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Lessons from the Pharmaceutical Antitrust Litigation: Indirect Purchasers, Antitrust Standing, and Antitrust Federalism

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LESSONS FROM THE PHARMACEUTICAL ANTITRUST LITIGATION: INDIRECT PURCHASERS, ANTITRUST STANDING, AND ANTITRUST FEDERALISM

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I. INTRODUCTION

This has been a banner year for antitrust developments in the pharmaceutical industry. Horizontal mergers at the retail and wholesale levels, in unprecedented number and of unprecedented size, have significantly increased concentration in both markets, raising official and public concern about the spectre of market power, collusion, and reduced competition in important segments of the industry.[1] Pharmaceutical manufacturers have continued a merger movement that began several years ago. In analyzing one of these mergers—the consolidation of Ciba-Geigy and Sandoz into Novartis—the Federal Trade Commission ("FTC") had occasion to deploy its controversial concept of "innovation markets."[2] Concerned lest the merger result in a monopoly of basic research in gene therapy techniques, the FTC required the firms, as a con-

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1. In refusing to give its approval to the proposed merger between Revco and RiteAid, the Federal Trade Commission ("FTC") employed its newly articulated "unilateral effects" analysis, in which the FTC seeks to determine whether a merger that does not threaten to concentrate the relevant market nevertheless poses risks to consumer well-being by removing a (or the) competitively significant alternative to one of the merged firms. The FTC's concern about the Revco merger was that, by extinguishing competition between chain pharmacies in certain geographical markets, it would effectively force HMOs seeking to create managed pharmacy benefits to deal with a single firm, to the detriment of consumers. For a discussion of the theory behind this type of analysis, see Jonathan B. Baker, *Mergers Among Sellers of Differentiated Products*, 11 ANTITRUST 23, 23 (Spring 1997); Carl Shapiro, *Mergers with Differentiated Products*, 10 ANTITRUST 23, 23 (Spring 1996); Gregory J. Werden, *Simulating Competitive Effects from Differentiated Products Mergers*, 11 ANTITRUST 27, 27 (Spring 1997).

2. This concept is controversial in part because it deals with a research "product" that has yet to—and may never—come to market and whose price and value are therefore difficult to establish, and in part because it is uncertain whether the analysis can successfully capture all of the locations where relevant research may be occurring. *See, e.g.*, Jonathan B. Baker, *Fringe Firms and Incentives to Innovate*, 63 ANTITRUST L.J. 621 (1995); Richard J. Gilbert & Steven C. Sunshine, *Incorporating Dynamic Efficiency Concerns in Merger Analysis: The Use of Innovation Markets*, 63 ANTITRUST L.J. 569 (1995).

dition of merger approval, to share with competitors their "unmatched portfolio of intellectual property assets . . . necessary to commercialize gene therapy markets."[3]

Vertical mergers have consolidated pharmaceutical manufacturers with pharmacy benefit managers ("PBMs"), seemingly providing the manufacturers with privileged access to the growing number of consumers participating in managed care pharmaceutical arrangements.[4] These arrangements have alarmed consumer advocates opposed to the expansion of managed care and unallied manufacturers, who fear that their products will be unfairly excluded from the formularies of manufacturer-affiliated PBMs. From an antitrust perspective, these mergers raise the possibility and the (as yet unrealized) fear that such alliances will effectively foreclose consumer access to the wide range of choice usually deemed appropriate to robust competition.

In turn, all these mergers are part of a larger consolidation movement that has transformed the entire health care industry over the past five years. While mergers occur in many industries and for many reasons—the desire to achieve economies of scale or scope or eliminate duplicative personnel and facilities, and the belief that new management can outperform incumbents—the recent wave of health care mergers has been driven largely by the growth of managed care organizations ("MCOs") and their increasing ability to wrest large discounts from healthcare providers. The bargaining power of large MCOs has resulted in a buyers' market that has forced upon sellers two important and ultimately transformative realizations: (1) to attain parity of bargaining power they must achieve equal (or comparable) size; and (2) to compete successfully for large managed care contracts, they must reduce their costs significantly. Since consolidation addresses both concerns, mergers have been the order of the day in all healthcare sectors, including the pharmaceutical industry.

The growth of MCOs has also led indirectly to the subject matter of this paper—the consolidated antitrust action pending in the Northern District of Illinois against virtually all leading manufacturers of brand-name prescription drugs. Plaintiffs, who number in the tens of thousands, are retail pharmacies ranging in size from individual, small pharmacies to large, multi-state chains, claiming to be aggrieved by the manufacturers' collective decision to deny them price discounts offered to their managed care and other institutional competitors. There are two distinct plaintiff groups. Class plaintiffs have al-

3. *See* Ciba-Geigy Limited, Proposed Consent Agreement, 62 Fed. Reg. 409, 411 (Jan. 3, 1997) ("Through the merger, the companies' alternative competing gene therapy technologies will be combined, reducing innovation competition.").

4. From a business perspective, the manufacturers' purchase of PBMs has had mixed results. Merck's purchase of Medco seems to have increased Merck's profitability, while poor earnings have forced Eli Lilly to write off more than half the purchase price of its newly-acquired PBM. *See* Thomas M. Burton, *Lilly Will Swallow $2.4 Billion Charge,* N.Y. TIMES, June 24, 1997, at A4.

leged a price-fixing conspiracy by which defendants eliminated price competition among themselves and maintained at artificially high levels the prices of brand-name drugs sold to retail pharmacies. Opt-out plaintiffs have alleged similar acts of unlawful price-fixing and have claimed as well that defendants' pricing practices constituted improper price discrimination in violation of the Robinson-Patman Act.[5]

This lawsuit is noteworthy not only for its size and complexity, but also for the variety and significance of the legal issues that have emerged. Among other things, the facts adduced through pre-trial discovery raise important and interesting questions about the availability of certain defenses under rule of reason analysis and under the Robinson-Patman Act, respectively.[6] Moreover, the case has generated two opinions—one by the district court, the other by the Seventh Circuit—dealing primarily with the issue of antitrust standing, an issue of widespread significance to antitrust generally. All plaintiffs are retailers. Each bought its "overpriced" products from wholesalers and none dealt directly with defendant manufacturers. Seizing on these undisputed facts, the manufacturers have argued that plaintiffs are "indirect purchasers" and thus lack antitrust standing, an argument that simultaneously raises difficult questions about doctrine and important issues of antitrust federalism.

II. THE PRESCRIPTION DRUG LITIGATION: A BRIEF DESCRIPTION

Both groups of plaintiffs in the Prescription Drugs Antitrust Litigation ("*PDAL*") have asserted essentially similar claims.[7] The gist of each is that beginning in the early 1980s, defendants colluded to create and maintain a dual pricing system that favors "institutional" or managed care buyers at the expense of retail pharmacies.[8] Under this system, defendants allegedly refused to

5. 15 U.S.C. §§ 13-13c, 21a (1994).

6. In the district court, defendants argued that their conduct—assuming that it occurred as alleged and that it constituted price-fixing and price discrimination—was justified by a legitimate business concern: they refused to extend discounts to retail customers, they said, because "unlike managed care, the retail customers did not have the power to affect market share." *In re* Brand Name Prescription Drugs Antitrust Litigation, No. 94-C897, 1996 U.S. Dist. LEXIS 4335, at *39 (N.D. Ill. Apr. 4, 1996) [hereinafter *PDAL*]. The court entertained these arguments despite their seeming irrelevance to the issues. Antitrust law does not normally permit defendants charged with price-fixing to argue that the price-fix was motivated by "legitimate" business concerns. With narrow exceptions not claimed to be applicable in this case, price-fixing is illegal per se—indefensible—under the antitrust laws. *See, e.g.*, National Collegiate Athletic Ass'n v. University of Ok., 468 U.S. 85 (1984); Broadcast Music, Inc. v. Columbia Broad. Sys., Inc., 441 U.S. 1 (1979). Nor have courts found any warrant in the Robinson-Patman Act for price discrimination that reflects the buyers' relative power. Rather, the law was enacted precisely to prevent large firms from using their size to obtain discounts unavailable to smaller competitors.

7. *PDAL*, 1996 U.S. Dist. LEXIS 4335, at *3.

8. *Id.*

afford retailers the same discounts and price-reductions routinely offered to institutional buyers, in an effort to keep prices to the retail sector at artificially high levels.[9] The asserted effect of this arrangement, not surprisingly, was to place retail pharmacies at a distinct competitive disadvantage.[10]

According to plaintiffs, the manufacturer cartel emerged as a response to changes in the healthcare marketplace during the 1970s.[11] In the early years of that decade, bowing to pressure from for-profit hospitals and other "traditional" healthcare institutions, some manufacturer-defendants granted institutional buyers discounts off the published wholesale prices of their drugs.[12] Defendants subsequently extended these discounting practices to the newly arrived mail order drug houses and "non-traditional" managed care organizations.[13] As the realization dawned, however, that the "original sin" of price discounting would eventually erode profit margins to unacceptably low levels, the manufacturers agreed—at seminars and industry-wide meetings and through a continuous exchange of information—to deny discounts to the non-traditional buyers and to make certain that no firm would deviate from this agreement.[14]

Defendants have offered valid business reasons for their pricing practices.[15] And while a trial might bear them out, pre-trial discovery has demonstrated to the district court's satisfaction that two of plaintiffs' important claims are substantially based in fact.[16] First, the court has found it "virtually undeniable" that defendants engaged in a tiered pricing system.[17] Second, it has concluded that plaintiffs have unearthed "ample circumstantial evidence to raise a reasonable inference that the . . . [defendants] engaged in collusive, anti-competitive conduct."[18] If the case proceeds to trial and plaintiffs can prove these facts, they may well recover the large treble damage award that they seek.

There is, however, an important procedural hurdle standing between plaintiffs and the prospect of recovery. The distribution of pharmaceuticals from manufacturer to consumer customarily takes place in three steps. Manufacturers sell to wholesalers, who in turn sell to retailers, who then market to consumers or their agents. This means that the retailer-plaintiffs did not buy directly from the manufacturer defendants, but rather from independent whole-

9. *Id.* at *2.
10. *Id.* at *6.
11. *Id.* at *5.
12. *PDAL*, 1996 U.S. Dist. LEXIS 4335, at *5.
13. *Id.*
14. *Id.*
15. *Id.* at *20.
16. *Id.*
17. *PDAL*, 1996 U.S. Dist. LEXIS, at *5.
18. *Id.* at *18.

salers that are not owned by the manufacturers and that claim not to have conspired with them to create or maintain the discriminatory pricing scheme.[19] In the special language of federal antitrust standing, the retailers may thus be "indirect purchasers," whose losses are usually not "antitrust injuries" and whose complaints therefore cannot be entertained.

III. ANTITRUST INJURY, INDIRECT PURCHASERS AND FEDERAL ANTITRUST STANDING

For purposes of standing, antitrust law distinguishes between plaintiffs seeking injunctive relief and plaintiffs seeking money damages.[20] It is relatively easy for the former to sue, but decidedly more difficult for the latter. The federal and state governments may sue in their parens patriae capacities to enjoin any antitrust violation that arguably harms their citizenry; private citizens are given fairly broad leeway to seek injunctions against allegedly anticompetitive behavior.[21] Parties seeking to recover monetary damages, however—whether retail pharmacies allegedly harmed by a price-fix or governmental entities suing as purchasers of goods or services—must satisfy the unique standing requirements of section 4 of the Clayton Act,[22] which provides in pertinent part:

> Any person who shall be injured in his business or property by reason of anything forbidden in the antitrust laws may sue therefor . . ., without regard to the amount in controversy, and shall recover threefold the damages by him sustained, and the cost of suit, including a reasonable attorney's fees.[23]

As interpreted by the Supreme Court, these requirements are different from, and more stringent than, those demanded of plaintiffs in other kinds of federal actions. Under Article III of the United States Constitution, plaintiffs must demonstrate standing in order to satisfy the "case or controversy" requirement necessary to the exercise of federal jurisdiction.[24] This demonstration entails a three-part showing: "(1) the party must personally have suffered an actual or threatened injury caused by the defendant's allegedly illegal conduct, (2) the injury must be fairly traceable to the defendant's challenged conduct, and (3) the injury must be one that is likely to be redressed through a fa-

19. Although drug wholesalers were named as defendants in the original complaints, they were dismissed from the case after the district court concluded that pre-trial discovery had failed to adduce any evidence to the effect that the wholesalers had participated in the manufacturers' conspiracy. *Id.* at *95.

20. *See* 15 U.S.C. §§ 15, 26 (1994).

21. *See id.* §§ 15(a)-(h), 26.

22. *Id.* § 15.

23. *Id.*

24. U.S. CONST. art. III, § 2.

vorable decision."[25] Antitrust plaintiffs must satisfy additional standards. Recognizing that "Congress did not intend the antitrust laws to provide a remedy in damages for all injuries that might conceivably be traced to an antitrust violation,"[26] the Supreme Court has construed the language of section 4 to limit standing in antitrust treble-damage actions to (1) those who have suffered the type of injury that the antitrust laws were intended to prevent and (2) those whose injuries result from defendant's unlawful conduct.[27]

Satisfying the distinctive concept of antitrust injury demands a broader showing of plaintiffs than that required for Article III standing. Not only must antitrust plaintiffs prove that they have been injured by the defendant's conduct, but they also must demonstrate that their injury is the kind that the antitrust laws were designed to prevent.[28] Since this latter requirement is more or less indeterminate—it is not and probably never has been perfectly clear, that is, what the Sherman Act and to a lesser extent, the Clayton Act, were "designed to prevent"—the question of what constitutes antitrust injury has generated a good deal of litigation and evolved along unique doctrinal lines,[29] unique in part because not every injury commonly understood amounts to an "antitrust injury" and in part because each alleged injury is sui generis. The judicial inquiry into "antitrust injury" generally occurs as part of a broader analysis of "the plaintiff's harm, the alleged wrongdoing by the defendants, and the relationship between them."[30] While courts regard a variety of factors as relevant to the standing inquiry[31]—including antitrust injury—the consensus view is that the standing determination ultimately depends upon the particular

25. Valley Forge Christian College v. Americans United for Separation of Church and State, 454 U.S. 464, 472 (1982).

26. Hawaii v. Standard Oil Co., 405 U.S. 251, 263 n.14 (1972). *See also* Serfecz v. Jewel Food Stores, 67 F.3d 591 (7th Cir. 1995).

27. Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc., 429 U.S. 477, 489 (1977).

28. For a recent statement and application of this well-established principle in another recent pharmaceutical antitrust case, see Barton & Pittinos, Inc., v. Smithkline Beecham Corp., No. 96-1941, 1997 U.S. App. LEXIS 18172, at *2 (3d Cir. July 18, 1997).

29. *See, e.g.*, Associated Gen. Contractors, Inc. v. California State Council of Carpenters, 459 U.S. 519, 535 n.31 (1983) ("Harm to the antitrust plaintiff is sufficient to satisfy the constitutional standing requirement of injury in fact, but the court must make the further determination whether the plaintiff is a proper party to bring a private antitrust action.").

30. Greater Rockford Energy & Techn. Corp. v. Shell Oil Co., 998 F.2d 391, 396 (7th Cir. 1993), *cert. denied*, 510 U.S. 1111 (1994) (quoting *Associated General Contractors*, 459 U.S. at 544-45).

31. *See, e.g.*, Lovett v. General Motors Corp., 975 F.2d 518, 520 (8th Cir. 1992) (listing such factors as "(1) the causal connection between the alleged antitrust violation and the harm to the plaintiff; (2) improper motive; (3) whether the injury was of a type that Congress sought to redress with the antitrust laws; (4) the directness between the injury and the market restraint; (5) the speculative nature of the damages; [and] (6) the risk of duplicate recoveries or complex damages apportionment").

facts of each case.[32]

The indirect purchaser rule, the standing doctrine at the heart of the dispute in *PDAL*, is a rule about antitrust injury. Though first articulated fully in *Illinois Brick*,[33] the rule traces its origins to *Hanover Shoe, Inc. v. United Shoe Machinery Corp.*,[34] decided nine years previously. There, a shoe manufacturer that purchased shoe equipment necessary to the manufacturing process sued its equipment supplier under section 4 of the Clayton Act, seeking treble damages for an allegedly illegal overcharge exacted by the equipment maker on the price of its equipment.[35] By way of defense, the equipment manufacturer offered to show that plaintiff had not been injured in its business within the meaning of section 4 because it had "passed on" the illegal overcharge—by raising the price of its shoes—to its retailer-customers.[36] Under defendant's theory, since the illegal overcharge was absorbed not by plaintiff but by plaintiff's customers—"indirect" purchasers of defendant's machinery—the customers were the only persons injured by the alleged antitrust violation and the plaintiff thus lacked standing to sue.[37]

The Supreme Court rejected this defense as a matter of law.[38] The Court held that, save for certain narrowly limited exceptions,[39] a direct purchaser suing for treble damages under section 4 is injured within the meaning of that section by the full amount of the overcharge paid by it.[40] An antitrust defendant, it concluded, may not attempt to avoid the claims of direct purchasers by attempting to show that indirect purchasers were the ones actually injured by the illegal overcharge.[41] The Court offered two reasons for this holding. First, it was unwilling to add to treble damage actions the further complications that would flow from efforts to trace the effects of an unlawful overcharge on indirect purchasers' prices, sales, costs, and profits, and to show that these effects would have differed in the absence of the overcharge.[42]

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32. *See, e.g.*, Sanner v. Board of Trade of Chicago, 62 F.3d 918, 927 (7th Cir. 1995) ("the standing determination is ultimately a product of the particularities of each case"); Bodie-Rickett & Assocs. v. Mars, Inc., 957 F.2d 287, 290 (6th Cir. 1992) ("no single factor is conclusive").

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

34. 392 U.S. 481 (1968).

35. *Id.* at 483.

36. *Id.* at 487.

37. *Id.*

38. *Id.*

39. The Court noted that a pass-on defense might be permitted in the situation of "an overcharged buyer [who] has a pre-existing 'cost-plus' contract, thus making it easy to prove that he has not been damaged . . . ." *Hanover Shoe*, 392 U.S. at 494.

40. *Id.*

41. *Id.*

42. *Id.* at 492-93. The Court stated,

A wide range of factors influence a company's pricing policies. Normally the impact of

Second, it expressed concern that unless direct purchasers could sue for the portion of the overcharge allegedly passed on to indirect purchasers, antitrust violators "would retain the fruits of their illegality" because indirect purchasers, each having absorbed but a relatively small portion of the total monopoly overcharge, "would have only a tiny stake in the lawsuit" and thus little incentive to sue.[43]

Hanover Shoe thus established the general proposition that with one narrow exception— the case of pre-existing cost-plus contracts—an antitrust defendant could not avail itself of the passing-on defense to defeat the treble damage claim of a direct purchaser. Though the case focused on antitrust defendants and the proper limits of defensive arguments, it nevertheless suggested something about the nature of antitrust injury and the category of buyers who would be viewed as having experienced it. Nine years later, in *Illinois Brick Co. v. Illinois*,[44] the Court addressed these issues directly.

Illinois Brick was the flip side of *Hanover Shoe*, concerned with the offensive rather than the defensive use of the passing-on argument. Petitioners manufactured concrete block and sold it in the Chicago metropolitan area, primarily to masonry contractors who would bid to supply the masonry requirements of large construction projects. General contractors on projects that had received bids from would-be masonry subcontractors would incorporate them into their own estimates for construction projects put out to bid—in this case by plaintiff-respondents, the state of Illinois and 700 local governmental entities in the Chicago area. Those respondent-buyers were thus very indirect purchasers, two steps removed from the original sale of concrete block—the manufacturers sold block to masonry firms, who effectively resold it to general contractors, who then used it in finished buildings which were sold to respon-

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> 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 . . . , he would have chosen a different price. Equally difficult to determine . . . is what effect a change in the company's price will have on total sales. Finally, costs per unit for a different volume of sales are hard to estimate. Even if it could be shown that the buyer raised his price in response to, and in the amount of, the overcharge and that his margin of profit and total sales had not thereafter declined, there would remain the nearly insuperable difficulty of demonstrating that the particular plaintiff could not or would not have raised his prices absent the overcharge or maintained the higher price had the overcharge been discontinued. 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. On the other hand, it is not unlikely that if the existence of the defense is generally confirmed, antitrust defendants will frequently seek to establish its applicability. Treble-damage actions would often require additional long and complicated proceedings involving massive evidence and complicated theories.

Id.

43. *Id.* at 494.

44. 431 U.S. 720 (1977).

dents.[45]

In its capacity as purchaser and on behalf of the local governmental entities, Illinois sued the manufacturer-petitioners under section 4 of the Clayton Act, alleging that they had conspired to fix the price of concrete block in violation of section 1 of the Sherman Act.[46] It alleged that the conspiracy resulted in overcharges of more than three million dollars for the block used in the buildings that respondents had purchased.[47] While the substantive antitrust violations seemed fairly clear-cut—by the time the matter reached the Supreme Court the manufacturers had settled with other plaintiff classes (masonry contractors, general contractors and private builders)[48]—the case raised an important and difficult question about antitrust standing. As the Supreme Court observed in framing the issue, "The only way in which the antitrust violation alleged could have injured respondents is if all or part of the overcharge was passed on by the masonry and general contractors to respondents, rather then being absorbed at the first two levels of distribution."[49]

In the district court, the manufacturers had moved for partial summary judgment against all plaintiffs that were indirect purchasers of concrete block, arguing that only direct purchasers had standing to sue for the overcharge.[50] The district court granted this motion, but the Court of Appeals for the Seventh Circuit reversed.[51] In its view, indirect purchasers such as respondents could recover treble damages for an illegal overcharge if they could prove that the overcharge was passed on to them through the intervening links in the chain of distribution.[52] The effect of this ruling was to afford antitrust plaintiffs a potentially powerful argument—that they had in fact been the ultimate and only victims of an illegal overcharge—that was unavailable to antitrust defendants.

The Supreme Court granted certiorari "to resolve a conflict among the Courts of Appeals on the question whether the offensive use of pass-on authorized by the decision below is consistent with *Hanover Shoe's* restrictions on the defensive use of pass-on."[53] For two reasons, the Court held that it was not.[54] First, the Court concluded that the rule regarding the availability

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45. *Id.* at 726.

46. Section 1 of the Sherman Act 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 hereby declared to be illegal . . . ." 15 U.S.C. § 1 (1994).

47. *Illinois Brick*, 431 U.S. at 727.

48. *See* Illinois v. Ampress Brick Co. Inc., 536 F.2d 1163, 1164 (7th Cir. 1976).

49. *Illinois Brick*, 431 U.S. at 727.

50. *Id.*

51. *Id.*

52. *Id.* at 727-28.

53. *Id.* at 728.

54. *Illinois Brick*, 431 U.S. at 748 (Brennan, J., Marshall, J., and Blackmun, J., dissenting).

of the pass-on argument—whatever it was—should apply equally to plaintiffs and defendants.[55] Symmetry in this respect was important, the court concluded, not for its own sake, but for reasons of fairness and administrability.[56] Second, it reaffirmed the construction of section 4 implicitly adopted by *Hanover Shoe*: the only party "injured in his business or property" by an unlawful overcharge is the direct purchaser; others further along the chain of distribution, however compelling their claims may seem, lack antitrust standing.[57] The more liberal rule adopted by the Seventh Circuit and others—that any party in the chain could sue to recover that portion of the overcharge which it allegedly absorbed—would, said the Court, substantially reduce the effectiveness of the antitrust treble-damages action.[58]

The rationale for this holding was two-fold. First, the Court explained that a symmetrical rule was fair. If the rule were one-sided—if indirect plaintiffs could recover treble damages but defendants could not employ a pass-on theory to preclude direct plaintiffs from also recovering treble damages—defendants would be subject to "a serious risk of multiple liability."[59] An asymmetrical rule would allow direct purchasers to recover the full amount of any overcharge, even though they had passed all of it on, while permitting indirect purchasers who had absorbed the overcharge to recover a like amount. Unwilling to open the door to duplicative recoveries,[60] the Court refused to arm antitrust plaintiffs with a weapon banned from defendants' arsenal.[61]

Second, the administrative considerations that animated the holding in *Hanover Shoe* also argued strongly for a two-sided rule. According to *Illinois Brick*, the "principal basis" for the Court's ruling in *Hanover Shoe* was its concern about "the uncertainties and difficulties in analyzing price and output decisions 'in the real economic world . . .' and [about] the costs to the judicial system and the efficient enforcement of the antitrust laws of attempting to reconstruct those decisions in the courtroom."[62] *Hanover Shoe* was unwilling to open antitrust litigation to the "massive evidence and complicated theories" that would inevitably accompany attempts to establish a pass-on defense against a direct purchaser.[63] Those important administrative concerns, said the Court, are no less acute when plaintiffs assert pass-on theories; indeed, they are "multiplied" when plaintiffs are several steps removed from defendants in

55. *Id.* at 728.
56. *Id.* at 731.
57. *Id.* at 729.
58. *Id.*
59. *Illinois Brick*, 431 U.S. at 730.
60. A prospect that the dissent found much less unpleasant and unlikely. *Id.* at 761.
61. *Id.* at 731.
62. *Id.* at 731-732.
63. *Hanover Shoe*, 392 U.S. at 493.

the chain of distribution.[64]

Of the two policy considerations informing the rationale of the Court's opinion in *Illinois Brick*, the desire to avoid the costly and intractable complexities of the tracing inquiry seemed more important. Assuming for argument's sake that the risks of multiple liability could somehow be avoided, the Court nevertheless emphasized that the difficulties of tracing unlawful overcharges through the chain of distribution would still weigh decisively against permitting suits by indirect purchasers:

> [E]ven if ways could be found to bring all potential plaintiffs together in one huge action (thereby avoiding the possibility of inconsistent adjudication and multiple liability), the complexity thereby introduced into treble-damage proceedings argues strongly for retaining the *Hanover Shoe* rule.[65]

In thus reinforcing and extending the rule of *Hanover Shoe*, the Court in *Illinois Brick* declared that exceptions to the indirect purchaser rule were to be very narrowly construed.[66] It conceded that some contexts involving indirect purchasers might not evoke concern about allocating damages and segregating the effects of an unlawful overcharge from the other business variables that might account for a price rise.[67] But it nevertheless rejected "attempts to carve out exceptions . . . for particular types of markets."[68] In its view, the task of deciding which markets merited exceptional treatment would force courts to engage in the kind of overly complicated inquiry that *Hanover Shoe* sought to avoid.[69] That case, said the Court in *Illinois Brick*, "implicitly discouraged the creation of exceptions to its rule barring pass-on defenses, and we adhere to [that] narrow scope of exemption."[70]

After *Illinois Brick*, the indirect purchaser rule would tolerate just two categories of exception. The first remained from *Hanover Shoe*, where the Court cited the case of a pre-existing cost-plus contract as a situation in which the pass-on defense might be allowed.[71] Because such contracts insulate direct purchasers from any loss of sales (their customers have committed to purchasing fixed quantities regardless of price), the impact of an unlawful overcharge is essentially pre-determined, said the Court, "without reference to the interaction of supply and demand that complicates the determination in the general case."[72] In *Illinois Brick*, the Court described a second category in which, because "market forces have been superseded," the pass-on defense

64. *Illinois Brick*, 431 U.S. at 732.
65. *Id.* at 731 n.11.
66. *Id.* at 745.
67. *Id.* at 743.
68. *Id.* at 744.
69. *Illinois Brick*, 431 U.S. at 744.
70. *Id.* at 745.
71. *Id.* at 735-36.
72. *Id.* at 736.

(and, by analogy, indirect purchaser standing) "might be permitted,"—cases in which "the direct purchaser is owned or controlled by its customer."[73] Save for these seemingly well-specified circumstances, the rule of *Illinois Brick* interprets section 4 of the Clayton Act in two ways: (1) to forbid antitrust defendants from showing that direct purchasers lack standing; and (2) to deny standing to all indirect purchasers.[74]

The implications of this restrictive rule were not lost on the *Illinois Brick* dissenters. Arguing that the Court had historically accorded section 4 a reach consistent with its broad remedial purposes of compensation and deterrence, Justice Brennan argued in dissent that the new rule—"that [section] 4 affords a remedy only to persons who purchase directly from an antitrust offender"—marked a "regrettable retreat" from the more expansive philosophy of earlier cases.[75] Because indirect purchasers often bear the brunt of antitrust injuries, the dissent predicted that the majority's decision would "severely undermine the effectiveness of the private treble-damages action as an instrument of antitrust enforcement."[76]

The majority acknowledged that its ruling would deny recovery to those indirect purchasers who suffered actual injury from antitrust violations.[77] Moreover, it agreed that section 4 seeks to compensate antitrust victims and deter would-be transgressors.[78] But, the majority believed that the new rule was nevertheless necessary to foster the principle of fair compensation: direct purchasers usually absorb most of an antitrust overcharge; the costly complexities entailed in attempting to allocate an overcharge among all purchasers, direct and indirect, would significantly deplete amounts available for recovery; and the difficulties of accurately ascertaining the amount of any overcharge absorbed by particular indirect purchasers would make it unlikely that the recovery awarded would reflect the actual injury.[79] Rather than strengthening the role of the treble-damages action, a rule permitting suit by indirect purchasers would so complicate and confuse antitrust litigation, the majority concluded, that those most injured by antitrust violations would lose their incen-

73. *Id.* at 736 n.16. As one court has described it, "Where market forces have been suspended, tracing problems disappear; the whole of the overcharge can be said to have 'passed through' to the ultimate consumer." *In re* Mid-Atlantic Toyota Antitrust Litigation, 516 F. Supp. 1287, 1293 (D. Md. 1981).

74. *See, e.g.*, Labrador, Inc., v. The IAMS Co., 105 F.3d 665 (9th Cir. 1997) ("*Illinois Brick* establishes a simple rule: Indirect purchasers cannot state a cause of action against manufacturers for damages under the Clayton Act.").

75. *Illinois Brick*, 431 U.S. at 749 (citing Mandeville Island Farms, Inc. v. American Crystal Sugar Co., 334 U.S. 219, 236 (1948).

76. *Illinois Brick*, 431 U.S. at 749.

77. *Id.* at 746.

78. *Id.*

79. *Id.* at 747.

tive to sue, seriously weakening the treble-damages action as a weapon of antitrust enforcement.[80]

IV. PDAL AND THE RULE OF ILLINOIS BRICK

A. The District Court Opinion

In *PDAL*, the manufacturer defendants brought two separate motions in the district court for summary judgment, claiming in each that the retailer plaintiffs were indirect purchasers precluded by *Illinois Brick* from bringing suit.[81] The first motion, heard before the start of discovery, was denied on the ground that since the complaint alleged that the manufacturers had conspired with wholesaler defendants to "fix, raise, maintain and stabilize" the prices charged plaintiffs for prescription brand-name drugs, *Illinois Brick* did not apply.[82] By the time of the second motion, however, "massive discovery" had demonstrated to the court that the alleged vertical conspiracy among manufacturers and wholesalers "was not vertical at all," but entirely horizontal and confined to the manufacturers.[83] Consequently, the so-called conspiracy exception to *Illinois Brick* was inapplicable. Two years after denying the manufacturers' first motion predicated on the indirect purchaser rule, the court felt compelled to "revisit" the issue.[84]

At the outset, the district court acknowledged that the Supreme Court had permitted few exceptions to the indirect purchaser rule and that unless one of those exceptions applied to the transactions at issue plaintiffs' claims would be barred. It observed that, at least superficially, plaintiffs appeared to be indirect purchasers of defendants' products: the "vast majority" of prescription drugs purchased by retail pharmacies came from wholesalers, which had in turn bought them from the manufacturer-defendants. Plaintiffs' status as indirect purchasers, said the court, would therefore "seemingly bar" them from pursuing their Sherman Act claims. But a "close examination of the evidence"

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80. *Id.* at 745.

81. *PDAL*, 1996 U.S. Dist. LEXIS 4335, at *84.

82. Though *Illinois Brick* did not address this situation, courts interpreting it have uniformly held and acknowledged that indirect purchasers may sue for treble damages when the illegal overcharges allegedly result from a conspiracy between the direct purchaser and the antitrust defendant. While labeled by most courts as an "exception" to the indirect purchaser rule, this situation is not a true exception to that rule because it does not involve pass-on damages. The direct purchaser/conspirator is not damaged at all—the nominal "indirect purchaser" is the only party injured by the antitrust violation. *See, e.g.*, Link v. Mercedes-Benz of N. Am., 788 F.2d 918, 929 (3d Cir. 1986); Arizona v. Shamrock Foods, Co., 729 F.2d 1208, 1211 (9th Cir. 1984), *cert. denied*, 469 U.S. 1197 (1985); *In re* Brand Name Prescription Drugs Litigation, 867 F. Supp. 1338 (N.D. Ill. 1994).

83. *PDAL*, 1996 U.S. Dist. LEXIS 4335, at *82-83.

84. *Id.*

led the court to the opposite conclusion.[85]

In particular, the court focused on undisputed evidence about the new dynamic of power in the pharmaceutical industry. The growing number of large institutional buyers that insisted on negotiating discounts directly with manufacturers had made wholesalers increasingly superfluous to the marketing effort, eroding their profitability, stripping them of their financial independence and placing them at the mercy of the manufacturers. The record was "replete," said the court, with evidence suggesting that the manufacturers alone made the decisions not to offer discounts to retailers. They did not consult with wholesalers about adopting or implementing the no-discount policy. They did not solicit or consider the wholesalers' opinions or advice about the wisdom of the policy. And indeed, the policy as applied appeared to harm wholesalers, who not only bore the brunt of retailer complaints about unfair treatment but realized "very little profit" from its implementation.[86]

Most telling, in the district court's view, was the direct and pervasive involvement by the manufacturers in the day-to-day mechanics of the discriminatory discounting system, which was maintained by means of a "chargeback" arrangement.[87] Pursuant to this arrangement, the manufacturers would directly negotiate a discounted price with each preferred customer, the wholesaler would sell to the preferred customer at the discounted price, and the manufacturer would then reimburse the wholesaler for the difference between its regular wholesale price and the discounted price actually paid.[88] While this arrangement might bear some superficial resemblance to independent commerce, it was clear to the district court that the wholesalers functioned as pawns of the more powerful manufacturers[89].

Because of their low profit margins and financial vulnerability, the wholesalers had no choice but to acquiesce in the manufacturers' plan. "Simply put," said the court, "the wholesalers functioned as glorified warehouses . . . , facilitating transactions in accordance with the manufacturers' instructions."[90] Under these circumstances, the court concluded, "where the actions of the intermediary are so totally dictated by the alleged antitrust violator," the

85. *Id.* at *89-*90.

86. *Id.* at *90-*91.

87. *Id.* at *91-*93.

88. Thus, if the manufacturer regularly charged the wholesaler $100 for some standard unit of a particular drug, but had agreed with a favored customer to sell it that drug at $75 per unit, the wholesaler would pay the manufacturer the "normal" price of $100, resell to the favored customer at $75, and then bill the manufacturer (charge it back) for the $25 differential.

89. "[T]he evidence shows that the Manufacturer Defendants exercised total control over the principal pricing decisions, both with regards to the wholesalers and with regards to the purchasers at the level of retail pharmacies and managed care." *PDAL*, 1996 U.S. Dist. LEXIS 4335, at *90.

90. *Id.* at *92-*93.

"control" exception to the rule of *Illinois Brick* permits indirect purchasers to sue.[91] Plaintiffs "were the only party harmed" by the unlawful discounting scheme: to deny them the right to sue "merely because the manufacturers have in place convenient middlemen for Illinois Brick protection" would undercut the rationale of *Illinois Brick* and do a disservice to its broader policy concerns.[92]

The district court thus interpreted the "control" exception of *Illinois Brick* to encompass situations in which the direct purchaser is "effectively" controlled by the antitrust violator.[93]

The district court's theory of "effective" control marked a radical departure from *Illinois Brick*. Not only did it expand on the Supreme Court's narrowly crafted "control" exception, but it strayed substantially from the precedential and policy underpinnings of the indirect purchaser rule. In announcing the "control" exception, *Illinois Brick* identified, "[a]nother situation in which market forces have been superceded [in addition to that of the "preexisting cost-plus contract"] and the pass-on defense might be permitted . . . where the direct purchaser is owned or controlled by its customer."[94] The Court emphasized that both exceptions to the indirect purchaser rule—the "control" exception and that for pre-existing cost-plus contracts—were designed to cover "situation[s] in which market forces have been superceded."[95] As to cost-plus contracts, the Court noted that market forces are circumvented because the direct purchaser is insulated from any decrease in its sales as a result of trying to pass on the overcharge: "[t]he effect of the [unlawful] overcharge is essentially determined in advance, without reference to the interaction of supply and demand . . . ."[96] It offered no comparable observation about how ownership or control might supercede market forces, perhaps because it judged their effects to be obvious. Where the customer owns or controls the direct purchaser (or vice versa), there are no arms-length transactions: the two firms effectively function as one, and neither can be said to have been harmed by the antitrust violation, since both share the fruits of the illegal overcharge.

This interpretation of the "control" exception depends on a certain view of the meaning of the terms "ownership" and "control." It is a narrow view, but admittedly the Court has told us to read these terms narrowly.[97] Moreover, as a practical matter, only where one firm owns either all or a controlling interest

91. *Id.* at *93.

92. *Id.* at *97.

93. *Id.*

94. *Illinois* Brick, 431 U.S. at 736 n.16. *Cf.* Perkins v. Standard Oil Co., 395 U.S. 642, 648 (1969); *In re* Western Liquid Asphalt Cases, 487 F.2d at 197, 199 (9th Cir. 1973).

95. *Illinois Brick*, 431 U.S. at 735-36 n.16.

96. *Id.* at 736.

97. *Id.* at 735-36.

of another's stock are "market forces . . . superceded."[98] In situations where there is no cross-ownership but a substantial amount of leverage, arm's length transactions are the rule, even when they require less powerful firms to acquiesce in the demands of the more powerful. In addition, stock ownership is easy to identify and measure. A controlling interest, though sometimes difficult to gauge, for the most part is measurable. But the kind of "effective control" that served as the basis for the district court's decision not only permeates the business world and defies measurement, it represents the normal play of market forces, not their supercession.

The two cases cited in the footnote in *Illinois Brick* setting forth the control exception support a limited reading of that exception.[99] Though neither dealt directly with the pass-on defense or the indirect purchaser rule, the cases apparently demonstrated the kinds of business relationships that typified the Court's notion of "control." The first, *Perkins v. Standard Oil Co.*,[100] was a price discrimination case brought under section 2(a) of the Robinson-Patman Act,[101] and for that reason an awkward precedent at best. The language of the Robinson-Patman Act expressly contemplates suits by parties even farther removed than indirect purchasers from the prohibited transaction (rivals of "customers" of persons who "knowingly receive" the benefit of unlawful price discrimination).[102] *Perkins* concerned the meaning of the term "customer."[103] The *Perkins* Court held that price discrimination that impaired competition between plaintiff and the "customer[] of a customer" could be actionable where the second customer was a majority-owned subsidiary of the first.[104]

The second cited case, *In re Western Liquid Asphalt Cases*,[105] involved an arrangement very much like the one in *Illinois Brick*. Governmental entities purchased construction projects from general contractors that incorporated price-fixed asphalt supplied to the generals by the defendant asphalt subcon-

98. *Id.* at 736 n.16.

99. *Id.*

100. 395 U.S. 642 (1969).

101. *Id.* at 643. The Act provides in pertinent part:

> It shall be unlawful for any person engaged in commerce, in the course of such commerce, either directly or indirectly, to discriminate in price between different purchasers of commodities of like grade and quality . . . , where the effect of such discrimination may be substantially to lessen competition or tend to create a monopoly in any line of commerce, or to injure, destroy, or prevent competition with any person who either grants or knowingly receives the benefit of such discrimination, or with customers of either of them . . . .

15 U.S.C. § 13(a) (1994).

102. 15 U.S.C. § 13(a) (1994).

103. *Perkins*, 395 U.S. at 647.

104. *Id.* at 647-48.

105. 487 F.2d 191 (9th Cir. 1973).

tractors.[106] Unlike *Illinois Brick*, however, the facts indicated that the defendants "control[led] a high percentage of their direct customers of asphalt, either through acquisition of stock or indirectly through various financial arrangements, including credit."[107] In the *Asphalt Cases*, as in *Perkins*, control was thus exerted, and the workings of the market superceded, not by some inchoate imbalance of power but by the leverage that naturally accompanies the observable relationships of owner-subsidiary and debtor-creditor.

The district court in *PDAL* cited one case, or rather a general statement of principle taken from that case, in support of its expansive approach to the "control" exception.[108] But this case, too, was somewhat of a curious precedent, largely because it held that the rule of *Illinois Brick* barred the suit in question.[109] Without discussing its facts or mentioning its holding, the district court referred to *Jewish Hospital Ass'n.* for the proposition that the *Illinois Brick* exception should apply where "the degree of control exercised by the defendant effectively transforms the transaction—from defendant to middleman to indirect purchaser—into one sale."[110] But the actual language of *Jewish Hospital Ass'n* arguably contemplates a more constrained interpretation. According to that opinion, which was expressly "[m]indful of the *Illinois Brick* Court's emphasis upon the narrow scope of the exemptions to the indirect-purchaser rule," the control exception should be "limited to relationships involving such functional economic or other unity between the direct purchaser and either the defendant or the indirect purchaser that there effectively has been only one sale."[111] The key words from that passage are not "effective control"—the district court's translation—but "narrow," "limited," and "functional . . . unity," words which confine the exception to cases involving stock ownership, credit arrangements, or financial ties.

The case of *In re Mid-Atlantic Toyota Antitrust Litigation*[112] also provides some small support for the district court's view. In that case the court decided that the two exceptions announced in *Illinois Brick* were "not meant to be necessarily exclusive," but were "simply expository,"[113] leaving the way open in theory for other courts to craft additional exceptions for other situations in which market forces were superceded. The *Toyota* plaintiffs, however, did not raise the "ownership or control" exception, so the court had no need to (and

106. *Id.* at 194.

107. *Id.* at 195.

108. *PDAL*, 1996 U.S. Dist. LEXIS 4335, at *88 (citing Jewish Hosp. Ass'n of Louisville, Ky., Inc. v. Stewart Mechanical Enter., 628 F.2d 971 (6th Cir. 1980)).

109. *Jewish Hospital Ass'n*, 628 F.2d at 972.

110. *PDAL*,1996 U.S. Dist. LEXIS 4335, at *88.

111. *Jewish Hospital Ass'n*, 628 F.2d at 975.

112. *In re* Mid-Atlantic Toyota Antitrust Litig., 516 F. Supp. 1287 (D. Md. 1981).

113. *Id.* at 1292.

thus did not) discuss its appropriate boundaries.[114] The broad proposition announced in *Toyota*—that situations other than ownership or control might warrant exemption from the indirect purchaser rule[115]—does not shed any light on the meaning of the "control" exception or on the characteristics of the "additional exceptions" contemplated but not identified by the court.

It seems, then, that the precedents invoked in support of the district court's notion of "effective control" provide a weak foundation for that notion. But precedent was not the only basis for the court's holding. Policy also played a role. Discovery had demonstrated the apparent existence of an unlawful manufacturer conspiracy. Plaintiffs had alleged, and seemed capable of proving, that they were seriously harmed by it. It was "clear" to the district court that plaintiffs "were the only party harmed."[116] Consequently, the court concluded that to deprive plaintiffs of the right to sue, "merely because the manufacturers have in place convenient middlemen for *Illinois Brick* protection would be to deny the plaintiffs any possibility for redress."[117]

B. The Court of Appeals' Opinion

The Court of Appeals for the Seventh Circuit reversed.[118] After reviewing the history of the *Illinois Brick* doctrine and concluding that the only exceptions to the doctrine "are those stated in *Illinois Brick* itself—'where the direct purchaser is owned or controlled by its customer'... or, we suppose vice versa"[119]—the court acknowledged that the first exception (ownership) was concededly inapplicable.[120] So also, said the court, was the second, control.[121] Customary means of control separate from ownership—interlocking directorates, minority stock ownership, loan agreements ceding managerial control of the wholesalers to the manufacturers, trust agreements—were admittedly missing from the wholesaler-manufacturer arrangement. More importantly, said the court of appeals, the district court placed "undue weight" on the chargeback system, in determining that the manufacturers effectively controlled their wholesalers.[122]

According to the Seventh Circuit, the chargeback system was irrelevant to the standing issue. Plaintiffs were suing because they had not received the discounts that put the chargeback system in motion: "[t]hey did not have contracts with the manufacturers, they did not receive discounts, and the wholesal-

114. *Id.*
115. *Id.* at 1292 & n.14.
116. *PDAL*, 1996 U.S. Dist. LEXIS 4335, at *97.
117. *Id.*
118. *PDAL*, 123 F.3d 599 (7th Cir. 1997).
119. *Id.* at 605 (quoting *Illinois Brick*, 431 U.S. at 736 n.16).
120. *PDAL*, 123 F.3d at 605.
121. *Id.*
122. *Id.*

ers did not receive chargebacks on sales to them."[123] Apart from the indirect effects of their alleged price-fixing conspiracy, the defendant-manufacturers did not intervene in the relationships between plaintiffs and their wholesalers.[124] From the perspective of the *Illinois Brick* doctrine, that is the salient point: plaintiffs are claiming treble damages from illegal overcharges passed on to them by wholesalers that had paid those same overcharges to the manufacturer-conspirators.[125] "This," said the court, "is just the kind of complaint that *Illinois Brick* bars."[126] In these circumstances, only the wholesalers—the direct purchasers of the defendants' product—are allowed to sue for damages, "even if every cent of the overcharge was promptly and fully passed on to the pharmacies in the form of a higher wholesale price."[127]

Though it reaches the correct result, the Seventh Circuit's analysis of the control exception is cramped and unresponsive to the district court's treatment of that issue. The district court seemed to view control in a functional sense: seen in its entirety, the relationship between manufacturers and wholesalers appeared to be one in which the former could and did dictate pricing policy to the latter. It regarded this power as the hallmark of effective control and thus thought it appropriate to invoke the control exception to *Illinois Brick*. By contrast, the Seventh Circuit ignored the question of effective control, focused exclusively on the chargeback system, assumed that its use might constitute the exercise of control, but concluded that since the system was confined to the favored purchasers, defendants had paid prices unaffected by the manufacturers' ability to control the wholesalers.

The Seventh Circuit opinion implies that the manufacturers' ability to dictate wholesaler pricing policies would permit plaintiffs to avail themselves of the control exception of *Illinois Brick* only if the manufacturers had affirmatively intervened in the wholesalers' pricing decisions vis a vis plaintiffs. If, for example, the manufacturers had used their economic power to force wholesalers to raise prices to plaintiffs, the Seventh Circuit might then have applied the control exception and permitted plaintiffs to sue. Since, however, the manufacturers allegedly used their power not to raise prices but to stabilize them, the court judged the exception to be inapplicable. This analysis appears to rest on a distinction without a difference.

More importantly, the Seventh Circuit failed to address the district court's flawed notion of an "effective control" exception,[128] seemingly adopting the notion in principle but rejecting its application to the facts of the case. Permit-

123. *Id.* at 606.
124. *Id.*
125. *PDAL*, 123 F.3d at 606.
126. *Id.*
127. *Id.*
128. *See id.* at 605.

ting this exception to creep into the *Illinois Brick* doctrine would, for the reasons suggested earlier, contribute substantially to undermining the efficacy of that doctrine. By failing to respond directly to the district court's attempt to import an "effective control" exception into *Illinois Brick*, the Seventh Circuit has created some unwarranted uncertainty about what should be a clear and relatively simple rule.

Oddly enough, perhaps, the Seventh Circuit's refusal to apply the control exception to the *PDAL* plaintiffs did not spell the end of their case. What it took away with one ruling, the court restored with two others, reversing the trial court's decisions dismissing the wholesalers as defendants and denying plaintiffs' motion to remand their state antitrust action to Alabama, the state on whose law that action relies.[129] The first of these actions is unremarkable. Recall that the district court had denied defendants' first motion to dismiss on indirect purchaser grounds because of the so-called conspiracy exception to *Illinois Brick*: wholesaler-defendants were alleged to have conspired with and assisted the manufacturer-defendants in their pricing scheme, and were therefore properly regarded as "direct" sellers to plaintiffs.[130] But the district court subsequently ordered the wholesaler-defendants dismissed from the lawsuit, reviving the indirect purchaser issue. This order, too, was on appeal to the Seventh Circuit.[131]

On the Seventh Circuit's view, the complaint raised a plausible factual question about the wholesalers' involvement in the manufacturers' alleged conspiracy that should not have been resolved on a motion for summary judgment.[132] Relying on recent Supreme Court precedent governing the use of summary judgment in antitrust litigation,[133] the wholesalers had argued that it made no economic sense for them to conspire with the manufacturers: a conspiracy that prevents them from selling to pharmacies at a discount reduces their sales volume and thus their profits.[134] Though this theory could explain the wholesalers' behavior, the plaintiffs posited a separate and equally compelling theory: recognizing their plight as "an endangered commercial species,"[135] drug wholesalers joined with manufacturers in order to discourage retail pharmacies from forming the kind of buying groups that could negotiate directly with manufacturers and further diminish the wholesalers' role.[136] Since the extensive record developed through discovery contained support for

129. *Id.* at 613-14.

130. *See supra* note 82 and accompanying text.

131. *See supra* notes 83-84 and accompanying text.

132. *PDAL*, 123 F.3d at 614.

133. Eastman Kodak Co. v. Image Technical Services, Inc., 504 U.S. 451, 467-69 (1992); Matsushita Elec. Indus. Co. v. Zenith Radio Corp., 475 U.S. 574, 589 (1986).

134. *PDAL*, 123 F.3d at 614.

135. *Id.*

136. *Id.*

each theory,[137] the Seventh Circuit concluded that summary judgment on the issue was improvidently granted, restored the wholesalers as defendants and remanded the matter for trial. With the wholesalers returned to defendant status, the plaintiffs were no longer indirect purchasers and their suit could proceed without hindrance by the *Illinois Brick* doctrine.

Even if plaintiffs had lost on the conspiracy question, however, and found their federal damages claim barred by *Illinois Brick*, their case would not necessarily have ended. By reversing the district court's refusal to remand plaintiffs' state antitrust action to Alabama, where it was initiated, the Seventh Circuit indirectly acknowledged a curious anomaly of antitrust standing. In many states, indirect plaintiffs foreclosed from recovering damages under federal antitrust law may nevertheless pursue their damage claims in state court under state antitrust law.

C. *The Pharmaceutical Litigation in the Aftermath of PDAL: Antitrust Standing and Antitrust Federalism*

States are free to enact their own antitrust laws, and almost all states have, modeling their statutes on the federal legislation. For the most part, these state laws regulate the same conduct as their federal counterparts, subject to the limits imposed by the commerce and due process clauses of the United States Constitution.[138] Shortly after the Supreme Court decided *Illinois Brick*, a number of states amended their antitrust laws to permit private damage actions by indirect purchasers.[139] In *California v. ARC America Corp.*,[140] the states of Alabama, Arizona, California and Minnesota brought class actions in federal

137. "Pretrial discovery included the taking of a thousand depositions and the production of fifty million pages of documents." *Id.* at 613.

138. *See generally* Herbert Hovenkamp, *State Antitrust in the Federal Scheme*, 58 IND. L.J. 375 (1983).

139. In the five years following *Illinois Brick*, twelve states enacted "repealer" legislation. *See* CAL. BUS. & PROF. CODE § 16750(a) (West 1987); D.C. CODE ANN. § 28-4509 (1996); HAW. REV. STAT. § 480-14(b)-(c) (1993); 740 ILL. COMP. STAT. ANN. § 10/7(2) (West 1992); KAN. STAT. ANN. § 50-801(b) (1995); MD. CODE ANN., COM. LAW I § 11-209(b)(2)(ii) (1990); MICH. COMP. LAWS § 445.778(2) (West 1989); MINN. STAT. ANN. § 325D.57 (West 1995); N.M. STAT. ANN. § 57-1-3 (Michie 1995); R.I. GEN. LAWS § 6-36-12(g) (1992); S.D. CODIFIED LAWS § 37-1-33 (Michie 1994); WIS. STAT. ANN. § 133.18(1)(a) (West 1989). Two other states enacted statutes prior to World War I, anticipating *Illinois Brick* and permitting indirect purchaser actions. *See* ALA. CODE § 6-5-60 (1993); MISS. CODE ANN. § 75-21-9 (1991). Not all of these statutes afforded standing to every category of indirect purchaser. Thus, for example, while most permit indirect purchasers to sue directly, Hawaii's law provides that only the attorney general may bring a class action on behalf of indirect purchasers; Rhode Island and Illinois have comparable limitations. *See generally* Ronald W. Davis, *Indirect Purchaser Litigation: ARC America's Chickens Come Home to Roost on the Illinois Brick Wall*, 65 ANTITRUST L.J. 375, 391-93 (1997).

140. 490 U.S. 93 (1989).

court against various cement producers alleged to have engaged in a nationwide conspiracy to fix cement prices. Plaintiffs sued under both federal antitrust law and their respective state antitrust laws, which authorized indirect purchasers to recover unlawful overcharges passed on to them.[141] Both sets of claims were settled against several of the defendants,[142] but the district court refused to allow payment of the states' indirect purchaser claims out of the settlement funds, on the ground that the states' indirect purchaser statutes had been preempted by federal law. The states appealed and the Court of Appeals for the Ninth Circuit affirmed.[143]

The Supreme Court reversed.[144] Notwithstanding the clear rule limiting federal antitrust standing to direct purchasers, the Court held that states' indirect purchaser statutes were not preempted by federal law.[145] In the Court's view, *Hanover Shoe* and *Illinois Brick* concerned themselves strictly with questions of federal statutory interpretation—particularly the meaning of section 4 of the Clayton Act. Neither discussed state law or addressed the possible preemptive effect of its holding.[146] And, ultimately, neither restricts state antitrust statutes from establishing broader rules of standing. "It is one thing," said the Court, "to consider the congressional policies identified in *Illinois Brick* and *Hanover Shoe* in defining what sort of recovery federal antitrust law authorizes;" but nothing "suggests that it would be contrary to congressional purposes for States to allow indirect purchasers to recover under their own laws."[147]

In holding that federal law does not preempt state laws allowing suits by indirect purchasers, the Supreme Court rejected the three concerns that had persuaded the Ninth Circuit that federal preemption was appropriate.[148] The court of appeals had ruled that because state laws permitted indirect plaintiffs to accomplish in state forums what they were forbidden to attempt in federal court they effectively undermined the congressional policies identified in *Hanover Shoe* and *Illinois Brick*.[149] According to the Supreme Court, however, the appeals court had misinterpreted those decisions.[150] "[T]he Court of Appeals concluded that state indirect purchaser statutes interfere with the congressional purpose of avoiding unnecessarily complicated proceedings on fed-

141. *Id.* at 98.

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

143. *In re* Cement & Concrete Antitrust Litig., 817 F.2d 1435, 1447 (9th Cir. 1987), *rev'd*, 490 U.S. 93 (1989).

144. *ARC America*, 490 U.S. at 106.

145. *Id.* at 101.

146. *Id.* at 102-03.

147. *Id.* at 103.

148. *Id.* at 101-105.

149. *ARC America*, 490 U.S. at 103.

150. *Id.*

eral antitrust claims. But these state statutes cannot and do not purport to affect remedies available under federal law."[151]

Second, the Ninth Circuit reasoned that permitting state indirect purchaser claims would diminish the incentives of direct purchasers to bring antitrust suits.[152] The presence of indirect plaintiffs would reduce both the pro rata recovery share of direct plaintiffs and the size of settlement offers made to them, and thus act on the margin, to discourage suits by direct purchasers.[153] Even if true, this prospect, said the Court, did not offend the policies behind federal antitrust law. "*Illinois Brick*," the Court stated, "was concerned that requiring direct and indirect purchasers to apportion recovery . . . would result in no one plaintiff having a sufficient incentive to sue under [section 4 of the Clayton Act]. State indirect purchaser statutes pose no similar risk to the enforcement of the federal law."[154]

Third, the Ninth Circuit feared that state indirect purchaser claims could subject antitrust defendants to multiple liability, in contravention of what it regarded as an "express federal policy" condemning multiple liability.[155] Not so, said the Supreme Court.[156] There is no federal policy against multiple liability generally, nor did *Illinois Brick* announce such a policy for antitrust cases. Rather, it was concerned simply with the construction of section 4 of the Clayton Act and the specific policy considerations informing its enactment. Neither it nor any other Supreme Court opinion has identified a federal policy against the imposition of state liability in addition to that imposed by federal law. "[S]tate causes of action are not pre-empted solely because they impose liability over and above that authorized by federal law, and no clear purpose of Congress indicates that we should decide otherwise . . . ."[157]

Since the decision in *ARC America* it has been clear that *Illinois Brick* does not preempt state antitrust law or create a uniform national rule of antitrust standing. States remain free to fashion their own remedies and procedural rules in suits involving their antitrust laws. They may, if they wish, confer standing on plaintiffs barred by *Illinois Brick* from suing under section 4 of the Clayton Act and may thus permit indirect purchasers to bring private treble-damage actions that would be impermissible in federal court. If those actions create administrative complications for state courts, or if they threaten antitrust defendants with multiple liability, so be it. What *Illinois Brick* forbids, state law may allow.

In permitting state legislatures to craft their own rules of antitrust standing,

151. *Id.*
152. *Id.* at 104.
153. *Id.*
154. *ARC America*, 490 U.S. at 104.
155. *Id.* at 105.
156. *Id.*
157. *Id.* at 103-05 (citations omitted).

ARC America struck a blow for antitrust federalism. In the process, however, it has encouraged the development and maintenance of rules with the potential to discriminate against indirect purchasers not favored with state legislative dispensation from *Illinois Brick*, while simultaneously subjecting manufacturers to numerous lawsuits, each in a different forum but all involving virtually identical claims. While the *PDAL* plaintiffs may eventually succeed with their state antitrust action—Alabama law expressly authorizes indirect-purchaser claims[158]—so also may other plaintiffs even more "indirect" than the retailers in *PDAL*. Proceeding concurrently with the *PDAL* litigation are two "local" antitrust suits charging the drug manufacturers with conspiring to deny discounts to retail druggists and pharmacies.[159] The allegations in these suits apparently track those in *PDAL*, but in each the plaintiff class is much larger, including not only "thousands of retail outlets," but also "tens of thousands of ultimate consumers with a myriad of health plans."[160] In each case, the statute authorizing the suit apparently permits the participation of consumer plaintiffs in the type of massive class action taking shape,[161] despite trial and administrative costs that must be mind-boggling.

But state antitrust law is hardly uniform. Many states continue to use federal decisions and rules of interpretation as the exclusive source of their own antitrust jurisprudence. In these states *Illinois Brick* bars suit by indirect purchasers. Thus, while plaintiffs in some jurisdictions may proceed with actions against the drug manufacturers, residents of other states—apparently similarly situated—have been foreclosed from suing by their states' adherence to the *Illinois Brick* doctrine.[162] Moreover, in two other states whose legislatures have declined to repeal *Illinois Brick*, the arguments favoring consumer standing have persuaded state courts to create a common law repealer of the indirect purchaser rule for consumer-plaintiffs injured by antitrust violations separately actionable under state consumer protection law.[163] Though these cases did not

158. *See* ALA. CODE § 6-5-60(a) (1993).

159. *See, e.g.*, 72 Antitrust & Trade Reg. Rep. (BNA) No. 1798, at 163 (Feb. 13, 1997) (citing Goda v. Abbott Labs., No. 01445-96, 1997 WL 156541, at *1 (D.C. Super. Ct. Feb. 3, 1997); Preciado v. Abbott Labs., No. 962294 (Cal. Super. Ct. Aug. 16, 1996)).

160. *Two Indirect Buyer Subclasses Can Pursue Claims Against Drug Makers*, 72 Antitrust & Trade Reg. Rep. (BNA) No. 1798, at 164 (Feb. 13, 1997).

161. In the District of Columbia, the statute permitting suits by indirect purchasers is D.C. CODE ANN. § 28-4509(a) (1997). In California the relevant statute is CAL. BUS. & PROF. CODE §16750 (West 1997).

162. *See, e.g.*, Blewett v. Abbott Labs., 938 P.2d 842, 846 (Wash. Ct. App. 1997) ("Although the merits of the indirect purchaser rule are debatable, we decline to join the debate."). *See also* Stifflear v. Bristol-Myers Squibb Co., 931 P.2d 471, 475 (Colo. Ct. App. 1996) ("[W]e decline to depart from the basic analytical framework developed by federal courts with respect to the standing requirements for claims alleging state antitrust violations.").

163. *See* Mack v. Bristol-Myers Squibb Co., 673 So. 2d 100 (Fla. Dist. Ct. App. 1996) (despite state antitrust law confining standing to direct purchasers, consumer/indirect purchasers

involve the kind of claims raised in the *PDAL* litigation, from a standing perspective they appear indistinguishable.[164]

As a result of this peculiar brand of federalism, the determinants of antitrust standing seem arbitrary. In some states, as in federal court, indirect plaintiffs are unable to sue. In others, state statutes permit suit, even by ultimate consumers whose injuries are more difficult to trace than those of the retailer plaintiffs in *PDAL*. In others still, courts confronted with the apparent bar of the *Illinois Brick* rule have sidestepped it by manipulating standing doctrine to suit felt needs. At least one federal court has permitted a suit in which direct purchasers sued for damages under federal law, while indirect purchasers sought an injunction under federal law (which is permissible under *Illinois Brick*) and attached to their request a pendant state law claim for damages.[165] Whatever one's view of antitrust federalism, this situation tests the proper limits of separate antitrust rules. It will necessarily encourage forum-shopping and likely result in a disparate and arbitrary pattern of private enforcement and recovery.

After the Supreme Court decided *ARC America*, the Antitrust Section of the American Bar Association created a task force to consider possible solutions to the problems raised by the inconsistent rules of antitrust standing that *ARC America* permitted. Without endorsing any particular approach, the Task Force Report[166] suggested three options: (1) retain the status quo; (2) Congressional legislation preempting state indirect purchaser laws; and (3) Congressional adoption of the complex allocative approach rejected in *Illinois Brick*, coupled with federal preemption. Though the problems of inconsistent standing rules have become more acute since 1990, Congress has taken no action on the Task Force recommendations or on any other legislation that might ameliorate those problems.

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of infant formula had standing to raise the claim that a price-fixing conspiracy by manufacturers of formula was an "unfair method of competition" or an "unfair act or practice" within the meaning of Florida's Deceptive and Unfair Trade Practices Act); Blake v. Abbott Labs., No. 03A01-9509-CV-00307, 1996 WL 134947 (Tenn. Ct. App. 1996) (indirect purchasers have standing to sue infant formula manufacturers for alleged price-fixing under the Tennessee Consumer Protection Act). *But see* Abbott Labs., Inc. (Ross Labs. Div.) v. Segura, 907 S.W.2d 503 (Tex. 1995) (consumer/indirect purchasers lack standing to sue for alleged antitrust violations under the Texas Deceptive Trade Act).

164. For a description of state antitrust actions involving indirect purchaser claims in other industries, see Davis, *supra* note 139, at 376-81.

165. City of St. Paul v. FMC Corp., 1991-1 Trade Cas. ¶ 69305 No. 3-89-0466, 1990 WL 265171 (D. Minn. 1990).

166. *Report of the American Bar Association Section of Antitrust Law Task Force to Review the Supreme Court's Decision in* California v. ARC America Corp., 59 ANTITRUST L.J. 273 (1990).

V. CONCLUSION: WHAT WE CAN LEARN FROM PDAL: THE SUPREME COURT SHOULD RECONSIDER *ILLINOIS BRICK*

Private standing is critically important to the overall enforcement scheme of the federal antitrust laws. The domain of business is enormous. Public agencies cannot be everywhere at once. Their resources are limited, their knowledge of potential wrongdoing derivative, and their areas of primary concern subject to periodic change. In many ways, the parties best positioned to enforce antitrust violations therefore are those who experience them first-hand. Private antitrust suits, however, make tremendous demands upon plaintiffs: their outcome is uncertain but their prosecution is notoriously time-consuming and expensive.[167] Along with the substantial social value produced by successful antitrust actions, the difficulties of private enforcement, including the difficulty of detecting unlawful conspiracies conducted secretly, help to explain the important role of the private treble damage award in the overall enforcement scheme.[168]

One might plausibly argue that in order to maximize the benefits of private enforcement, the prospect of treble damages should be more widely available, encouraged by courts through more expansive rules of antitrust standing. On this reasoning, the bigger the class of potential plaintiffs the greater will be the number of violations detected and punished, as well as the number of future violations deterred. Arguments about the incentive effects of rules of standing, however, are largely untested (and perhaps untestable). On the one hand, courts can speculate, as the majority did in *Illinois Brick*, that because indirect purchasers generally suffer smaller injuries than direct purchasers,[169] the former will be less inclined to sue, and that, by creating more claimants for a fixed recovery pool, a rule that extended standing to indirect purchasers would deter suits by potential direct purchaser-plaintiffs.[170] On the other hand, though, one can just as easily hypothesize, along with those state legislatures that have repealed *Illinois Brick*, that a plaintiff class that includes indirect purchasers will generate additional and useful enforcement incentives.[171]

Estimating the marginal benefits of expanded private enforcement has ad-

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167. Ball Mem'l Hosp., Inc. v. Mutual Hosp. Ins., Inc., 784 F.2d 1325, 1340 (7th Cir. 1986).

168. For a fuller discussion of the role of the treble damages award, see Robert H. Lande, *Are Antitrust "Treble" Damages Really Single Damages?*, 54 OHIO ST. L.J. 115 (1993).

169. Although, this may not always, or even usually, be true. *See* HERBERT HOVENKAMP, FEDERAL ANTITRUST POLICY § 16.6(d), at 570 (1994).

170. 431 U.S. 720, 745 (1977).

171. That is not, of course, the only premise. Others have to do with importance of compensation for injury suffered, and the notion that the presence of indirect purchasers will neither unduly complicate the administration of antitrust litigation nor create intractable apportionment problems. For a broad discussion of the competing interests at stake in the standing debate, see generally *Report of the American Bar Association Section of Antitrust Law Task Force to Review the Supreme Court's Decision in* California v. ARC America Corp., *supra* note 166.

ditional difficulties. It is not enough to determine, for example, even if it could be determined, that expansive rules of standing would lead to increased enforcement and deterrence. One would need to weigh those (presumed) benefits against the higher costs of the more complicated trials that such rules would likely generate. Comparing presumed benefits of one kind against hypothetical costs of another is, to put it mildly, not an easy task. It seems doubtful, then, that we could properly analyze the issue of indirect purchaser standing by resort to some empirical calculus.

The propriety of antitrust standing for indirect purchasers does not lend itself to empirical analysis. As in other areas of antitrust, empirical inquiry is indeterminate and simply cannot produce the one "right" answer. Perhaps, however, a satisfactory answer would suffice. Perhaps the answer can come from re-examining the concededly imprecise but broader values that have been the focus of the indirect purchaser debate since the decision in *Illinois Brick*,[172] a debate that has pitted advocates of efficiency in litigation (the supporters of *Illinois Brick*) against champions of full compensation to victims (its critics). All agree that rules of standing are meant to be fair, both to litigants and the judicial system generally. They further agree that, as a first principle, it seems fair to permit those injured by antitrust violations—whether direct or indirect purchasers—to recover their damages proximately caused. If the system could accurately compensate injured parties without harming other interests, arguably fair outcomes would result.

For the supporters of *Illinois Brick*, two seemingly insurmountable problems stand in the way of fair results. The first is the problem of multiple recovery. Under existing rules of standing, direct purchasers can recover treble damages for monopoly overcharges paid by them; if indirect purchasers could also sue, they would be eligible to recover all of the overcharges passed on to them. In some cases, defendants might thus be made to pay six-fold rather than treble damages. The second is the problem of determining the amount of the pass-on to indirect purchasers. As Judge Posner observed in his *PDAL* opinion, "Tracing a price hike through successive resales is an example of what is called 'incidence analysis,' and is famously difficult."[173]

But these problems may not be so intractable as feared. Admittedly, some indirect plaintiffs may not be able to prove their damages with the requisite

172. *See, e.g.*, Cooter, *Passing On the Monopoly Overcharge: A Further Comment on Economic Theory*, 129 U. PA. L. REV. 1523 (1981); Harris & Sullivan, *Passing on the Monopoly Overcharge: A Comprehensive Policy Analysis*, 128 U. PA. L. REV. 269 (1979); Herbert Hovenkamp, *The Indirect Purchaser and Cost-Plus Sales*, 103 HARV. L. REV. 1717 (1990); Landes & Posner, *The Economics of Passing On: A Reply to Harris and Sullivan*, 128 U. PA. L. REV. 1274 (1980); 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 (1979).

173. 123 F.3d at 605.

certainty, but that is a risk shared by all plaintiffs. Moreover, there is no logical or practical reason why incidence analysis should remain perpetually difficult. Indeed, plaintiffs in *PDAL* and in similar litigation in the District of Columbia offered expert testimony—accepted by the trial courts—using a variety of economic methodologies to prove the amounts of the unlawful overcharges and the extent to which they had been passed on to indirect purchasers.[174] Because of the limitations imposed by *Illinois Brick*, judicial experience with these methodologies is very limited. Expanded rules of standing might further encourage plaintiffs and their experts—concerned lest their cases seem too complex for juries to comprehend—to develop allocation methodologies that are relatively simple and easy to understand.[175] If no such methodologies were forthcoming, at least courts would be able to see—first-hand, not hypothetically—the complicating effects of expanded standing and could then determine from experience, not presumption, whether those effects were outweighed somehow by the added fairness of fuller compensation.

By the same token, if (or as) allocation methodologies improve, defendants need not fear the prospect of duplicative recovery. The counter-factual presumption that direct and indirect plaintiffs have each suffered equally and fully from the monopoly overcharge can be abandoned in favor of a more precise and fully compensatory rule. Under the current regime, direct plaintiffs now bear the burden of proving the monopoly overcharge; under expanded rules of standing, while plaintiffs would still shoulder that burden, they would be forced either to prove or agree upon the amount or proportion of the total overcharge paid by each group.

Since the decision in *Illinois Brick*, while federal courts have had almost no experience with indirect purchasers and their supposed problems, state courts have proven increasingly hospitable to their claims. As demonstrated by *PDAL*, one upshot of this particular instance of antitrust federalism has been to shift cases from federal to state courts, accomplishing little of substance except to disqualify from suit those plaintiffs still tethered to the federal rule. At the same time, the fact that state courts are willing, and even eager, to entertain the claims of indirect purchasers strongly suggests that the rationale of *Illinois Brick* is open to serious question. In this respect, the state actions paralleling the litigation in *PDAL* have offered us the best that federalism has to give—useful counter-examples to the federal rule, evidence that there is another and perhaps a better way, and an opportunity to reconsider antitrust

174. 72 Antitrust & Trade Reg. Rptr. (BNA)163 (Feb. 13, 1997).

175. In both the *PDAL* and the District of Columbia pharmaceutical antitrust litigation, Goda v. Abbott Labs., No. 01445-96, 1997 WL 156541 (D.C. Super. Ct. Feb. 3, 1997), the court accepted an affidavit by plaintiffs' expert economist offering to prove through a variety of economic methodologies the amounts the unlawful overcharges and the extent to which they had been passed on to indirect purchasers. *See Two Indirect Buyer Subclasses*, *supra* note 160, at 163.

standing.