co. v. Illinois, 431 U.S. 720 (1977).

2. 15 U.S.C. § 15 (1970), which provides:

> 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 . . . without respect to the amount in controversy, and shall recover threefold the damages by him sustained, and the cost of suit, including a reasonable attorney's fee.

3. 15 U.S.C. § 1 (1970) provides in relevant 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. In this case plaintiffs sought to demonstrate that masonry contractors, who had incorporated defendants' blocks into walls and other masonry structures, passed on the alleged overcharge to general contractors, who incorporated the masonry structures into entire buildings, and that the general contractors in turn passed on the overcharge to plaintiffs in the bids submitted for those buildings.

5. Illinois v. Ampress Brick Co., 67 F.R.D. 461, 468 (N.D. Ill. 1975). The district court relied on a past Supreme Court decision, Hanover Shoe, Inc. v. United Shoe Machinery Corp., 392 U.S. 481 (1968).

6. Illinois v. Ampress Brick Co., 536 F.2d 1163, 1167 (7th Cir. 1976).

7. Illinois Brick Co. v. Illinois, 431 U.S. 720, 728-29 (1977).

Section 4 of the Clayton Act authorizes a private right of action for violation of the antitrust laws. Congress broadly defined the parties who could maintain such a suit as "any person who shall be injured in his business or property by reason of anything forbidden in the antitrust laws . . . ."[8] A person who has purchased goods directly from an alleged price-fixer need only establish a prima facie showing of an illegal overcharge in order to seek redress.[9] However, often a business which has been overcharged as a result of price-fixing simply raises its prices to reflect the overcharge, a practice known as "passing-on" the illegal increment of cost. Thus, distributors may avoid the consequences of price-fixing violations committed by those preceeding them in the distribution chain, and as a result it is the ultimate consumer who actually is injured by the overcharge.[10]

Passing-on was developed originally as a defense asserted by alleged price-fixers to suits brought by the direct purchasers of their goods.[11] The defendants contended that the direct purchasers suffered no injury because the added cost due to the illegal price agreement had been passed on to their customers. In *Hanover Shoe, Inc. v. United Shoe Machinery Corp.*,[12] the Supreme Court held that the passing-on theory was no defense to a suit brought by direct purchasers. Defendant United Shoe refused to sell rather than lease its shoe manufacturing equipment; plaintiff Hanover Shoe alleged that this resulted in higher costs and violated the antitrust laws. United Shoe contended that the plaintiff was not injured because it had passed on the economic disadvantages by raising the price of its shoes.[13]

The Court rejected this argument, finding that the injury was complete and legally actionable when the overcharge was paid. The Court stated that recognition of the passing-on defense would present insurmountable problems of proof because of the difficulty of tracing the economic effect

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8. 15 U.S.C. § 15 (1970).

9. *See, e.g.*, Hanover Shoe, Inc. v. United Shoe Machinery Corp., 392 U.S. 481, 488 (1968); Handler and Bleckman, *Antitrust and the Consumer Interest: The Fallacy of Parens Patriae and A Suggested New Approach*, 85 YALE L.J. 626, 638 (1976); Pollock, *Standing To Sue, Remoteness of Injury, and the Passing-on Doctrine*, 32 A.B.A. ANTITRUST L.J. 5, 7 (1966).

10. McGuire, *The Passing-on Defense and the Right of Remote Purchasers to Recover Treble Damages Under* Hanover Shoe, 33 U. PITT. L. REV. 177, 181 (1971).

11. Cases denying the defense include: Commonwealth Edison Co. v. Allis-Chalmers Mfg. Co., 335 F.2d 203 (7th Cir. 1964); Atlantic City Electric Co. v. General Electric Co., 226 F. Supp. 59 (S.D.N.Y. 1964); Public Util. Dist. No. 1 v. General Electric Co., 230 F. Supp. 744 (W.D. Wash. 1964). Cases allowing the defense include: Freedman v. Philadelphia Terminals Auction Co., 301 F.2d 830 (3rd Cir. 1962); Miller Motors, Inc. v. Ford Motor Co., 252 F.2d 441 (4th Cir. 1958); Clark Oil Co. v. Phillips Petroleum Co., 148 F.2d 580 (8th Cir.), *cert. denied*, 326 U.S. 734 (1945).

12. 392 U.S. 481 (1968).

13. *Id.* at 491-92.

of the overcharge for equipment to the price charged for a pair of shoes.[14] The Court also feared that recognition of the passing-on defense would permit antitrust violators to go unpunished by removing from the controversy the plaintiff with the greatest incentive to prosecute and leaving enforcement to parties with insignificant claims, such as the purchasers of a single pair of shoes.[15]

However, the *Hanover Shoe* Court also indicated that the passing-on defense might be appropriate when the absence of actual injury to the direct purchaser was easily ascertainable, as for example, where sales were made pursuant to a "cost-plus" contract between the direct and indirect purchasers. Here the direct purchaser is completely reimbursed for all his costs, and receives a fixed fee which represents his profit.[16]

Lower court decisions conflicted as to the effect of *Hanover Shoe* on the right of indirect purchasers to recover when they could prove that overcharges were passed on to them, causing injury under section 4 of the Clayton Act.[17] Some courts interpreted *Hanover Shoe* as limiting recovery to the initial purchaser in the chain of distribution, reasoning that *Hanover Shoe* held, as a matter of law, that proof of passing-on is precluded absent a cost-plus or similar arrangement.[18] These courts also asserted that affording standing to indirect purchasers while denying the defendant the opportunity to show that a particular purchaser passed on the overcharge would expose defendants to multiple liability by allowing both direct and indirect purchasers to recover for the same overcharge.[19]

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14. *Id.* at 492-93.

15. *Id.* at 494.

16. *Id.*

17. The following cases held that *Hanover Shoe* forecloses plaintiffs from showing passing-on: Donson Stores, Inc. v. American Bakeries Co., 58 F.R.D. 481 (S.D.N.Y. 1973); Balmac, Inc. v. American Metal Prods. Corp., 1972 Trade Cas. ¶ 74,235 (N.D. Cal.); Denver v. American Oil Co., 53 F.R.D. 620 (D. Colo. 1971); Philadelphia Hous. Auth. v. American Radiator & Standard Sanitary Corp., 50 F.R.D. 13 (E.D. Pa. 1970), *aff'd sub nom.* Mangano v. American Radiator & Standard Sanitary Corp., 438 F.2d 1187 (3rd Cir. 1971); United Egg Producers v. Bauer Int'l Corp., 312 F. Supp. 319 (S.D.N.Y. 1970).

Cases holding that *Hanover Shoe* does not restrict standing are: *In re* Western Liquid Asphalt Cases, 487 F.2d 191 (9th Cir. 1973), *cert. denied,* 415 U.S. 919 (1974); *In re* Master Key Antitrust Litigation, 1973-2 Trade Cas. ¶ 74,680 (D. Conn.); Boshes v. General Motors Corp., 59 F.R.D. 589 (N.D. Ill. 1973); Southern Gen. Builders, Inc. v. Maule Indus. Inc., 1973-1 Trade Cas. ¶ 74,484 (S.D. Fla. 1972). *See* West Virginia v. Chas. Pfizer & Co., 440 F.2d 1079 (2nd Cir.), *cert. denied,* 404 U.S. 871 (1971).

18. *See, e.g.,* Donson Stores, Inc. v. American Bakeries Co., 58 F.R.D. 481, 484 (S.D.N.Y. 1973); Philadelphia Hous. Auth. v. American Radiator & Standard Sanitary Corp., 50 F.R.D. 13, 25-26 (E.D. Pa. 1970).

19. *See, e.g.,* Donson Stores, Inc. v. American Bakeries Co., 58 F.R.D. 481, 484 (S.D.N.Y. 1973).

The United States Court of Appeals for the Ninth Circuit, in *In re Western Liquid Asphalt Cases*,[20] rejected these arguments and refused to confine standing under section 4 to direct purchasers or to indirect purchasers who bought pursuant to a cost-plus contract. The court allowed governmental consumers to recover against the manufacturers even though the asphalt had been purchased by general contractors, who had passed on the anticompetitive prices in their bids for highway projects.

Several other courts [21] and most commentators [22] also rejected the proposition that *Hanover Shoe* precluded proof of passing-on as a theory of recovery. They perceived *Hanover Shoe* as one of a long line of cases which emphasized the protection of the treble-damage remedy as a primary enforcement mechanism of the antitrust laws, thus favoring offensive passing-on because it would ensure that the party suffering injury had a remedy available to him.[23]

The Supreme Court in *Illinois Brick* settled the dispute among the lower courts by rejecting offensive passing-on.[24] Mr. Justice White, writing for the majority, first reasoned that offensive passing-on as a theory of recovery would be inconsistent with the restrictions on the defensive use of passing-on enunciated in *Hanover Shoe*.[25] He pointed out the inequity of exposing a defendant to multiple liability by allowing an indirect purchaser to use the passing-on theory to recover damages from a defendant while prohibiting the defendant from asserting a passing-on defense against a direct purchaser. An indirect purchaser could recover an overcharge proven to have been passed-on to him without prejudicing the rights of a direct purchaser also to recover the full amount of the overcharge.[26] Either *Hanover Shoe* must be overruled or narrowly limited to its facts, the Court reasoned, or the use of offensive passing-on must be barred.[27]

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20. 487 F.2d 191 (9th Cir. 1973), *cert. denied*, 415 U.S. 919 (1974).

21. *See* cases cited in note 17 *supra*.

22. *See, e.g.*, McGuire, *The Passing-on Defense and the Right of Remote Purchasers to Recover Treble Damages Under* Hanover Shoe, 33 U. PITT. L. REV. 177 (1971); Schaefer, *Passing-on Theory in Antitrust Treble Damage Actions: An Economic and Legal Analysis*, 16 WM. AND MARY L. REV. 883 (1975); Comment, Mangano *and Ultimate-Consumer Standing: The Misuse of the* Hanover *Doctrine*, 72 COLUM. L. REV. 394 (1972); Note, *The Effect of* Hanover Shoe *On the Offensive Use of the Passing-on Doctrine*, 46 S. CAL. L. REV. 98 (1972); Comment, *Standing to Sue in Antitrust Cases: The Offensive Use of Passing-on*, 123 U. PA. L. REV. 976 (1975). *But see* Handler and Blechman, *Antitrust and the Consumer Interest: The Fallacy of Parens Patriae and a Suggested New Approach*, 85 YALE L.J. 626 (1976).

23. *See, e.g., In re* Western Liquid Asphalt Cases, 487 F.2d 191, 197 (9th Cir. 1973), *cert. denied*, 415 U.S. 919 (1974); Boshes v. General Motors Corp., 59 F.R.D. 589, 594 (N.D. Ill. 1973).

24. Illinois Brick Co. v. Illinois, 431 U.S. 720 (1977).

25. *Id.* at 728.

26. *Id.* at 730.

27. *Id.* at 736.

In choosing to reject offensive passing-on, the Court declared that its use would unduly complicate antitrust suits because of the difficulty of tracing the complex economic adjustments involved in a change in the cost of a particular product. The majority was unwilling to burden the courts with the task of tracing the effects of an illegal overcharge to direct purchasers on prices consumers paid for goods.[28]

The antitrust laws would be more effectively enforced, the Court argued, by concentrating the full recovery in the direct purchasers. Allowing indirect purchasers to recover would reduce seriously the incentive to sue by dividing the potential recovery among a much larger group and increasing the overall cost of recovery. Thus, the policy of encouraging vigorous private enforcement of the antitrust laws was viewed as supporting adherence to *Hanover Shoe* and rejection of offensive passing-on as a theory of recovery.[29]

Mr. Justice Brennan, dissenting, condemned the majority's ruling as being a "regrettable retreat" from the broad objectives of compensation and deterrence set out in section 4 of the Clayton Act.[30] These goals are frustrated, he claimed, by the fact that often direct purchasers who act as middlemen may have little incentive to sue suppliers if they are able to pass on the bulk of the overcharge to the ultimate consumer. By precluding an indirect consumer, who actually suffers, from maintaining suit, antitrust violators go unpunished and victims remain uncompensated. Because there is no danger in the offensive passing-on situation that the price-fixer will escape liability, Justice Brennan contended that there were "sound reasons for treating offensive and defensive passing-on differently." [31]

The dissent dismissed the argument that allowing passing-on would involve long and complicated proceedings by pointing out that this is generally true of all antitrust cases. Existing procedural mechanisms were considered capable of virtually eliminating the danger of multiple liability. Thus, the dissent felt the proper resolution of *Illinois Brick* would be to limit *Hanover Shoe* to cases of defensive passing-on where direct and indirect purchasers are not parties to the same action.[32]

The principle objective of the antitrust laws is to promote competition by proscribing certain types of market conduct thought to lead to monopolization, such as collusive price-fixing.[33] To further the goal of free competition, Congress enacted a "drastic remedy," section 4 of the Clayton Act, which allows victims of antitrust violations to recover three times the actual, demonstrable damages. The treble-damage action not only punishes the violator but also compensates the injured party. Moreover, Congress sought

28. *Id.* at 741-42.
29. *Id.* at 745-46.
30. *Id.* at 748-49 (Brennan, J., dissenting).
31. *Id.* at 753-54 (Brennan, J., dissenting).
32. *Id.* at 753 (Brennan, J., dissenting).
33. L. SULLIVAN, LAW OF ANTITRUST 14 (1977).

to provide an incentive for private enforcement of antitrust laws and make compliance with the antitrust laws less costly than violations.[34]

The impact of *Illinois Brick* on the scheme of enforcement envisioned by Congress is anomolous. The Court's ruling in effect permits a direct purchaser to recover *four* times the amount of overcharge due to an antitrust violation—once from its customers, the indirect purchasers, and three times the amount from the violator. Thus, direct purchasers receive a windfall, whereas the true victims go uncompensated.[35]

Moreover, in many situations offensive passing-on would be the only way to ensure punishment of antitrust violators. For a number of reasons, the direct purchaser may be unwilling to pursue the statutory remedy. A direct purchaser often will fear that litigation will result in boycotts or discrimination. The threat of disrupting a stable business relationship or losing a reliable source of supply will inhibit many direct purchasers from enforcing the antitrust laws.[36] These considerations may outweigh the lure of treble damages, especially when the economic detriment arising from a violation can be passed on to customers. Preventing the indirect purchaser from suing in these situations may virtually guarantee that the violator will go unpunished.

Thus, the *Illinois Brick* decision cannot be rationalized within the framework of traditional antitrust enforcement policy. However, the majority expressed two major concerns with the effects of offensive passing-on which were so problematic as to override any negative impact on antitrust policy: the danger of multiple liability for the violator and the undue complexity involved in proving passing-on.

The danger of multiple liability is a legitimate concern. However, it has been argued persuasively [37] that procedural devices such as statutory interpleader,[38] intervention,[39] joinder of parties,[40] interdistrict transfer and consolidation of cases,[41] the four-year statute of limitations [42] and the doctrine of collateral estoppel would provide relief for the violator. Perhaps the most satisfactory solution is the apportionment of damages proposed by the Ninth Circuit.[43] This plan would allow the intermediary to

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34. *See* Schaefer, *supra* note 22, at 908.

35. *See* Pollock, *supra* note 9, at 38.

36. *See* Note, *The Effect of* Hanover Shoe *on the Offensive Use of the Passing-on Doctrine*, 46 S. CAL. L. REV. 98, 112 (1972).

37. *See, e.g., In re* Western Liquid Asphalt Cases, 487 F.2d 191, 198-201 (9th Cir. 1973), *cert. denied*, 415 U.S. 919 (1974); Boshes v. General Motors Corp., 59 F.R.D. 589, 596-97 (N.D. Ill. 1973).

38. 28 U.S.C. § 1335 (1970).

39. FED. R. CIV. P. 24.

40. FED. R. CIV. P. 19.

41. 28 U.S.C. § 1407 (1970).

42. 15 U.S.C. § 156 (1970).

43. *See In re* Western Liquid Asphalt Cases, 487 F.2d 191, 200-01 (9th Cir. 1973), *cert. denied*, 415 U.S. 919 (1974).

recover the amount of the overcharge not passed on as well as lost profits shown to have resulted from the increased costs. The indirect purchaser could recover the remainder of the overcharge and any other damages proximately caused.

This approach has the advantage of allowing all parties with demonstrable damages to recover, and also ensures the existence of a viable plaintiff to prosecute the antitrust violator. However, the apportionment plan conflicts with the principle established by *Hanover Shoe*, that the direct purchasers are entitled to recover the entire amount of the overcharge without regard to any passing-on.[44] But *Hanover Shoe* did not confront the situation where both direct and indirect purchasers were potential plaintiffs. Moreover, the rationale of *Hanover Shoe* was that direct purchasers should be able to recover, even though they passed on the injury, in order to guarantee private prosecution of Sherman Act violations. Thus, *Hanover Shoe* should not inhibit fashioning a remedy such as apportionment where the policies of deterrence and compensation are accommodated.

The problem of demonstrating an injury due to passing-on is amenable to solution through the use of expert witnesses.[45] The extent to which an overcharge can be passed on depends upon the elasticity of consumer demand and the elasticity of supply in the market in which the direct purchaser sells.[46] Economists are capable of analyzing the market effect presumably with the same degree of assurance that other market phenomena are analyzed. Statistical techniques exist to measure the elasticities of supply and demand in a given market. Even assuming that difficulties of proof exist, conclusively foreclosing a remedy is not justified.[47] Most treble-damage antitrust actions are complicated and require the use of sophisticated analytical techniques in order to isolate the consequences of illegal market activity from the adverse effects of general market conditions.[48] Indirect purchasers should have at least the opportunity to prove that they did suffer injury.

The *Illinois Brick* decision also poses a threat to the scope of the recently enacted Hart-Scott-Rodino Antitrust Improvements Act of 1976[49] that was intended to permit state Attorneys General to file suits on behalf of consumers within the state. Advocates of the legislation intended that parens patriae suits be permissible on behalf of both direct and indirect consumers, relying on the language of section 4 of the Clayton Act which

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44. Hanover Shoe, Inc. v. United Shoe Machinery Corp., 392 U.S. 481 (1968).

45. *See* Schaefer, *supra* note 22, at 916.

46. *Id.* at 915.

47. *See, e.g., In re* Master Key Antitrust Litigation, 1973-2 Trade Cas. ¶ 74,680, at 94,979 (D. Conn.).

48. *See, e.g.*, Illinois Brick Co. v. Illinois, 431 U.S. 720, 758-59 (1977) (Brennan, J., dissenting).

49. Pub. L. 94-435, § 301, 90 Stat. 1383 (1976).

does not itself restrict the class of potential plaintiffs to direct purchasers.[50] *Illinois Brick's* restrictive interpretation of section 4 seriously undermines the objectives of the new legislation.

Perhaps the best solution was suggested in the majority's opinion in *Illinois Brick*, where Justice White pointed out that Congress was free to amend section 4 to permit recovery by indirect consumers.[51] Hopefully, Congress will react to the *Illinois Brick* decision and thus keep the doors of the federal courts open to ultimate consumers who often bear the economic burden of remote violations of the antitrust laws.

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50. Rep. Rodino, a sponsor, stated during the House debates:
> [A]ssuming the State attorney general proves a violation, and proves that an overcharge was 'passed on' to the consumers, injuring them 'in their property'; that is, their pocket books—recoveries are authorized by the compromise bill whether or not the consumers purchased directly from the price-fixer, or indirectly, from intermediaries, retailers, or middlemen. The technical and procedural argument the consumers have no 'standing' whenever they are not in privity with the price-fixer, and have not purchased directly from him, is rejected by the compromise bill. Opinions relying on this procedural technicality . . . are squarely rejected by the compromise bill.

16 CONG. REC. H10,295 (daily ed. Sept. 16, 1976).

51. Illinois Brick Co. v. Illinois, 431 U.S. 720, 733-34 n.14 (1977).