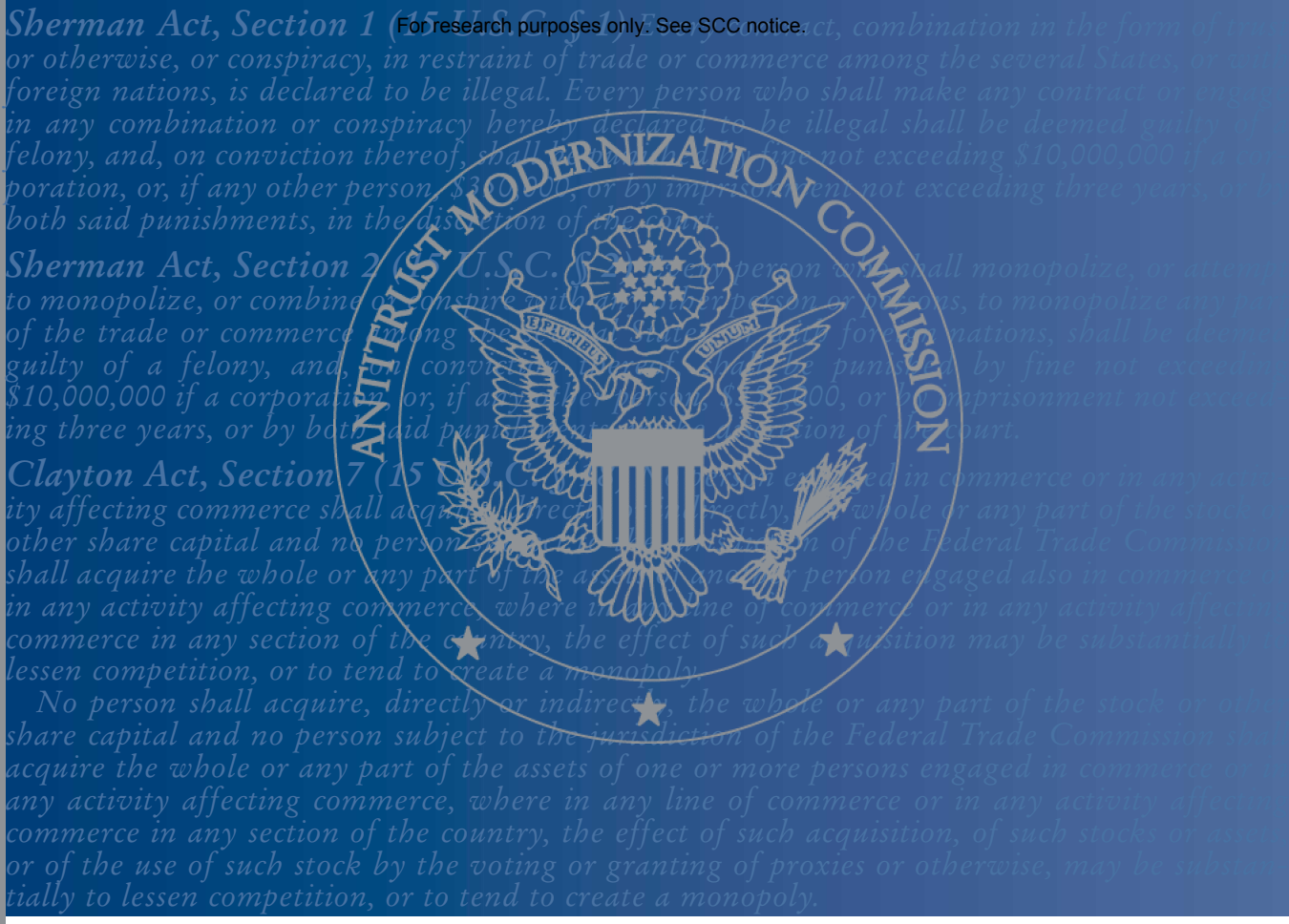

ANTITRUST MODERNIZATION COMMISSION

REPORT AND RECOMMENDATIONS

APRIL 2007

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2. BACKGROUND

The following explains the history of the controversy over direct and indirect purchaser litigation and discusses the problems that conflicting federal and state policies have created, as well as attempts so far to address those problems.

A. History

As noted above, the question of how to treat the "pass on" of antitrust damages from one purchaser to the next first arose in *Hanover Shoe, Inc. v. United Shoe Machinery*.[7] There, the Supreme Court held that an antitrust defendant could not assert the pass on of overcharges from one purchaser to the next as a defense in a suit brought by the direct purchaser.[8] The ruling thus enabled direct purchasers to recover all overcharges they suffered from an antitrust violation, even if the direct purchasers passed on some or all of the overcharge to their customers (that is, indirect purchasers). In 1977, nearly ten years later, the Supreme Court in *Illinois Brick Co. v. Illinois* applied what it saw as the logical corollary, holding that federal antitrust law allowed only direct purchasers, and not indirect purchasers, to sue to recover the overcharge they had paid.[9] The Court viewed this as applying the same rule to both plaintiffs and defendants: neither could rely on the pass on of overcharges to either bring, or defend against, a suit based on federal antitrust law.[10] The Court further reasoned that restricting suits solely to direct purchasers would promote more effective private enforcement and avoid multiple and inconsistent liability for defendants and the need to "trace the complex economic adjustments" to determine the impact on indirect purchasers.[11]

A vigorous dissent, however, argued that the holding "frustrates both the compensation and deterrence objectives of the treble-damages action."[12] The dissenters emphasized congressional intent that consumers recover for their antitrust injuries, as had been recently expressed in 1976, when Congress passed legislation to allow state attorneys general to use *parens patriae* authority to sue for Sherman Act violations on behalf of state citizens.[13] The dissenters were not persuaded that the complexity of assessing and allocating damages for both direct and indirect purchasers was any greater than the complexity of other antitrust issues.[14]

The Court's decision in *Illinois Brick* immediately sparked a heated controversy.[15] Critics, including leading Senators and Representatives, agreed with the dissent that the decision ignored the will of Congress by leaving consumers and other indirect purchasers without a remedy to redress serious antitrust injuries.[16] Bills to overrule the decision by federal statute were quickly introduced.[17] Despite intensive efforts, however, these bills failed, and the rule of *Illinois Brick* has continued to govern in federal courts.[18]

Attacks on *Illinois Brick* were not limited to efforts in Congress; opponents brought their case to state legislatures and courthouses as well. Starting with California in 1978, legislatures in many states began passing *Illinois Brick* "repealers"—that is, statutes that specifically authorized indirect purchasers to recover damages under state antitrust laws.[19] In some

states, courts interpreted existing state laws to allow recoveries by indirect purchasers alleging antitrust violations.[20] In 1989 the Supreme Court confirmed the validity of state laws permitting indirect purchasers to sue for damages, holding that those laws were not impliedly preempted by federal antitrust law.[21] At the present, more than thirty-five states permit indirect, as well as direct, purchasers to sue for damages under state law.[22]

B. Problems and Attempts to Address Them

Indirect purchaser litigation under state law has become increasingly common, especially since the mid-1990s.[23] Such cases are frequently pursued separately rather than consolidated with other actions in a federal court proceeding. Litigation involving recoveries by direct and indirect purchasers for the same antitrust violation often has proceeded in at least two different courts, with direct purchasers filing under federal antitrust law in federal courts and indirect purchasers pursuing their state antitrust claims in state courts, resulting in wasteful, duplicative litigation.[24]

Some judges and parties have taken steps to reduce the duplication and wasted resources resulting from multiple federal and state proceedings concerning the same alleged antitrust violation. For example, on occasion, a federal judge presiding over a direct purchaser action has "contact[ed] the various state judges in an attempt to coordinate discovery, thus avoiding duplicative efforts; in most instances, those attempts were successful."[25] Some indirect purchasers have brought their state law damage claims in federal court under the federal court's supplemental jurisdiction.[26] In these cases, the indirect purchasers have asserted a federal antitrust claim seeking injunctive relief (which is not barred under *Illinois Brick*) and have requested that the federal court hear their state law claims for damages pursuant to the court's supplemental jurisdiction.[27] Although this procedure appears to have been used successfully with some frequency in recent years,[28] it can provide only a partial remedy to the problems of duplicative litigation. Plaintiffs may not use it when they cannot seek injunctive relief, for example, from a price-fixing cartel that has disbanded following criminal prosecution. In addition, defendants cannot use a federal court's supplemental jurisdiction to remove cases from state court to federal court, where they can be consolidated.

Under the new CAFA enacted by Congress in June 2005, however, defendants now can remove certain indirect purchaser class actions to federal court, where they may be consolidated with other actions, pursuant to the multidistrict litigation (MDL) process.[29] Under CAFA, "[f]ederal jurisdiction, with a few exceptions, now exists over class actions in which (1) minimal diversity exists (that is, where at least one plaintiff and one defendant are diverse), (2) the putative class contains at least 100 members, and (3) the amount in controversy is at least $5 million."[30] CAFA does create a number of exceptions to this broad grant; however, as discussed below, some predict that these will have limited application to state indirect purchaser class actions.[31] Even if removal is achieved, the Supreme Court's