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Abstract

Any scheme for private antitrust enforcement is framed by two main questions: who will have standing – direct or indirect purchasers – and will the passing-on defense be allowed. Imagine that a cartel of oil producers forces gas stations – direct purchasers – to buy petrol at a higher than competitive price. The gas stations then raise the price for the final customers – indirect purchasers. When the gas stations sue the cartel, the cartelist will claim that no damage has occurred to the gas stations, because the gas stations have passed on the overcharge to its final customers – the passing-on defense.

In the United States, the ruling of the California Supreme Court in *Clayworth v. Pfizer*, alongside a report of the Antitrust Modernization Commission of 2007, spurred new debate on whether the 1970s Federal case law should be overruled. The situation in the European Union has been even more challenging. The Court of Justice of the EU surprised everybody with two landmark cases in the early 2000s, in which the court set up a basic scheme for private antitrust enforcement. However, neither the EU nor the Member States had the appropriate legislation in place. The article analyzes these latest developments, offering new solutions to both jurisdictions.

I argue that the practice of passing on increases the total social welfare loss resulting from the existence of a cartel. To remedy the problem, I suggest a system that allows the passing-on defense, grants indirect purchasers standing, and multiplies the damages award. Such a system will lead to direct-purchaser suits being the rule, with indirect purchasers remaining subsidiary enforcers. It will also prompt the direct purchasers to commence the antitrust litigation in the proper time, thus limiting the additional social inefficiencies created by the cartel.

Keywords

Competition law; private antitrust enforcement; passing on; treble damages; law and economics; torts; European Union; United States.

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Comments are welcomed at tomas.dumbrovsky@yale.edu

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INTRODUCTION

The passing-on defense is evoked in private antitrust litigation. The defendant, a member of a cartel, raises this kind of defense against a claim for damages brought by a direct purchaser of the cartel's product. The defendant argues that the direct purchaser passed on the overcharge resulting from the price-fixing conduct of the cartel to its own customers. Consequently, the direct purchaser suffered fewer, or no, damages. The problem of passing on is intertwined with the question of who should have standing in the private enforcement of antitrust law – the direct purchaser only, or both the indirect and direct purchasers.

I claim that the choice of the passing-on-standing scheme must satisfy both the economic aims of public regulation of competition and the corrective justice aims of general tort law. We must stop looking at private antitrust enforcement through the lenses of deterrence or compensation and return to the function of antitrust law: to limit social inefficiencies resulting from the existence of cartels (a multiplication of overcharge during the passing on, damages awards, and litigation costs are all additional social welfare losses to those created by the cartel itself). We must also realize that antitrust enforcement is indeed a hybrid, and avoid the error of trying to explain its public law features through private law categories; the treble rule functions as a public payment – though extracted from the cartelist – to private enforcers in order to fulfil public enforcement tasks and should not trouble continental private lawyers. With this in mind, however, any divergence from general torts must be justified and the chosen scheme must satisfy a requirement of systemic and methodological coherence.

Based on the analysis of private antitrust enforcement variants in the United States and the European Union, I claim that the practice of passing on increases the total social welfare loss resulting from the existence of the cartel. To remedy this problem, I propose a system that allows the passing-on defense, grants indirect purchasers standing, and multiplies the damages award. Such a system should lead to direct-purchaser suits being the rule, with indirect purchasers remaining subsidiary enforcers. In addition, it would prompt the direct purchasers to commence the antitrust litigation in the proper time, thus limiting the social inefficiencies created by the cartel.

Overview of the debate

It appears that in the United States, the U.S. Supreme Court settled the issue more than thirty years ago in *Hanover Shoe*[1] and *Illinois Brick*.[2] According to this case law, indirect purchasers lack standing and the passing-on defense is not available. The direct purchaser is entitled to recover threefold the overcharge of each unit bought from the cartelist (treble damages), plus the litigation costs. At the national level, many states were uncomfortable with the Hanover-Shoe-Illinois-Brick solution taken at the federal level and have since adopted a different scheme for intrastate private antitrust litigation.[3] Among them California, the state with the biggest market in the United States, grants standing to indirect purchasers with the California Cartwright Act. The question of passing on has been left aside for some time. In 2010, the California Supreme Court in *Clayworth v. Pfizer* declared that California antitrust law does not permit a defendant accused of price fixing to invoke a defense that points to direct purchasers having passed on any alleged overcharges to their customers.[4] Although that solution

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[1] Hanover Shoes Inc. v. Unites Shoe Machinery Corp., 392 U.S. 481 (1968).

[2] Illinois Brick Co. et al. v. Illinois et al., 431 U.S. 720 (1977).

[3] In thirty-six states and the District of Columbia, state laws allow the indirect purchaser to sue. Antitrust Modernization Comm'n, Report and Recommendations vi (2007) [hereinafter AMC REPORT], *available at* http://govinfo.library.unt.edu/amc/report_recommendation/toc.htm. The U.S. Supreme Court upheld the states' right to regulate the question in intrastate situations differently from federal rule in California v. ARC America Corp., 490 U.S. 93 (1989). For analysis, see *Report of the ABA 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).

[4] Clayworth v. Pfizer, Inc., 49 Cal.4th 758, 233 P.3d 1066 (Cal. 2010).

is in line with *Hanover Shoe*, California law, as mentioned, differs from federal law on the question of who may bring such suits, thus allowing standing to indirect purchasers as well.[5]

At the same time, a call to overrule *Hanover Shoe* and *Illinois Brick* has been repeatedly made at the federal level.[6] On the one hand, in its 2007 report, the Antitrust Modernization Commission (AMC) urged to overrule both cases and a fair division of treble damages between direct and indirect purchasers.[7] In its report on the state and challenges of antitrust law, prepared for the administration of Barack Obama, the American Antitrust Institute, on the other hand, opposed the enactment of specific legislation previously proposed by AMC for the reformation of *Illinois Brick*.[8]

In the European Union, recourse to the passing-on defense has been discussed with increasing interest over the last decade due to pressure from the Court of Justice of the European Union (CJEU) aimed at the private enforcement of antitrust law.[9] The CJEU, in its decisions *Courage* (2001) and *Manfredi* (2006), urged the Member States to come up with standing for indirect purchasers. The European Commission intensified the debate with several policy documents (2005 Green paper, 2008 White paper, 2011 Draft Harm Quantification Guidance),[10] aimed at building up consensus for future Europe-wide legislation. The CJEU case law seems utterly inadequate and the Member States that are supposed to remedy the gap (as their law is the applicable law) face several problems. First, they mostly lack practical experience with private enforcement and their supplementary legal apparatus is still insufficient (especially in the area of class action). Second, the idea of private enforcement is difficult to reconcile with many traditional doctrines established in continental Europe. And third, the matter is politically sensitive, as it is understood as an attempt to implant the American 'ill culture of litigation' in Europe.[11]

The Commission's and the Court's intentions to catalyze this development are based on their need to outsource antitrust enforcement to private parties.[12] It can be seen as yet another step in the

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[5] Cartwright Act, CAL. BUS. & PROF. CODE § 16720 (West 2010).

[6] Straight after the Illinois Brick ruling, several legislative attempts to overrule the case were made. *See, e.g.,* Kennedy-Rodino bill and numerous hearings on the matter in the 95th and 96th Congress: *Restoring Effective Enforcement of the Antitrust Laws: Hearings on H.R. 2060 and H.R. 2204 and Other Proposals Before the Subcomm. on Monopolies and Commercial Law of the House Comm. on the Judiciary*, 96th Cong., 1st Sess. 44-79 (1979) [hereinafter 1979 House Hearing]; *Effective Enforcement of the Antitrust Laws: Hearings on H.R. 8359B Before the Subcomm. on Monopolies and Commercial Law of the Comm. on the Judiciary*, 95th Cong., 1st Sess. 23-71 (1978) [hereinafter 1978 House Hearing]; *Fair and Effective Enforcement of the Antitrust Laws: Hearings on S. 1874 Before the Senate Comm. on the judiciary*, 95th Cong., 1st Sess. 92-96, 101-28 (1978) [hereinafter 1978 Senate Hearing].

[7] AMC REPORT, *supra* note 3, at 275 and 277.

[8] ALBERT A. FOER ED., THE NEXT ANTITRUST AGENDA 220 and 237-239 (2008).

[9] Case C-453/99, Courage Ltd v. Bernard Crehan and Bernard Crehan v. Courage Ltd and Others, 2001 E.C.R. I-6297; and Joined Cases C-295/04 to C-298/04, Vincenzo Manfredi v. Lloyd Adriatico Assicurazioni SpA, Antonio Cannito v. Fondiaria Sai SpA, Nicolò Tricarico v. Assitalia SpA, and Pasqualina Murgolo v. Assitalia SpA, 2006 E.C.R. I-6619.

[10] ASHURST, STUDY ON THE CONDITIONS OF CLAIMS FOR DAMAGES IN CASE OF INFRINGEMENT OF EC COMPETITION RULES (2004) [hereinafter ASHURST REPORT], *available at* http://ec.europa.eu/competition/antitrust/actionsdamages/comparative_report_clean_en.pdf; *Commission Green Paper on Damages Actions for Breach of the EC Antitrust Rules*, COM (2005) 672 final (Dec. 19. 2005) [hereinafter 2005 GREEN PAPER]; and *Commission White Paper on Damages Actions for Breach of the EC Antitrust Rules*, COM (2008) 166 final (April 2, 2008) [hereinafter 2008 WHITE PAPER]. *See also Commission Draft Guidance Paper on Quantifying Harm in Actions for Damages Based on Breaches of Article 101 or 102 of the Treaty on the Functioning of the European Union* (June 2011) [hereinafter 2011 DRAFT HARM QUANTIFICATION GUIDANCE]. The Draft Harm Quantification Guidance is currently open for public consultation: "The aim of this Guidance Paper is to offer assistance to national courts and parties involved in actions for damages by making more widely available information relevant for quantifying the harm caused by antitrust infringements" (Action for Damages, COMMISSION DG COMPETITION, http://ec.europa.eu/competition/antitrust/actionsdamages/index.html, emphasis omitted).

[11] *See*, *generally* DANIEL R. KELEMEN, EUROLEGALISM: THE TRANSFORMATION OF LAW AND REGULATION IN THE EUROPEAN UNION 5-7 (2011).

[12] In the case of private enforcement, a private party who brings an action to a national court commences the litigation. The Commission can therefore benefit from the material gathered by private parties for its public prosecution, or leave the matter entirely to the national competition regulator. The CJEU, as a consequence, can spend less time with direct actions

decentralization of competition law supervision and enforcement after the major reform of 2003.[13] The Commission policy documents favor the scheme of making the passing-on defense available, together with the provision of standing for indirect purchasers.

Objectives, methodology, and organization

The aim of this article is to reexamine the Hanover-Shoe-Illinois-Brick doctrine and the economic analysis that accompanied it (mainly the Landes/Posner-Harris/Sullivan debate) in the light of the trans-Atlantic debate in the past decade.

Though with occasional hesitation, the European Commission (and the CJEU) has accepted that economic analysis is the leading approach to antitrust infringement.[14] However, when it comes to damages, economic analysis is challenged by justice considerations and further hesitation over the entrenchment of treble damages instead of simple restitution. This has raised questions of whether to grant primacy to deterrence or to compensation, public or private enforcement, and the question of unlawful enrichment in cases of standing of indirect-purchasers without the possibility for passing on, etc.

The article asserts that, once economic analysis has been accepted for the evaluation of antitrust infringements, we should approach the question of damages, their calculation and apportionment among the cartel's victims, from the same perspective (methodological coherence). Given the entrenchment of justice considerations in tort law, especially in the civil law tradition, in order not to detach antitrust torts from general torts (that is to preserve systemic coherence), while at the same time ensure methodological coherence, we need to search for solutions in which economic analysis leads to the same result as the justice approach. My aim here is to suggest one such solution.

Economic analysis of how to remedy the situation after antitrust infringement is specific in that market forces cannot rectify the violation, it requires the court's intervention. The task of the legislator (or the court) is to give the proper incentive to the right group of individuals so that the total social welfare loss from the antitrust violation is limited. This raises questions such as how to dismantle the cartel in a way that increases competition and thus increase output and lower prices;[15] who is in the best position to incur the costs of litigation; how to allocate damages among the victims so that they have the same wealth as they could have had under conditions of competition,[16] etc.

There are four options in the passing-on-standing matrix that ought to be considered here: the Hanover-Shoe-Illinois-Brick rule (no standing for the indirect purchaser and no passing-on), the Clayworth rule (standing but no passing-on), the Cartel rule (no standing but passing-on), and the Courage-Manfredi rule (both standing and passing-on). On the following pages, I will generally consider a simplified scenario of a three-level business chain consisting of manufacturers (cartelists), direct purchasers (resellers), and indirect purchasers (final customers).

The article is organized along the lines of the four options mentioned above, with the exemption of the Cartel rule that obviously fails to fulfill any of the discussed objectives of antitrust laws. In the first part, the economic issues of passing-on and direct- versus indirect-purchaser rules are explained through the debate that followed the *Illinois Brick* ruling of the U.S. Supreme Court. The

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(brought against Commission decisions in public antitrust prosecution) and focus on the preliminary references from national courts, which provide the CJEU with an opportunity to deal with doctrinal issues instead of being engaged in the time consuming and complex full antitrust review of antitrust violations.

[13] Council Regulation 1/2003, The implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty, 2003 O.J. (L 1) 1.

[14] The economic approach took the lead in the late 1980s under the Commissioners Peter Sutherland and Sir Leon Britten and was reestablished in the 2000s when an economist and scholar, Mario Monti, became Competition Commissioner. Under Monti, however, competition law also became an instrument for sustaining other Union policies and began to be directed towards consumer welfare. DAMIAN CHALMERS, GARETH DAVIES & GIORGIO MONTI, EUROPEAN UNION LAW: CASES AND MATERIALS 918- 924 (2d ed., 2010).

[15] That is, not to diminish the competitiveness of the individual members of the cartel while at the same time to deter them from colliding in the future.

[16] E.g., to address the diminished purchasing power of the final customers given the long-time indirect overcharge, which is a result of price-fixing.

second and third part look more closely at the alternatives (Clayworth and Courage-Manfredi rules) through the current debate on the passing-on and standing issues in both the United States and Europe. The latter will also allow us to look at the development of these issues since *Illinois Brick*.

I HANOVER-SHOE-ILLINOIS-BRICK RULE

A. *The Landes/Posner-Harris/Sullivan debate*

In the aftermath of *Illinois Brick*, the University of Chicago Law Review and the University of Pennsylvania Law Review hosted a heated debate between the 'Chicago School'[17] proponents Professors William Landes and Richard Posner, on one side and the Berkeley Professors Robert Harris and Lawrence Sullivan,[18] on the other side.[19]

Both sides of the debate used economic analysis to examine the consequences of the Illinois-Brick rule on antitrust enforcement from the viewpoint of two antitrust objectives – deterrence and compensation. While Landes & Posner presented strong arguments supporting the formula of *Illinois Brick*, Harris & Sullivan concluded that the indirect-purchaser rule better serves the needs of antitrust enforcement.

Both sides recognized that as multiple claims ought to be avoided, overruling *Illinois Brick* (that is, overruling *Hanover Shoe* as well) would mean that passing-on defense would have to be allowed. That led to two options; keeping the direct-purchaser rule without passing-on defense or the establishment of an indirect-purchaser rule with passing-on defense.

Landes & Posner presented several reasons for keeping the Illinois Brick rule. First, direct purchasers are in better position to sue, they have more information and it is less costly for them to search for additional information on antitrust violations; their compensation following a successful suit is higher than in the case of an indirect purchaser, and so they have more incentives to sue. Out of the available options, the direct purchasers are the most efficient enforcers. Landes & Posner also showed that paradoxically, more enforcers lead to less enforcement.[20] The allocation of the exclusive right to sue to direct purchasers creates most incentives and leads to the highest deterrence. From an economic point of view, deterrence is a prevailing objective of antitrust enforcement: "If most antitrust violations were deterred, the occasions for compensation would be few. The converse is not true: even if the victims of antitrust overcharges were fully reimbursed, the social inefficiencies of the violations would persist."[21] The enforcement shall be allocated exclusively with the more efficient enforcers, that is, with the direct purchasers.

Landes & Posner supported their economic analysis with empirical data on antitrust enforcement in the district courts that had allowed both direct- and indirect-purchaser suits prior to *Illinois Brick*[22] and conducted an impact study on the ban of passing-on defense in *Hanover Shoe*.[23]

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[17] For a recent overview of the formation of the Chicago School and its main arguments, see George L. Priest, *The Limits of Antitrust and the Chicago School Tradition*, 6 J. COMP. L. & ECON. 1 (2010).

[18] Lawrence A. Sullivan was 'raised' within the 'Harvard school' tradition but later became a proponent of the 'post-Chicago school'. Harris's and his debate with Landes & Posner can be considered an earlier critique of the 'Chicago school'. *See* mainly Robert G. Harris & Lawrence A. Sullivan, *Passing On the Monopoly Overcharge: A Response to Landes and Posner*, 128 U. PA. L. REV. 1280, 1280-1281 (1980) (hereinafter Harris & Sullivan, Response).

[19] William M. Landes & Richard A. 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); Robert G. Harris & Lawrence A. Sullivan, *Passing On the Monopoly Overcharge: A Comprehensive Policy Analysis*, 128 U. PA. L. REV. 269 (1979); William M. Landes & Richard A. Posner, *The Economics of Passing On: A Reply to Harris and Sullivan*, 128 U. PA. L. REV. 1274 (1980) (hereinafter Landes & Posner, Reply); Harris & Sullivan, Response, *supra* note 18.

[20] "The paradox of less enforcement with more potential enforcers is simply the application of the well-known economic problem of external economies to antitrust enforcement. Each party's expenditure on enforcement confers a benefit on the other parties, but no one has an incentive to take account of this external benefit in determining the level of his own expenditures." Landes & Posner, *supra* note 19, at 624.

[21] Landes & Posner, *supra* note 19, at 605.

[22] *Id.* at 614, fn. 30. The studies used at the 1978 Senate Hearing show that in the preceding year, the direct-purchaser suits represented 96% in the Southern District of New York, 67% in the Northern District of California (23% were indirect-

First, the empirical data showed that the total number of suits was higher under the exclusive direct-purchaser rule rather than under its alternative. Second, direct-purchaser suits were far more numerous than indirect-purchaser suits. And finally, the ban on passing-on defense led to a substantial increase of private antitrust suits. In sum, overruling *Illinois Brick* (and thus overruling *Hanover Shoe*) would weaken the direct-purchaser's incentive to sue, lowering the overall level of antitrust enforcement.

As mentioned above, Landes & Posner refused the compensatory problem at the start, based on the logic that though antitrust enforcement has two objectives, deterrence and compensation, the deterrence objective is superior. This is so because if antitrust violations were deterred, the occasions for compensation would be few, while the opposite does not hold true. Moreover, Landes & Posner showed that the compensation for indirect purchasers is rather illusory due to the large number of injured indirect purchasers with relatively small claims, which can be litigated mostly through class actions where damages awards are usually lower (as the attorneys have incentive to settle the claims)[24] and the bigger part of the recovery is spent on attorney's fees.[25] Moreover, the indirect-purchaser rule lowers the incentives for the direct purchasers to sue and both direct and indirect purchasers are willing to spend less on investigating possible antitrust violations (due to cooperation problems).

Harris & Sullivan opposed the views of Landes & Posner.[26] Even though they used economic analysis, they did not fully disregard the compensatory issue, but brought together both economic and legal arguments for compensatory justice. First, they claimed: "because direct purchasers often suffer little economic loss [as they pass on the overcharges to indirect purchasers], their relative incentive to seek out and sue antitrust violators may be relatively weak."[27] Second, Congress mandated that anybody injured by antitrust violation may recover three times the damages sustained.[28] This provision prevents double recovery as it gives not only subjective rights to injured individuals to seek treble damages, but it also mandates the courts not to exceed treble damages.[29] For instance, if a direct purchaser sues first and is awarded treble damages, then the courts would not be able to award damages to indirect purchasers in the event that they were later to bring a case. Regarding their subjective rights, the indirect purchasers are entitled to recovery and the direct purchasers, who do not suffer damages (as they have passed on the overcharges to the indirect purchasers), will not fall within this provision of the Clayton Act (the positive side of compensatory justice). Given the scope of the courts' mandate, antitrust violators are protected against excessive, repeated, or multiple claims (the negative side of compensatory justice). Clearly, Landes & Posner give precedence to the deterrence

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purchaser suits and the rest were suits by both direct and indirect purchasers), 81% in the District of Arizona (3% were indirect-purchaser suits and the rest, suits by both direct and indirect purchasers).

[23] Landes & Posner compared suits at the district courts that allowed passing-on defense prior to *Hanover Shoe* with the situation at the same courts after the U.S. Supreme Court banned the passing-on defense. Their study indicates that the *Hanover Shoe* decision led to an increase in private antitrust cases commenced per year by 26% to 35%. *Id.* at 630 et seq. They assign the increase to a greater incentive for the direct purchasers to sue price-fixing practices.

[24] Landes & Posner support this point with the empirical study of Rosenfield, *An Empirical Test of Class-Action Settlement*, 5 J. LEGAL STUD. 113 (1976), who found "that attorney's fees in antitrust class actions are greater when cases are settled than when they are tried." Landes & Posner, *supra* note 19, at 613, fn. 27.

[25] To be sure, litigation costs including a *reasonable* part of the attorney's fee are recoverable aside of the treble damages. *See infra* note 28.

[26] The testimony of Richard Posner in the 1978 House Hearings forms the core of the Landes-Posner article, which was published at the time when the Harris-Sullivan article was in galley proof. Harris & Sullivan added several reactions to the Landes-Posner article in their footnotes (Harris & Sullivan, *supra* note 19, at 294, fns 61a, 67, 97a. Later, both sides were given the possibility to comment in the University of Pennsylvania Law Review. *See supra* notes 18 and 19.

[27] Harris & Sullivan, *supra* note 19, at 277.

[28] The relevant part of section 4 of the Clayton Act reads: "any person who shall be injured in his business or property by reason of anything forbidden in the antitrust laws may sue therefore in any district court of the United States in the district in which the defendant resides or is found or has an agent, without respect to the amount in controversy, and shall recover threefold the damages by him sustained, and the cost of suit, including a reasonable attorney's fee." 15 U.S.C. § 15 (2006).

[29] Harris & Sullivan, *supra* note 19, at 272.

objective based on their economic analysis, while Harris & Sullivan offer the possible reconciliation of deterrence with compensation.[30]

B. *Competitive downstream markets*

Harris & Sullivan examined the short- and long-run effects of cartel overcharges on the behavior of direct purchasers in competitive markets. In the short-run, their model suggests that when the cartel overcharge raises fixed costs (for instance the cost of machinery), the direct purchasers bear these costs. In this case, the overcharge does not affect the supply; the direct purchaser produces the same amount of products as if there were no overcharge (the fixed costs do not shift the supply curve and so the demand curve crosses the supply curve at the same point as it did before the existence of the cartel overcharge).

The Landes-Posner article raises an auxiliary question to the problem of fixed versus variable costs. They claim that the compensatory objective of antitrust is fulfilled under the Illinois-Brick rule because direct purchasers pass on the share of the anticipated damages award to their customers in the form of a discount.[31] Harris & Sullivan oppose this reasoning.[32] The direct-purchaser income in the form of a damages award does not affect the marginal costs and therefore has no effect on the price or the quantity of the outcome.[33] Landes & Posner however claim that a direct purchaser is in a better position to determine whether he is being overcharged. Then, as a rational firm, he calculates the damages award multiplied by the probability of a cartel discovery (revenues) and determines how much is reasonable to spend on conducting an investigation (costs). As investigation and litigation are likely to be time consuming, they allow the direct purchaser to distribute the anticipated revenues and costs throughout the life-span of the cartel. In the Landes-Posner view, the reseller includes the damages award, multiplied by the probability of a cartel discovery, into his marginal revenues and costs of investigation and litigation (above and beyond the anticipated legal fees), into his marginal costs, that is, revenues and costs for the next item sold, and sets the price accordingly. The Landes-Posner claim needs some correction. The price paid by indirect purchasers would be lower than the price plus the overcharge (as the direct purchaser would invest less in investigation and litigation than is the amount of the anticipated award), but usually higher than the pre-cartel price. Indirect purchasers would therefore still be overcharged (the overcharge would be smaller but not eliminated), and not fully compensated. Landes & Posner consider the remaining overcharge to be payment to the direct purchasers for litigating also "on the behalf" of indirect purchasers.[34]

When the cartel overcharge increases the variable costs of the direct purchaser (meaning the supply curve shifts upwards), the rate of passing on (how much of the overcharge is passed on) depends on the elasticity of the supply and demand. Out of four extreme possibilities, a cartel is likely to occur in two only; in situations of a close to perfectly elastic supply and in situations of a close to perfectly inelastic demand. In both cases, the passing on rate is close to 100%,[35] meaning that the

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[30] *Id.* at 273.

[31] Landes & Posner, *supra* note 19, at 605-608.

[32] Harris & Sullivan, *supra* note 19, at 298-299, fn. 67, and mainly Harris & Sullivan, Response, *supra* note 18, at 1282-1285.

[33] *Id.* at 298.

[34] The critique of Harris-Sulllivan is supported by institutional analysis that is used to correct neoliberal microeconomic modeling. It is more reasonable to expect that a reseller would not consider the damages award to be his profit. Rather, he takes it as a windfall auxiliary to the main objective; that is, to get rid of the upstream cartel that raises the price the reseller has to charge to his customers, limiting his output and thus his revenues. We can hardly expect that a reseller would put an anticipated damages award on the credit side in the books before he even starts investigating. Finally, it is necessary to see that the Landes-Posner exercise with evaluating the entitlement to sue may be understood as a method to assess how an entitlement shall be distributed originally. For this method see in general Guido Calabresi & A. Douglas Melamed, *Property Rules, Liability Rules, and Inalienability: One View of the Cathedral*, 85 HARV. L. REV. 1089, 1090 (1972).

[35] The rate of passing on (RPO) is defined as $\varepsilon_S/(\varepsilon_S+\varepsilon_D)$, where ε_S is the elasticity of supply and ε_D is the elasticity of demand. Harris & Sullivan, *supra* note 19, at 287, fn. 52.

overcharge is likely to be passed on nearly in full to the consumers.[36] In sum, whether passing on occurs or not depends on the type of costs a direct purchaser incurs from a cartel's overcharge; if they are fixed costs (e.g. machinery), passing on is unlikely, if they are variable costs (flour in the case when the direct purchaser is a bakery or bricks when the direct purchaser is a construction company), the overcharge is very likely to be passed on in full in the short run.

The Harris-Sullivan model thus refutes one of the usual arguments, that courts are unable to assess whether passing on has occurred and how much of the overcharge was passed on to the consumers. Focusing on evidentiary material on the type of costs rather than on elasticities (which are sufficiently predictable with the help of an economic model), a court may reach a conclusion regarding passing on much more easily, and with certainty sufficient for a civil suit.[37] Harris & Sullivan object to the argument of Landes & Posner, which states that both the elasticity of demand and the elasticity of supply in any given case have to be observed.[38] This, according to Harris & Sullivan, is virtually impossible. In the view of Harris-Sullivan, when either the demand or the supply curve takes an extreme value (perfect elasticity or perfect inelasticity), the shape of the other curve becomes irrelevant. "Because in the long run supply is likely to be perfectly elastic (and when it is not, it will be readily apparent), an estimate of elasticity of demand will rarely be required for the long-run analysis."[39] Based on this observation, Harris & Sullivan conclude that as a rule, all cartel overcharges to direct purchasers will in the long run be passed on to consumers.

The difficulty of assessing the damages and share under an indirect-purchaser rule is therefore substantially limited to a level where the evaluation is not inefficiently costly and surely manageable for a court. Based on evidentiary material, the court can conclude whether the overcharge affected fixed or variable costs. In the former case, the court will deny the indirect purchaser standing as no injury has occurred. In the later case, as a rebuttable presumption, it will assume that the entire overcharge was passed on to the indirect purchaser and thus calculate the indirect-purchaser share of damages award as a share of input, which will be the source of the overcharge in the final product of the direct purchaser. The court can then divide the damages accordingly.

C. *Non-competitive downstream markets*

So far, we have presumed that at the resellers' level markets are competitive. However, downstream markets may not be competitive. Harris & Sullivan show that the effect of a two-level monopoly on the passing-on rate is rather paradoxical, as a profit maximizing reseller-monopolist would absorb some part of the overcharge imposed upstream (see figure 1).[40]

[36] The two other theoretical scenarios, perfectly elastic demand and perfectly inelastic supply, where the passing-on rate is close to zero (that is, the direct purchaser of cartel goods cannot pass the overcharge to consumers), are situations that are not profitable for the cartel and hence the cartel is unlikely to occur.

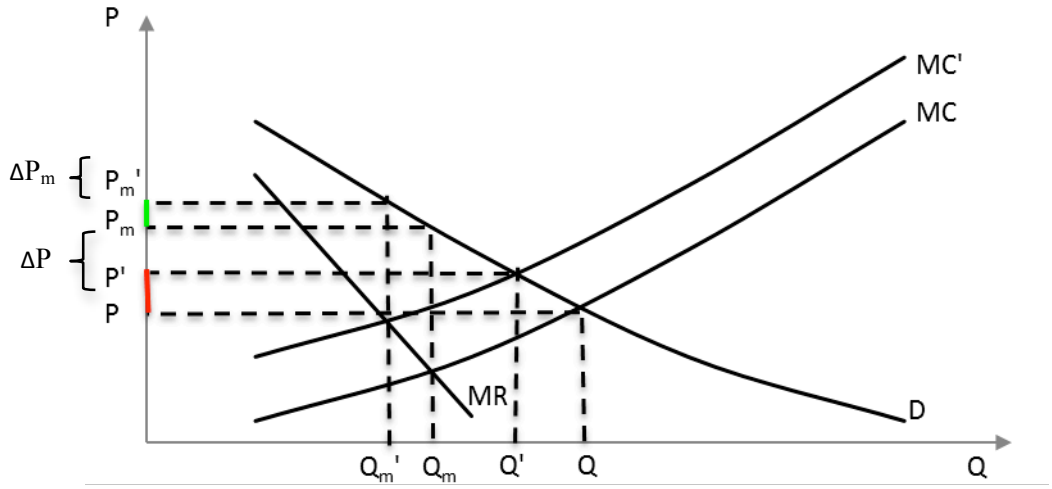
[37] That is our point of interest in this article rather than public prosecutions of cartels.

[38] Landes & Posner, *supra* note 19, at 619.

[39] Harris & Sullivan, *supra* note 19, at 294, fn. 61a.

[40] *Id.* at 296-297.

Figure 1. Comparison of competitive- and monopolist-reseller passing-on rate[41]



Supposing that the reseller is a rational profit-maximizing firm, he, (1) if facing a competitive market, sets the price *P* at the point where marginal costs curve *MC* cross the demand curve *D* (the price *P'* reflects the shift of the marginal-costs curve upwards (*MC'*) as a result of upstream-cartel overcharge that raises the variable costs); (2) if having significant market power, it first sets the quantity of outcome Q_m at the level where marginal costs *MC* equal marginal revenue *MR* and sets the price P_m at the level where customers are willing to buy that quantity of the reseller's product. The reseller-monopolist price in the situation of an upstream-cartel overcharge that shifted the marginal costs *MC* curve upwards (*MC'*) is set once again after the reseller first decides on the quantity Q_m' of the outcome that would be profit maximizing, that is, where marginal costs *MC'* equal marginal revenues *MR*. It is now obvious, though somewhat paradoxical, that a reseller-monopolist will pass on less of the overcharge to customers than a reseller facing competition. Moreover, Harris & Sullivan note that a reseller with significant market power would be able to use his power in downstream markets also upwards towards the cartel. This then results in (i) a smaller overcharge than under a situation where the reseller faces a competitive downstream environment and hence possesses less bargaining power in upstream markets, and in (ii) sharing of the overcharge ("joint profit maximizing").[42]

Harris & Sullivan employ institutional analysis to reinforce their theoretical findings. They focus on the pricing practices of resellers. While their economic model suggests that resellers are likely to pass the entire cartel overcharge to their customers, they admit that the majority of firms do not reach such a level of sophistication that would allow them to set the price according to neoclassical microeconomic models (which attempt to describe the situation in the industry as a whole rather than deal with individual company behavior). Firms use, in general, two techniques to set the prices of their product lines; markup pricing and cost-plus pricing.[43] Harris & Sullivan examined the passing-on rates

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[41] Where *MR* denotes marginal revenue; *D* is demand; *MC* is marginal costs (that is, supply); *MC'* denotes shifted marginal costs due to cartel overcharge; *P* is the price of the reseller's product; *P'* is the price in a situation where the reseller is overcharged by a cartel; *Q* denotes the quantity of the reseller's product; *Q'* is the quantity where the reseller faces overcharges by a cartel; P_m is the price set by a reseller who does not face competition; P_m' is the price set by a reseller-monopolist in reaction to overcharges by an upstream cartel; Q_m is the quantity produced by a reseller in a monopolist position, whereas Q_m' is the quantity produced by a reseller-monopolist when facing an upstream cartel; ΔP is the change in price from *P* to *P'*; and ΔP_m accounts for the change in price from P_m to P_m'.

[42] Sharing the fruits of a cartel does not imply a reseller's participation in illegal conduct. It may be simply the result of the reseller's strong bargaining position resulting from the fact that he (legally) 'controls' downstream markets. *See* Harris & Sullivan, *supra* note 19, at 297.

[43] "[M]ost businesses begin the pricing exercise on the cost side, measuring direct costs and apportioning indirect costs by a markup or cost-plus method." *Id.* at 309.

for each of these pricing techniques.[44] When markup pricing is used, the passing-on rates are mostly over 100%. Cost-plus pricing also leads to a 100% or more passing-on rate, though generally this is lower than in the case of markup pricing. The paradox of markup pricing results from the fact that markup pricing is based on calculating the input of direct costs (invoice price) and then adding to the invoice price a percentage margin that covers both indirect costs and a reasonable profit. The margin rates are often customary in the relevant industry. That means that if the input is overcharged due to the existence of an upstream cartel, and the input is a direct cost, the reseller adds for instance 50% (customary margin in the industry) and thus passes on to the customers 150% of the overcharge.

D. *Cost-plus contracts*

The Hanover-Shoe-Illinois-Brick case law explicitly left open one option when passing-on defense is allowed, though it did not elaborate in any way on this exception.[45] It is permissible when the relationship between the direct and the indirect purchasers is based on a so-called cost-plus contract. In this situation, the price of a direct purchaser's product is directly derived from the costs of inputs. In regulated industries, where the market does not determine the price, this is usually the case. Contracts with customers then often stipulate that the final price changes with the change of input costs (e.g., the price of petrol).

Although it may seem that the cost-plus exception left the indirect purchaser with a considerable scope to sue (offensive use of passing on), the U.S. Supreme Court narrowed down the exception significantly, thereby making it almost impractical. *Kansas v. UtiliCorp United* was a suit against a natural gas pipeline provider by both a natural gas utility (direct purchaser) and a state acting *parens patriae* on behalf of the consumers (indirect purchasers).[46] The Court was faced with the question whether the sale to a public utility represents a cost-plus-contract exception under *Hanover Shoe*. The Court repeated one of the main arguments of *Hanover Shoe* and *Illinois Brick*; it is almost impossible to establish that a direct purchaser passed on all of the overcharges to an indirect purchaser. The public utilities market does not work simply on the basis of cost-plus pricing. Public utilities providers must apply for rate increases to the public regulator. Whether the rate is increased and if so, by how much, is a result of many factors. The fact that public utilities may have little incentive to sue does not outweigh the Hanover-Shoe-Illinois-Brick rule.[47] Most of the lower federal courts have interpreted any remaining exceptions narrowly.[48] This development has precluded many suits by consumers, including those filed as class actions.[49]

E. *Summary*

The Landes/Posner-Harris/Sullivan debate helps us identify what is at stake under the Hanover-Shoe-Illinois-Brick jurisprudence and we may be able to reconcile the opinions presented by the debaters. First, the difficulty of estimating damages remains the same under any of the rules (either the indirect-purchaser rule or its alternative) and will therefore not be of interest for the purposes of this article. This means that, among other things, we do not need to be primarily concerned with the question

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[44] *Id.* at 303-9.

[45] "We recognize that there might be situations – for instance, when an overcharged buyer has a pre-existing 'cost-plus' contract, thus making it easy to prove that he has not been damaged – where the considerations requiring that the passing-on defense not be permitted in this case would not be present." *Hanover Shoe*, 392 U.S. at 494.

[46] Kansas v. UtiliCorp United, Inc., 497 U.S. 199 (1990).

[47] THOMAS D. MORGAN, CASES AND MATERIALS ON MODERN ANTITRUST LAW AND ITS ORIGIN 490-491 (2d ed. 2009).

[48] *See*, *e.g.* Labrador, Inc. v. Iams Co. 105 F.3d 665 (9th Cir. 1996), and *In* re Brand Name Prescription Drugs Antitrust Litig., 123 F.3d 599, 605-606, 613-614 (7th Cir. 1997) (Posner, J.) (declaring that drug wholesalers did not fall within the 'control' exception of *Illinois* Brick). For the latter, cf. how a similar question was solved in *Clayworth*, 49 Cal.4th (infra p. 18), which was a state antitrust case. William H. Page, *The Limits of State Indirect Purchaser Suits: Class Certification in the Shadow of Illinois Brick*, 67 ANTITRUST L.J. 1, 1 and fn 3 (1999).

[49] Morgan, *supra* note 47, at 491.

whether a cartel charges the same overcharge continuously, changes the overcharge instantaneously, or whether the cartel was intermittent.[50]

Second, Harris & Sullivan show that in the vast majority of cases, the court can determine a general passing-on rate, based on theoretical and institutional analyses, and subsequently adjust the rate according to the concrete pricing practices used by the direct purchaser in question.[51]

Though markup pricing can lead to a considerable increase of the overcharge (by 50%, 100% or even more) within the process of passing on to final customers, from a legal point of view it is impossible for an indirect purchaser to recover the increase of the overcharge from the cartel. Although this amount is traceable to the existence of an overcharge, it does not create an injury. Injury (*in iuria*) is by definition the harm caused to somebody as a result of the unlawful behavior of another. The markup pricing of the reseller is, of course, not unlawful. The increase of the overcharge cannot be attributable to the illegal behavior of the antitrust violator as it is not up to him to define what pricing techniques the firms further down the chain use. These techniques do not change with the creation of a cartel. Though the indirect loss of a purchaser may increase at the intermediate level, he does not suffer an injury from such increase. In any case, the injured party recovers threefold the overcharges and this increase is likely to cover all additional costs (the markup of overcharge, litigation costs above and beyond reasonable legal fees, etc.). The decision of the legislator to treble the damages award is, however, not driven by compensatory justice, but by the deterrence objective and is therefore a public law addition to the general tort law scheme. The treble rule does not aim to restitute any additional 'injury,' but is a kind of payment (reward) to private enforcers for fulfilling public enforcement tasks.

Third, Landes & Posner convincingly asserted that the exclusive direct-purchaser rule is the most efficient. This assertion is based on their conviction that the deterrence objective of antitrust laws is superior to compensatory issue.[52] The direct-purchaser incentive to sue is higher if his right is exclusive. He is also in the best position (due to his access to information) to investigate whether a cartel has occurred, and he is more willing to invest in the investigation and litigation under the direct-purchaser rule than he would be under its alternative. This does not hold true for indirect purchasers in any case (even if they possess the exclusive right to sue).

However, the lack of harm due to passing on alters the behavior of direct purchaser. He realizes the harm when he evaluates his costs. He does that regularly in order to adjust the price, disregarding the occurrence of a cartel, and hence may become suspicious and invest in a cartel discovery. When a direct purchaser adjusts the price, he automatically starts to pass on the overcharges to his customers. That means that at the point where a direct purchaser may become suspicious about upstream cartel, he also ceases to be harmed. Indeed the opposite may happen; he markups the overcharge and increases his revenue.[53] At a certain point, the direct purchaser passes on enough of the markup overcharges, that he covers the initial losses he incurred before he adjusted the price. All these processes are likely to happen within a year after the cartel occurred. At that point, a profit maximizing firm endowed with the exclusive right to sue, which had already recovered its damages through a passing-on rate exceeding 100%, could be expected to wait maximum period allowed by the statute of limitations (four years), then sue the cartel, and be awarded three times the overcharges

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[50] To be sure, this finding is relevant for the amount that was passed on. There is always a delay between the imposition of an overcharge and the reaction of a direct purchaser to the increased price. That would, once again, depend on the pricing practices of a direct purchaser that have to be disclosed in litigation. Harris & Sullivan believe that these practices follow the custom in the industry and so can be, again as a rebuttable presumption, readily available for the court to examine in advance. Harris & Sullivan, *supra* note 19, at 304.

[51] That varies little from the model, and can be easily discerned from the firm's accounting. The information to be researched by the court is (i) what is the pricing practice of the firm, (ii) whether the overcharge affected direct or indirect costs, and (iii) how often the firm re-prices their products.

[52] Their attempt to show that even if the compensatory objective is superior, the direct-purchaser rule will still be more efficient, is far less convincing.

[53] The quantity he produces comes closer to the point where the marginal costs curve intersects the marginal revenues curve. *See* figure 1, *supra* p. 11 (Although *MC* curve shifted upwards to *MC'*, *Q'* is closer to Q_m' than *Q* to Q_m).

accumulated over the past four and half years.[54] A free-riding problem does not arise, because all of the direct purchasers of the cartel have the same incentive to wait as long as possible.[55] The share of any direct purchaser of the overall damages award neither changes over time, nor do purchasers risk losing their right if others sue before them. As damages are calculated per item sold, the increase or decrease of the number of injured parties is to a certain extent irrelevant as well.[56] Such behavior by a direct purchaser is, however, on the edge of legality, because the direct purchaser knowingly benefits from the illegal behavior of the antitrust violator.[57]

The existence of an upstream cartel must be harmful to direct purchasers in order to give them the incentive to launch a legal suit as soon as possible. Since *Illinois Brick*, world trade liberalization has increased. It is likely that substitute products from foreign markets appear as a reaction to a cartel.[58] It takes some time for this to occur, during which time direct purchasers may tolerate, or even benefit from, the cartel. As soon as a substitute product appears (demand becomes more elastic), direct purchasers are in loss; they can no longer pass on the entire overcharge and will take action against the cartel.[59]

Landes & Posner are right that the direct purchasers are the most efficient antitrust enforcers and that deterrence is increased under the Illinois-Brick rule. However, *Hanover Shoe* and *Illinois Brick* also give direct purchasers an incentive to prolong the existence of the cartel and de facto participate in its illegal scheme, in order to extract as much as possible from the final customers before turning to extract treble damages from the cartelist. This conduct increases the total social welfare loss: the cartelist produces less for a higher price (basic loss); the direct purchaser, in response, also produces less and charges its customers even more (the basic loss multiplies); after a maximum period of approximately five years, the direct purchaser sues the cartel. The accumulated amount of overcharge is likely to be enormous and its tripling may well have a devastating effect on the cartelist, substantially decreasing its production capacity and, in the worst case scenario, making the cartel firms go bankrupt. It is important to note that even without the harmful effect of the damages award on the cartel's firm production capacity, the treble damages themselves represent a considerable social welfare loss, because nothing is produced[60] for this amount (an additional loss to social welfare).[61] For

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[54] Under the Clayton Act, the statute of limitations is four years. The limitations period does not begin until the damages are incurred and *ascertainable*. 15 U.S.C. § 15(b).

[55] A "negative" free-riding problem might appear, though: a direct purchaser who sues first bears more costs of the investigation and litigation than other direct purchasers, who may then enjoy the benefits of evidence that have been already collected.

[56] The only limitation is the overall assets of the cartel firms. Yet, if there is not enough money, the individual plaintiffs' recovery will be decreased proportionally and, once again, a free-riding issue does not arise.

[57] We can look at the situation as a tacit agreement between the cartelist and the direct purchaser, who are aiming to extract and share the overcharges from the final customers (vertical collusion).

[58] The cartel can prevent this from happening, at least partly, by conspiring to prevent the reimport of their own products from foreign markets as well as to restrict the competition from substitutes. *See*, *e.g. Clayworth*, 49 Cal.4th, at 758.

[59] This exercise shows that an economic analysis dealing with legal entitlements as if they were simply goods needs some "real world" adjustments. It is difficult to imagine that the managers in most of the firms count on the probability of a cartel existence, use statistical methods to evaluate the probability of successful litigation, assess the future costs of investigation and litigation against the damage award, discount their products to the final customers, and thus pass on a share of the future treble damages, etc. In most of the cases, it is more reasonable to expect that direct purchasers follow their routine; when input costs increase, they adjust the price to their customers; if they become suspicious about the reason for input costs to increase, they may invest some money to investigate the situation and if enough evidence is gathered, they will sue the cartel, providing that the damages award is expected to surpass the litigation costs.

[60] First, a considerable part of the damages award and litigation costs ends up in the attorney's pocket, and second, the plaintiff is likely to consider the rest of the award as a windfall and the award is not likely to be reflected in the marginal revenues, so that the price can be decreased and the firm can produce more at a lower price, which would increase social welfare.

[61] Here yet another distortion resulting from the Illinois-Brick rule comes to light. The cartelists may discount their products (decreasing the overcharge) in order to prevent the direct purchaser from the litigation. This situation differs from the one treated *supra* at p. 10. While in the case at p. 10, a reseller gives a discount to indirect purchasers; here, the manufacturer-

all these gains, neither the cartelist nor the direct purchaser produce a single item (in fact they produce less during the existence of the cartel), while both the cartelist and the final customers lose money. In sum, while the Hanover-Shoe-Illinois-Brick rule may deter cartelists by incentivizing the more efficient enforcers – the direct purchasers – it also incentivizes them to prolong the cartel's existence. The Illinois-Brick rule thus multiplies the total social welfare loss.

II. CLAYWORTH RULE

In July 2010, the California Supreme Court issued a ruling in *Clayworth v. Pfizer* in which the court laid down an alternative to the federal Hanover-Shoe-Illinois-Brick rule. It declared that California state antitrust law does not permit the defendant to raise the passing-on defense. Unlike the federal rule, the California legislation, named the Cartwright Act, allows the indirect purchaser to sue for damages caused by a cartel.

Together with several other Californian pharmacies, Mr. Clayworth, the owner of a retail pharmacy, sued several major manufacturers of pharmaceuticals like Pfizer, Novartis, Johnson & Johnson, and Aventis for damages. He claimed that Pfizer and others unlawfully conspired to fix the prices of their brand-name pharmaceuticals. According to Mr. Clayworth, they agreed to set artificially high prices, not to reimport their lower-priced products into the United States, and to cooperate in restricting competition from generics. With these arrangements, Pfizer and others were able to maintain prices 50 to 400% above the prices at which they sold the same drugs in the foreign markets.[62]

The *Clayworth* case was a suit by retailers. The drug manufacturers, Pfizer et al., sold their products to the wholesalers, who in turn sold them to Mr. Clayworth and other pharmacies. The business chain included manufacturers (Pfizer et al.), wholesalers, retailers (the pharmacies of Clayworth et al.), and final customers. The passing-on issue appeared in two ways. On the one hand, the cartel claimed that Clayworth et al. passed on the overcharges to the final customers. Mr. Clayworth, on the other hand, in order to prove an injury, would have to inevitably assert that wholesalers passed on the cartel's overcharges to him. However, because Clayworth was granted the standing of a direct purchaser,[63] the court did not need to solve the conundrum of how to both allow the offensive use of passing on and forbid the defensive use of passing on.[64]

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cartelist discounts its product to direct purchasers. While Landes & Posner see the discount as a form of 'voluntary' antitrust damages and claim that the discount will be passed on to the indirect purchasers, Harris & Sullivan oppose this point. In their view, there is no reason why the discount should be passed on. The arguments of Landes & Posner are more convincing: the discount leads to lower input costs and if resellers, as Harris & Sullivan argue elsewhere, use the markup or cost-plus pricing techniques, the discount is inevitably reflected in the reseller's price charged to the final consumers. Both sides of the debate, however, disregard whether such a situation is likely to occur at all. If a discount is given at the outset of the cartel's existence, then the overcharge is lower, but still exists, and the cartel will be sued after a considerable amount accumulates (some overcharge needs to exist as that is the reason why the cartel has emerged in the first place). If the discount is offered at the breaking point when the direct purchaser subtracts as much as possible from the final customers and considers a legal suit against the cartelist, then the discount would have to be higher than the treble damages minus the litigation costs, which is as improbable as the former situation. Finally, the direct purchaser will not sue the cartelist only if the discount is so explicit that he becomes part of the cartel. Then under the Illinois-Brick rule, the direct purchaser loses his standing, because the next purchaser in the chain becomes the direct purchaser (the cartel absorbs the reseller's level).

[62] *Clayworth*, 49 Cal.4th, at 765.

[63] *Clayworth* shows that there is a way for federal courts to limit the consequences of Illinois Brick by relaxing the definition of direct purchaser. In *Clayworth*, the wholesalers' prices were set in the following way: "Manufacturers sell their drugs to wholesaler at a price referred to as the wholesaler acquisition cost. In turn, various independent entities use the wholesale acquisition cost to calculate and publish benchmark drug prices, termed the average wholesale price, for use in the industry. Wholesalers resell the drugs to Pharmacies at prices based on a percentage of the average wholesale price. […] As a result, when Manufacturers increase their prices, the costs of drugs to Pharmacies increase by the same percentage amount." *Clayworth*, 49 Cal.4th, at 765.

[64] It was exactly this problem that led the U.S. Supreme Court to deny indirect purchasers standing in *Illinois Brick*: if the passing-on defense is not allowed in direct-purchaser suits (defensive use of passing on), it cannot be used by the indirect purchaser who has to prove that passing on occurred in order to establish an injury (offensive use of passing on). Martin

Pfizer raised the passing-on defense against Clayworth, claiming that Clayworth suffered no damages because he passed on the overcharge yet further down the business chain to the final customers. According to the court, it was proven and undisputed that the pharmacies' pricing practices led them to pass on the entire overcharge to the final customers. The court declared that the passing-on defense was generally not permitted. First, the legislative history of the Cartwright Act, which does not give guidance on the availability of passing-on, suggests that amendments made in response to *Illinois Brick* (allowing the indirect purchaser to sue) demonstrate a legislative intent to incorporate the federal rule of *Hanover Shoe* (no passing-on defense). Second, the California antitrust law strongly emphasizes the deterrence objective, together with ensuring full "disgorgement of any ill-gotten proceeds" that would be compromised by allowing the passing-on defense in this case.[65] Third, the danger of double recovery by multiple classes of plaintiffs is not great enough to compromise the deterrence and compensation (or rather the full extraction) objectives of California antitrust law. Finally, even if direct purchasers pass on the entire overcharge, they still may suffer an injury (for instance, by losing sales).[66]

Although the court generally outlawed the passing-on defense, it determined conditions under which the passing-on defense could be allowed: first, the cost-plus-contracts exception of *Hanover Shoe* is applicable under California state antitrust law as well. Second, in litigation, when both direct and indirect purchasers are successful in establishing price fixing by the defendant, the court will prevent double recovery by permitting the passing-on defense by the defendant.[67]

The second exception is of utmost importance. Because a direct purchaser cannot assess the situation in advance, he has to count on the worse scenario, that is, that *generally* the passing-on defense is admissible (though according to the California Supreme Court, passing-on is *generally* not allowed). According to Landes & Posner, that will lead to a diminishing of the incentive for direct purchasers to invest in cartel discovery and litigation, and the level of antitrust enforcement will decrease. The Harris-Sullivan analysis supports this point by establishing that direct purchasers are likely to pass on the entire overcharge (plus a margin) to their customers (that means that the passing-on defense will be often successful, if allowed). The analysis above, however, shows that passing on is necessarily delayed until the next regular re-pricing evaluation by a direct purchaser, and that tripling the overcharges incurred so far is a sufficient incentive.

III. COURAGE-MANFREDI RULE

A. *Courage and Its Aftermath*

In 2001, the Court of Justice of the European Union declared in *Courage v. Crehan* that the full effect of the EU competition law[68] required that individuals were entitled to "claim damages [before a Member State's court] for losses caused to [them] by a contract or by conduct liable to restrict or distort competition."[69]

The decision took most of the courts and legislatures of EU Member States by surprise. The Commission reacted with a frantic effort to build up support for the EU wide harmonization of, or at least cooperation in, the matter of private antitrust enforcement. It called a tender to identify and analyze the obstacles to successful action for damages existing in EU Member States. A report of the London based international law firm Ashurst, published in 2004, found "astonishing diversity and total underdevelopment" in the area of damages actions for breach of antitrust laws in the then 25 Member

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Hellwig, *Passing-On Defense in Horizontal Price-Fixing Cases*, *in* PRIVATE ENFORCEMENT OF EC COMPETITION LAW 121, 123 (Jürgen Basedow ed., 2007).

[65] *Clayworth*, 49 Cal.4th, at 763.

[66] The previous analysis of Hanover-Shoe-Illinois-Brick rule in this article has shown, however, that this is not true in most of the cases.

[67] *Clayworth*, 49 Cal.4th, at 787.

[68] The Consolidated Version of the Treaty on the Functioning of the European Union art. 101, Sep. 5, 2008, 2008 O.J. 47 [hereinafter TFEU or the Treaty].

[69] Courage v. Crehan, E.C.R. I-6314, at para. 26.

States of the Union.[70] The study found only about sixty damages actions for breach of antitrust laws (private antitrust cases) ever having been tried in EU jurisdictions (eighteen based on EU antitrust provisions); with just half of them resulting in damages awards at the time of the report.[71] The following obstacles to private antitrust enforcement identified in the report are of particular interest for our analysis: (i) lack of clarity regarding the legal basis for such suits; (ii) requirement of "interest" for standing; (iii) underdeveloped collective redress;[72] (iv) Member States generally understood damages actions as being restitutionary in nature, with only a few states providing for punitive or exemplary damages; [73] (v) the passing-on defense "was theoretically possible (although the defendant would bear the burden of proof) and indirect purchasers could theoretically sue (but would have trouble in proving a causal link). The passing-on defense was considered possible in Denmark, Germany (by some courts) and Italy, where the question had arisen."[74]

Significant leverage was given to *Courage* in May 2004 when Council Regulation 1/2003 came into force. It gives full jurisdiction to EU Member States courts to apply EU competition law, which was until then impeded by the exemption clause of then Article 81 para. 3 of the Treaty.[75]

As the next step, in 2005 the Commission published a Green Paper on Damages action for breach of EC antitrust rules,[76] in which it unveiled its policy: "Facilitating damages claims for breach of antitrust law will not only make it easier for consumers and firms who have suffered damages arising from an infringement of antitrust rules to recover their losses from the infringer but also strengthen the enforcement of antitrust law."[77] The Commission aimed at improving the standing of indirect purchasers, the final customers. Stimulating indirect-purchaser suits would increase antitrust enforcement, the Commission thought. Given the jurisdiction of EU Member States' courts and the absence of EU rule on the matter, "it is for the legal systems of the Member States to provide for detailed rules for bringing damages actions."[78] As the Green Paper served the purpose to open expert and wide public discussion, it mainly identified the problems based on the Ashurst report and a range of possible solutions, rather than suggesting any rule. Regarding the passing-on defense and indirect-purchaser standing, it warned, in line with the Hanover-Shoe-Illinois-Brick case law, that the defense "substantially increases the complexity of damages claims" and that "[e]videntiary problems also burden actions of indirect purchasers, as they might be unable to prove the extent of their damages and the causative link with the infringing behaviour."[79] The Green Paper added a variant of the Clayworth rule: "A two-step procedure, in which the passing-on defence is excluded, the infringer can be sued by any victim and, in a second step, the overcharge is distributed between all the parties who have suffered a loss. This option is technically difficult but has the advantage of providing fair compensation for all victims."[80]

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[70] ASHURST REPORT, *supra* note 10, at 1.

[71] *Id.* at 1.

[72] Though nearly all the Member States provided for collective or representative actions of some type (especially actions brought by representative associations), only in two states were there pending claims of this sort; nothing that would correspond to the U.S. class action existed.

[73] *Id.* at 1-3

[74] *Id.* at 6-7.

[75] Walter van Gerven, *Private Enforcement of EC Competition Rules in the ECJ – Courage v. Crehan and the Way Ahead*, *in* PRIVATE ENFORCEMENT OF EC COMPETITION LAW 19, 23 (Jürgen Basedow ed., 2007).

[76] 2005 GREEN PAPER, *supra* note 10.

[77] *Id.* at 3.

[78] *Id.* at 4; Courage v. Crehan, E.C.R. I-6314, at para. 29.

[79] 2005 GREEN PAPER, *supra* note 10, at 8.

[80] *Id.* at 8.

B. *Formulating the Courage-Manfredi Rule*

The CJEU took a step further in 2006 in *Manfredi v. Lloyd Adriatico Assicurazioni*.[81] It reaffirmed that "any individual can claim compensation for the harm suffered where there is a causal relationship between that harm and an agreement or practice prohibited [by EU competition law]."[82] The CJEU sought to create, in line with the U.S. debate on private enforcement, sufficient incentives for private enforcers to sue antitrust violations. However, the CJEU left the primary responsibility for developing the system of private enforcement to the Member States, providing that they follow a set of common rules based on two general principles; effectiveness and equivalence.[83] Regarding the extent of the recovery, "injured persons must be able to seek compensation not only for actual loss (damnum emergens) but also for loss of profit (lucrum cessans) plus interest."[84] Aware of doctrinal limitations in the Member States, the CJEU also declared that its case law did not mean that Member States' courts could not take steps to prevent unjust enrichment.[85]

Two years after *Manfredi*, the Commission published a White Paper on Damages actions for breach of EC antitrust rules.[86] In this policy document, the Commission formulated the Courage-Manfredi rule, its preferred solution to the passing-on-standing problem. The Commission interprets the CJEU's declaration that *any individual* can claim compensation before Member States' courts as applicable to indirect purchasers as well.[87] The Commission is aware that "[i]ndividual consumers, but also small businesses, especially those who have suffered scattered and relatively low-value damage, are often deterred from bringing individual action for damages by the costs, delays, uncertainties, risks and burdens involved."[88] Therefore, indirect-purchaser rule may be effective only if there are "mechanisms allowing aggregation of the individual claims of victims of antitrust infringements."[89] The Commission suggests the introduction of two complimentary mechanisms of collective redress: first, representative actions brought by qualified entities such as consumer associations, state bodies (similar to U.S. *parens patriae* actions)[90] or trade associations; and, second, opt-in collective actions, in which victims *expressly decide* to combine their individual claims into one single action (whereas the U.S. class action system follows the opt-out rule).[91] Given the difficulty of cartel discovery by indirect purchasers, the Commission presupposes that collective redress action would be undertaken in the majority of cases after the public prosecution of a cartel, that is, after the competition authorities of the EU Member States or the Commission itself issue a final decision finding an antitrust violation. The Commission therefore suggests that such final decisions of Member States' competition authorities shall be binding upon the civil courts, which deal with private antitrust suit in any Member State.[92]

I have already mentioned that the CJEU expressed its concerns about ensuring full compensation on the one hand and preventing unjust enrichment, on the other. The Commission

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[81] Manfredi v. Lloyd Adriatico Assicurazioni, E.C.R. I-6619.

[82] *Id.* at para. 61.

[83] The CJEU explained that the Member States had to ensure two general principles: "that such [Member State's] rules are not less favorable than those governing similar domestic actions (principle of equivalence) and that they do not render practically impossible or excessively difficult the exercise of rights conferred by [Union] law (principle of effectiveness)." *Id.* at para. 62.

[84] *Id.* at para. 95. After receiving the response to its preliminary question in the Manfredi case, the Italian court awarded double damages in order to give full effect to the Union antitrust law. Chalmers, Davies & Monti, *supra* note 15, at 955.

[85] Courage v. Crehan, E.C.R. I-6314, at para. 30; Manfredi v. Lloyd Adriatico Assicurazioni, E.C.R. I-6619, at para. 94.

[86] 2008 WHITE PAPER, *supra* note 10, ch 2.1.

[87] To be sure, neither *Courage*, nor *Manfredi* were indirect-purchaser suits.

[88] *Id.* at 2.1.

[89] *Id.* at 2.1.

[90] Hart-Scott-Rodino Antitrust Improvements Act. 15 U.S.C. § 18a.

[91] Fed. R. Civ. P. 23.

[92] 2008 WHITE PAPER, *supra* note 10, ch 2.3.

aspired to cope with this by allowing passing on in both the defensive and the offensive ways. Invocation of passing on in a litigation should serve two objectives – ensure full compensation and prevent multiple recoveries – and thus protects indirect purchasers as well as cartelists. The right mix of deterrence versus compensation objectives is ensured through burden-of-proof distribution. On the one hand, "defendants should be entitled to invoke passing-on defense against a claim for compensation of an overcharge. The standard of proof for this defense should not be lower than the standard imposed on the claimant to prove the damage."[93] On the other hand, "indirect purchasers should be able to rely on the rebuttable presumption that the illegal overcharge was passed on to them in its entirety."[94]

C. *Quantifying Overcharges and Passing-on Rate*

The CJEU emphasized that the victims of antitrust violations are entitled to full compensation, including actual loss, loss of profit, and interest.[95] In 2011, the Commission published a Draft Guidance Paper on Quantifying Harm.[96] Part 3 of the Guidance Paper focuses on quantifying the overcharges of price-fixing cartels and passing on of overcharges. The main approach is based on the so-called 'but-for analysis'; placing the injured party in the position in which it would have been, had the antitrust violation not occurred. The quantification of harm therefore requires comparing the position of the injured party in the factual situation of a price-fixing cartel with its hypothetical position under the non-violation scenario.[97] An empirical study prepared for the Guidance Paper shows that the average overcharge is 20% above the competitive price.[98] In order to quantify overcharges, the Guidance Paper prefers a comparator-based method, and especially a time comparison. This gives a good estimate of overcharges, especially when we know the price before the cartel emerged and the price after the cartel ceased to exist, so that we may take into account approximately how the markets would have evolved if there had been no cartel. Regarding the passing-on rate, given that we already know the overcharge per unit estimated through the comparator-based method, the Guidance Paper does not offer a clear rule. It rather repeats various variables that affect the passing-on rate, and which we encountered earlier in this article. We can summarize three different situations only: first, if direct purchasers face downstream competition from competitors who are not buying from the cartel, they will not be able to pass on the overcharge to their customers;[99] second, if all direct purchasers buy the input from the cartel and are in competition, in all likelihood

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[93] *Id.* at 2.6.

[94] *Id.* at 2.6.

[95] Manfredi v. Lloyd Adriatico Assicurazioni, E.C.R. I-6619, at paras 95 and 97.

[96] 2011 DRAFT HARM QUANTIFICATION GUIDANCE, *supra* note 10. After holding public consultations, the Commission intends to adopt a Communication on quantification of harm in antitrust damages actions later in 2013. *Commission actions expected to be adopted / Actions prévues pour adoption par la Commission: 21/02/2013 - 31/12/2013*, 2013, p. 34, *available at* http://ec.europa.eu/atwork/pdf/f orward_programming_2013.pdf.

[97] *Id.* at 8-9. This article deals with a simplified scenario of a three-level chain of manufacturers, resellers, and final customers. The Guidance Paper points also to other situations and aims to offer a method applicable to those situations as well. For instance, it identifies that harm is caused to potential final customers who do not buy a product because of its increased price, or buy a substitute. A cartel may also aim only at stabilizing the prices that would otherwise decrease in competitive markets. Furthermore, the suppliers of the cartel (that is, the upstream part of the chain) are likely to be harmed, because the cartel uses its downstream market power to negotiate lower than a competitive price for its input (the cartel 'undercharges' its suppliers). *Id.* at 40. The Guidance Paper does not consider yet another scenario, in which the cartel may pass on the benefit of the downstream overcharge upstream to its suppliers; that is, to buy the input at a higher than the competitive price (for instance, to drive out the potential competitors who were not willing to join the cartel).

[98] *Id.* at 42. *See* the study QUANTIFYING ANTITRUST DAMAGES 88 et seq. (2009), *available at* http://ec.europa.eu/competition/antitrust/actionsdamages/index.html.

[99] This situation is not treated in the present article. Under normal circumstances, the direct purchaser affected by the cartel, and facing downstream competition from firms not buying from the cartel, will change his supplier. If this is easy, than the cartel loses its purpose. Because the direct purchaser continues buying from the cartel, it means that he is likely to be contractually bound to do so. If this is so, the problem is not one of antitrust law, but contract law (the problem of the 'weak party', etc.).

the passing-on rate will be 100%; finally, if the direct purchaser is a monopolist, he is likely to absorb part of the overcharge.[100]

D. *Summary*

The *Courage* ruling constituted a breaking point in the effort to build up a Union system of private antitrust enforcement and was enthusiastically endorsed by the Commission. In Commission's view availability of private enforcement would further advance the decentralization of antitrust enforcement by outsourcing public enforcement to private parties,[101] with the effect of increasing enforcement (deterrence) and decreasing costs. The ruling, however, comes into a different light if viewed from a tort law point of view, and it is indeed this dimension that the CJEU mainly had in mind.[102] The genesis of the Courage-Manfredi rule provides an important interpretative benchmark.

Non-contractual liability for damages was explicitly stipulated for breaches of Union law committed by Union institutions.[103] In 1991, the CJEU notably ruled that the Member States were also liable for damages caused to individuals by a breach of Union law by Member States' authorities.[104] In 1992, the CJEU was finally faced with a question of a non-contractual damages claim of an individual against another individual. In *Banks v. British Coal*, the Banks mining company claimed damages against the British Coal Corporation, the monopolistic owner of coal reserves in the United Kingdom that had the authority to grant mining licenses.[105] In Banks' view, its licensing agreement with British Coal was in breach of EU antitrust law. Banks claimed damages caused by excessive licensing fees and low prices received from British Coal for the coal Banks extracted. At that time, the CJEU held that EU antitrust laws[106] were not directly applicable and that therefore an individual could not rely on them in a private suit.

However, Advocate General Walter van Gerven, in his opinion for the CJEU, paved the way for the *Courage* decision that came few years later. Van Gerven maintained that if a provision of Union law was to be found directly applicable, it logically followed that it provided a sufficient basis for damages claims.[107] In other words, even if a Member State's legal order does not recognize private antitrust damages claims, the entitlement is provided by Union antitrust law itself (assuming that the antitrust violation has a European dimension) and a Member State court is obliged to award damages. The entitlement was found in EU tort law established so far, which was extended to antitrust claims.

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[100] 2011 DRAFT HARM QUANTIFICATION GUIDANCE, *supra* note 10, at 48-49. For the last scenario see *infra* part I.C of this article.

[101] The CJEU explicitly recognized that dimension: "the existence of such a right strengthens the working of the [Union] competition rules and discourages agreements or practices, which are frequently covert, which are liable to restrict or distort competition. From that point of view, actions for damages before the national courts can make a significant contribution to the maintenance of effective competition in the [Union]." Courage v. Crehan, E.C.R. I-6314, at para. 27.

[102] Cf. van Gerven, *supra* note 73; and ASSIMAKIS P. KOMNINOS, EC PRIVATE ANTITRUST ENFORCEMENT. DECENTRALISED APPLICATION OF EC COMPETITION LAW BY NATIONAL COURTS 176-179 (2008).

[103] Art. 340 TFEU case law.

[104] Joined cases C-6/90 and C-9/90, Andrea Francovich and Danila Bonifaci and others v. Italian Republic, 1991 E.C.R. I-5357. It is worth noting that the Advocate General in the *Francovich* case was Jean Mischo, who later returned to the CJEU again as an Advocate General and delivered the opinion in *Courage*.

[105] Case C-128/92, H. J. Banks & Co. Ltd v. British Coal Corporation, 1994 E.C.R. I-1209.

[106] The case concerned now repealed Arts. 65 and 66 of the Treaty establishing the European Coal and Steel Community. However, the findings regarding special antitrust provisions for the coal industry were applicable to general Union antitrust laws.

[107] "[T]he right to obtain reparation in respect of loss and damage sustained as a result of an undertaking's infringement of [Union] competition rules which have direct effect is based on the [Union] legal order itself. Consequently, as a result of its obligation to ensure that [Union] law is fully effective and to protect the rights thereby conferred on individuals, the national court is under an obligation to award damages for loss sustained by an undertaking as a result of the breach by another undertaking of a directly effective provision of [Union] competition law." Opinion of Mr. Advocate General van Gerven in Banks v. British Coal, E.C.R. I-1209, para. 45. For further development of van Gerven's thoughts into a coherent theoretical framework see Walter van Gerven, *Of Rights, Remedies and Procedures*, 37 COMMON MKT. L. REV. 501 (2000).

Komninos makes this dimension explicit: "The enunciation of a [Union] right in damages … is a logical consequence of the Court's abundant case law on state liability, and reflects the more general principle of [Union] law that 'everyone is bound to make good loss or damage arising as a result of his conduct in breach of a legal duty' (*neminem laedere*)."[108] The principle that everyone has to make good loss arising from unlawful conduct is a fundamental claim of corrective justice. The Union private antitrust enforcement system seems thus rooted in corrective justice rather than in economic analysis.[109]

IV. ECONOMIC ANALYSIS AND CORRECTIVE JUSTICE: PASSING-ON DEFENSE FROM A GENERAL TORTS POINT OF VIEW

A private antitrust enforcement doctrine shall fulfill two conditions; systemic coherence and methodological coherence. Private antitrust enforcement is but a segment of general torts and can diverge from the development of general torts only to the extent necessary for fulfilling objectives other than restitution (compensation). Antitrust enforcement differs from general torts in an important way, as the deterrence aspect of antitrust laws is of considerably higher importance than in general torts. However, private enforcement is concerned with damages and litigation and involves many auxiliary problems that are not and should not be of immediate interest to antitrust laws and are left to general tort law. Systemic coherence is therefore of particular importance. The requirements for methodological coherence go in the opposite direction. As antitrust laws regulate the markets, the economic approach to devising such laws promises to achieve the social aim of regulation, leaving the market to do most of the regulation by itself and intervening only when the market fails to correct distortions. The interpretation of antitrust laws should logically follow the economic method; that means that also private enforcement, where the legal basis of the claim is in antitrust laws, should prefer an economic analysis. Due to the tension between systemic coherence and methodological coherence, how to reconcile these two requirements is the question that must be addressed.

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[108] Komninos, *supra* note 102, at 170-171. He builds on the framework developed by van Gerven, *supra* note 105.

[109] The CJEU case law and the Commission's ongoing pressure led the EU Member States to intensify legislative works on improvements of their private antitrust enforcement systems. Within the limits of this article, I do not examine these changes in-depth. There are only few cases dealing with passing-on defense. The English courts have not yet decided on the status of passing on. In *Devenish Nutrition v. Sanofi-Aventis*, the Court of Appeals seems to allow the passing-on defense. The French courts have differed on this question. While the Paris Business Court allowed the passing-on defense (*Juva v. Roche*), the Nanterre Business Court's reasoning is alarming. In *Arkopharma v. Roche*, the court denied damages to Arkopharma due to the fact that, because all direct purchasers were harmed by a cartel, Arkopharma as one of the direct purchasers could have passed the overcharges to its own customers. Because Arkopharma did not use that option, the causal nexus between the antitrust violation and the damage was interrupted and Arkopharma is not entitled to damages. In other words, if a direct purchaser can pass on a cartel's overcharges to its customers, it is obliged to do so. This extreme view on the passing-on problem may arise in many European systems, which contain a duty to prevent damages (that logically entails a duty to limit the damage already caused, for instance by passing-on). *See* Friedrich Wenzel Bulst, *Passing-on*, *in* PRIVATE ENFORCEMENT OF COMPETITION LAW 67, 70-71 (Jürgen Basedow, Jörg Philipp Terhechte & Luboš Tichý eds., 2011). In Germany, amended §33(3) GWB states that "If a good or service is purchased at an excessive price, a damage shall not be excluded on account of the resale of the good or service." (English translation *at* http://www.bundeskartellamt.de/wEnglisch/download/pdf/GWB/110120_GWB_7_Novelle_E.pdf). The amendment, however, brought more confusion than clarity into the passing-on issue. Some scholars understand it as excluding passing-on defense, others see it as shifting the burden of proof to the defendant, which is obvious in the case of a passing-on defense. Should it be applicable also to the case of offensive use of passing on, that is, when indirect purchasers sue? In the latter case, passing on is a rebuttable presumption and it is up to the cartelist to prove the opposite. *See* Sonja E. KESKE, GROUP LITIGATION IN EUROPEAN COMPETITION LAW. A LAW AND ECONOMICS PERSPECTIVE 237-238 (2010). In Wulff-Henning Roth's view, passing-on defense was not allowed before the 2005 reform of German antitrust laws because indirect purchasers lacked standing (direct-purchaser rule and passing-on defense, that is the Cartel rule, would lead to unjustified relief of the tortfeasor, the antitrust violator). Since after the reform indirect purchasers have standing, the denial of passing-on defense lacks reason. "As German tort law does not accept multiple claims by different parties for one and the same damage, the existence of a passing-on defense has to be accepted." Wulff-Henning Roth, *Private Enforcement of European Competition Law - Recommendations Flowing from the German Experience*, *in* PRIVATE ENFORCEMENT OF EC COMPETITION LAW 61, 76 (Jürgen Basedow ed., 2007).

A. *Systemic coherence problem*

Why are passing-on and indirect standing evergreens of antitrust enforcement? In fact, the passing-on defense and indirect standing in damages are quite unusual. Consider the following example: a pleasant coastal city suffers from an influx of crime due to higher unemployment caused by the fact that a major ammunition factory, the main employer in the city for decades, was shut down during an economic recession. Soon, shoplifting and other minor crimes increase; each year, big supermarkets suffer losses from shoplifting; at one point, the costs of preventing shoplifting surpass the losses resulting from shoplifting and the supermarkets realize that some losses from shoplifting are inevitable; in their annual budgets, supermarkets start counting on the anticipated losses; the amount probably varies little from year to year, given the current rate of unemployment in the city; supermarkets, able to predict the amount to be lost each year, include the amount in their direct costs;[110] it follows that they pass their losses from shoplifting to the customers by increasing prices.

Now, consider that an organized gang of thieves is caught and convicted. The court declares that the gang stole goods of a total value of $100.000 over the course of three years. A group of regular customers of the supermarket sues the gang. They calculate that over the past three years the customer group bought goods for a total value of $200.000, which represents 3% of the value of all goods bought in the supermarket over the past three years. Given that the supermarket passed on the 'overcharge' to all customers in the course of three years, the amount passed on reached $100.000 in total for the activities of the gang.[111] We can suppose that the supermarket diffused the 'overcharge' it passed on into the average shopping basket, passing on more or less the same amount to each of its regular customers. Then we can calculate that to the group 'overcharges' amounting to $3.333 in total were passed on. And yet, we would wonder whether the customers were entitled to sue the gang and recover damages.

Even more striking in such situations is the problem of a passing-on defense. Imagine that after the gang was convicted, the supermarket filed a civil suit to claim damages ($100.000 is surely an amount worth litigation). In their defense, the members of the gang raise the argument that the supermarket passed on the losses to its customers. They claim that, as a result, the supermarket did not suffer any injury and should not be entitled to recover any damages.

Is there a difference between antitrust violations and the scenario just presented? An unlawful behavior (shoplifting) causes considerable damage. The victim directly harmed regularly passes on his losses to the final customers. And yet, it is hard to imagine a court that would allow passing-on defense to the gang of thieves. It is also hard to imagine that the customers' suit against the gang would be successful.

The scenario shows that we do not consider the passing-on issue in most of the tort situations. Presumably, everybody who incurs losses would seek to pass them on further to somebody else and this person would pass them on further yet. The customers in our scenario would try to pass on the 'overcharge' from the supermarket products further down whichever chain they are part of. They will give less pocket money to their children; renegotiate the contract with their gardener; urge their employer to raise their salary; they will decide not to buy a new car, etc. Does this mean that if sued by the customers (the indirect victims) the gang can raise passing-on defense against them as well? Who is then entitled to recover damages: the gardener, the employer, or the car dealer? The possibility of further passing-on is infinite as we are all part of multiple chains, and these chains are in the end circular rather than downstream or upstream. It may happen that no one is actually harmed.

Tort lawyers would argue that the reason why a customer, rather than anybody else in the passing-on chain, is not entitled to recover against the gang of thieves is in the remoteness of the harm; that is, the causal nexus is interrupted. However, the economic analysis suggests that to pass on the losses to somebody else is rather an obvious consequence of one's harm.

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[110] The more products are there on the shelves, the higher the shoplifting, i.e., losses are related to the quantity 'produced' and may be therefore defined as marginal costs.

[111] We can suppose that a price increase due to the passing on of the 'overcharge' does not hurt the competitiveness of the supermarket, because the average annual losses resulting from shoplifting would be similar for the supermarket´s competitors who would also pass on their losses ('overcharge') to their customers.

B. *Methodological coherence problem*

The explanation for the discrepancy between antitrust and general torts lies in the methodology used for their analysis. While economic analysis prevails in the antitrust litigation of both the United States and the European Union, it is less used in other tort litigations (and is virtually nonexistent in the tort litigations in the EU Member States). The methodological superiority of the economic analysis in antitrust civil litigation, which is but part of general torts, is the result of a methodological chain, as already mentioned: competition law regulates the markets; legislation is therefore, at least in theory, devised with the help of economic analysis; the public enforcement of competition law then logically follows this *telos* of competition (antitrust) laws. Civil litigation in antitrust matters, despite being part of general torts, represents a private mirror image of public enforcement. Indeed, in the Commission's view, it is a tool of decentralized enforcement of European Union antitrust law; that view only blurs further the line between public enforcement and private litigation. Scholars almost unilaterally refer to the emerging European Union civil antitrust litigation as 'private enforcement', not as torts or civil litigation. This only underlines the specific nature of the civil litigation of antitrust claims, which is understood as public enforcement by other means, losing most of its private dimension. It is rather closer to privatized public regulation than to general torts.

V. ASSESSMENT AND RECOMMENDATION

A rational actor will seek a way to pass on his losses to someone else. As we are all part of multiple chains that are rather circular, the passing on is likely to be infinite. An important objective of law is to establish the line beyond which passing on becomes legally irrelevant. The line is set, as this article has shown, rather arbitrarily.

An injury is caused at the time when a direct purchaser buys a product from the cartel. It is, from this point onwards, irrelevant what the purchaser-reseller does afterwards in order to limit the harm. He can lay off several employees or raise prices. In litigation, it may be proven that both actions were direct consequences of the cartel overcharge; yet, the court will deal only with the price increase. This shows that the compensation objective is not the key. Why should we compensate the final consumers and not the employees? In which sense am I, as the owner of a flat in a house built from bricks produced by a concrete cartel (about four levels upstream) more harmed than the laid-off employee of the brick manufacturer? It is *not* the aim of antitrust enforcement to compensate all losses. Rather, the *ultimate aim is to limit the social welfare loss* resulting from distorted competition. This is not the same as the deterrence objective of antitrust enforcement. Limiting social welfare loss in antitrust enforcement is superior to its particular objectives: deterrence and compensation. Even if we move the debate from the deterrence versus compensation objectives of antitrust *enforcement* to the level of purpose of antitrust *laws* as such, some scholars argue that the overarching aim of antitrust laws is to limit consumer welfare loss, not the total welfare loss, because antitrust laws were passed to protect consumers.[112] If we accept this, then we have to compromise on the method used in adjudicating antitrust violations. It means that courts should not use economic analysis. The methodological coherence requirement will then dictate avoiding economic analysis also in devising antitrust laws. As this is unacceptable, the economic-efficiency approach (limiting the total welfare loss) needs to remain the main approach of antitrust enforcement. Moreover, as the above analysis has shown, by limiting social welfare loss we achieve both deterrence and compensation, without prioritizing either of the two. These two objectives will be balanced, leading to the highest possible limitation of total social welfare loss from the cartel.

Let me introduce my solution to the passing-on-standing conundrum. Passing on, as this article argues, multiplies the total social welfare loss created by the initial illegal behavior of the

[112] *See*, *e.g.* Robert H. Lande, *Proving the Obvious – The Antitrust Laws Passed to Protect Consumers (Not Just to Increase Efficiency)*, 50 HASTINGS L.J. 959 (1999). Cf. also Hannah L. Buxbaum, *Private Enforcement of Competition Law in the United States – Of Optimal Deterrence and Social Costs*, *in* PRIVATE ENFORCEMENT OF EC COMPETITION LAW 41, 44 (Jürgen Basedow ed., 2007) (claiming that deterrence has emerged as the paramount goal of U.S. private antitrust enforcement).

cartelists. One of the ways to limit social welfare loss resulting from the cartel price-fixing practices is *by limiting the passing on itself*. First, potential plaintiffs need to be motivated to commence antitrust litigation as soon as they discover upstream price-fixing. The enforcement regime ought to prevent any possibility to benefit from delaying the suit. Second, the passing-on defense will be allowed. Given that most of the firms start passing on the cartel overcharge after their first regular evaluation of input costs that leads to re-pricing, it is also the time when they become aware of the possibility of upstream price-fixing. With the availability of passing-on defense, direct purchasers will be prompted to commence an investigation of cartel behavior. Because they will be aware that the damages award will consist of threefold the overcharge that has not been passed on, they will face a choice. Direct purchasers can either to pass on the overcharge and impede the discovery so that they can collect what they lost until the re-pricing decision, and limit investigation and litigation costs. Or, based on the probability of cartel existence, direct purchasers can temporarily absorb the overcharge and later collect threefold of all the overcharges thus absorbed up to the court ruling, which, in the case of successful litigation, will be more than they save through passing on. In sum, in order to limit the total social welfare loss resulting from the existence of cartel, we need to circumscribe the behavior of direct purchaser to pass on the overcharges (increased by markup) to its customers (indirect purchaser). To do so, I suggest allowing passing-on defense.

The next issue is who shall have standing. Landes & Posner convincingly established that direct purchasers are more efficient enforcers and that the indirect-purchaser rule diminishes direct-purchaser incentive to invest in cartel discovery and litigation. One option is what I have called the Pro-Cartel rule, that is to give to direct purchasers exclusive right to sue and allow the passing-on defense. The rule is very problematic. Although it fulfills our aim to prevent passing on by allowing the passing-on defense and it give exclusive right to direct purchasers, it unacceptably protects the cartelists. The previous analysis has shown that direct purchasers may benefit from the cartel. They can decide to collect a small share of the price-fixing scheme through passing on the overcharges increased by markup instead of betting on successful litigation and collecting treble damages in the rather distant future. If their right to sue is exclusive, the only option to stop the cartel is public prosecution, which is expensive, slow, and understaffed. Thus the preferred solution, if the passing-on defense ought to be allowed, is to give standing to indirect purchasers as well.

So far, my solution that best limits the total social welfare loss resulting from the existence of cartel consists of (i) allowing passing-on defense and (ii) giving standing to both direct and indirect purchasers. The last issue is how to keep direct purchasers, who remain the more efficient enforcers, motivated to take the lead in the antitrust enforcement, with indirect-purchaser suits being only subsidiary. Treble damages award presents a sufficient motivation. In connection with permitting the passing-on defense, it gives direct purchasers sufficient incentive to sue the cartel as soon as possible, thus limiting the social welfare loss in several ways. First, it limits the duration of the cartel; second, the multiplication of the welfare loss through passing on of overcharges increased by markup does not occur, or occurs only for the time necessary to gather enough evidence against the cartel; third, it lowers the damages award;[113] and fourth, it is likely to lower the costs of litigation.[114] Though the treble-damages rule is a standard in the United States, provisions that would double[115] or treble the damages need to be enacted in the European Union, so that direct purchasers are compensated for 'losing' the exclusive right to sue and are sufficiently motivated to take a lead in the antitrust enforcement. This solution, which seems to be both doctrinally and politically extremely difficult to accept, must be evaluated in light of the arguments presented in this article. Legislators need to

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[113] Again, the total social welfare loss is limited given that the direct purchaser takes the award as a windfall and does not produce more for the award, while the cartelist's production capacity is not harmed excessively.

[114] We may assume that the shorter the illegal conduct, the less evidentiary material needs to be gathered, and the less time is spent on damages calculation, etc.

[115] The original draft of the Sherman Act provided for double damages. Senator Hoar, who had criticized the double-damages rule as insufficient, proposed the treble-damages rule instead. He did not explain why that multiplication would be adequate. It is believed that the treble rule was taken from the English Statute of Monopolies. LYNN H. PASAHOW, LAWRENCE R. FULLERTON, STEPHEN W. ARMSTRONG, AT EL., TREBLE-DAMAGES REMEDY 18-19 (1986).

understand that by providing for private enforcement of antitrust law they outsource public service to private parties and so the private enforces must be compensated. Scholars and judges need to understand that private antitrust enforcement is a hybrid between public prosecution and civil claims. The twofold or threefold increase of the damages actually caused is a public law payment, and it has little to do with private law doctrines. Every cartel price-fixing affects thousands and thousands of people on a regular basis, something other torts do only exceptionally. Surely, the two antitrust enforcement objectives, deterrence and compensation, need to be balanced. However, both objectives have to lead to the ultimate aim of antitrust enforcement, which is to limit the total social welfare loss resulting from the existence of cartel. The indirect-purchaser rule with passing-on defense and double or treble damages award is the most likely to fulfill that aim.

CONCLUSION

The choice of a passing-on-standing matrix must satisfy both the economic aims of public regulation of competition and the corrective justice aims of general tort law. Antitrust enforcement reflects these aims in its two fundamental objectives: deterrence and compensation. Neither of the two objectives is superior as both must satisfy the ultimate goal of antitrust as such; to limit social inefficiencies resulting from the existence of cartels. The extent of social inefficiencies is measured as the total social welfare loss through the existence of a cartel. The practice of passing on the cartel overcharge from the direct to the indirect purchaser increases the total social welfare loss. The way to restrict passing on the cartel overcharge to the indirect purchaser is to allow passing-on defense. If that is so, then indirect purchasers should be given standing. However, because direct purchasers are the more efficient enforcers, they should be prioritized over the indirect purchasers by giving the former an incentive in the form of double or treble damages awards. Thus, indirect-purchaser suits can remain subsidiary, taking place in the few cases when direct purchasers benefit from the cartel and are unwilling to commence litigation. Doubling or tripling the damages award serves the function of a payment to plaintiffs for performing the public duty of cartel prosecution. The treasury saves a considerable amount by outsourcing most of the enforcement work to private parties. The multiplication of the damages award reflects the public dimension of antitrust and should not be treated from the perspective of private law.