

1-1-1989

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## Repository Citation

Klitzke, Ramon A., "Can Indirect Purchasers Recover Damages Under State Antitrust Laws?" (1989). *Faculty Publications*. Paper 353. <http://scholarship.law.marquette.edu/facpub/353>

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## *Can indirect purchasers recover damages under state antitrust laws?*

by Ramon A. Klitzke

**State of California, et al.**

**v.**

**ARC America Corporation, et al.**  
(Docket No. 87-1862)

*Argument Date: Feb. 27, 1989*

This may prove to be the most significant case of the decade for consumers injured by anticompetitive conduct.

State and federal antitrust laws provide the remedy of money damages to purchasers of goods injured by a seller's anticompetitive conduct. Federal law provides a private treble damages remedy under Section 4 of the Clayton Act, 15 U.S.C. § 15. Many states have similar statutes which antitrust plaintiffs are finding increasingly attractive.

A product typically passes through a chain of distribution before reaching the ultimate consumer. A direct purchasing middleman will resell a product to another purchaser who thereby becomes an indirect purchaser "downstream" from the original seller. A direct purchaser paying more than the competitive price to a member of an illegal price-fixing cartel has clearly suffered a compensable antitrust injury.

An indirect purchaser, separated from the antitrust violator by at least one reseller, has also been injured. But indirect damages are uncertain unless the resale was under a "pre-existing, fixed quantity, cost-plus contract," thus passing the injury on intact to the indirect purchaser. Although the indirect purchaser is clearly damaged to some degree even when all direct damages are not passed on to the indirect purchaser as such, the Supreme Court has denied damages to indirect purchasers. *Illinois Brick v. Illinois*, 431 U.S. 720, 736 (1977).

Unlike Section 4 of the Clayton Act, 13 states and the District of Columbia provide statutory remedies for indirect injury caused by anticompetitive conduct. In *California v. ARC America Corp.* the Court has an opportunity to decide whether these statutes, which permit indirect purchasers to sue for damages, are preempted under the supremacy clause of the U.S. Constitution.

### ISSUES

1. Does the supremacy clause preclude a state from autho-

- rizing a state antitrust remedy for indirect purchasers?
2. Does the federal statutory remedy for direct purchasers bar a state from authorizing a remedy for indirect purchasers?

### FACTS

In the 1970's, the Antitrust Division of the Arizona Attorney General's Office uncovered evidence of a national conspiracy among cement manufacturers to fix and stabilize prices in the face of declining demand and excess capacity. Agreements governed virtually every aspect of the manufacture and sale of cement and cement products, ranging from the rate of return to be received by the industry and the formula for calculating transaction prices, to the standardization of credit terms, product specifications and even such trivial details as night-time unloading allowances.

Beginning in September of 1976, the states of Arizona, California, Minnesota and Alabama filed complaints against a number of cement manufacturers and their trade association, alleging a conspiracy in violation of the Sherman Act, 15 U.S.C. § 1, and seeking damages, injunctive relief, attorney fees and costs. The plaintiffs also alleged violations of each of their state laws and included claims for damages based on indirect purchases of cement.

Private plaintiffs filed "tag-along" complaints based on Arizona's investigation and filing. A total of 35 lawsuits were filed in 12 federal district courts. By 1980, all of the complaints had been transferred to the Arizona federal district court. The state law claims were transferred and consolidated with the federal claims under the court's pendent jurisdiction.

By October 1981, settlements had been agreed upon totaling \$32 million in cash plus 135,000 shares of stock in one of the defendant companies. The district court approved a plan for distributing the settlement fund in proportion to the amount of cement purchases. The distribution of the settlement fund is the subject of this appeal to the Supreme Court.

The district court refused to allow payments out of the settlement fund for claims based on state indirect-purchaser statutes. The judge held that state downstream-purchaser statutes "are clear attempts to frustrate the purposes and objectives of Congress, as interpreted by the Supreme Court in *Illinois Brick*, and, accordingly, are preempted by federal law."

On appeal, the U.S. Court of Appeals for the 9th Circuit affirmed, holding that state indirect-purchaser statutes imper-

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missibly interfere with policies behind the federal antitrust laws and are therefore preempted. The court concluded that "state law claims in this case based on indirect purchases of cement that do not fall within any exception to the rule of *Illinois Brick* are preempted because they stand 'as an obstacle to the accomplishment of the full purposes and objectives' of federal antitrust law." *In Re Cement and Concrete Antitrust Litigation*, 817 F.2d 1435, 1447 (9th Cir. 1987).

The states of Alabama, Arizona, California and Minnesota have appealed to the Supreme Court. They seek to reach into the settlement fund to recover damages as indirect purchasers of cement and cement-containing products. The ARC American Corporation was a direct purchaser of cement from the defendants who settled and was a member of one of the designated classes entitled to a share of the settlement fund.

### BACKGROUND AND SIGNIFICANCE

The history of antitrust jurisprudence is rich with state antitrust regulation. States have enjoyed crucial roles throughout the arena of antitrust development. Early in the 19th century, a number of states undertook common-law and statutory prosecutions for conspiracies in restraint of trade. State antitrust activity greatly increased at the turn of the century as new collective business arrangements proliferated by the thousands, and economic concentration increased substantially. Prior to the enactment of the Sherman Act in 1890, 15 U.S.C. §§ 1-7, at least 14 state constitutions had antimonopoly provisions. By 1915, at least 35 states had their own antitrust legislation.

When enacting the Sherman Act, Congress expressed a clear intent that the federal law supplement, and not inhibit, state activity aimed at suppression of restraints of trade and monopolies:

Whatever legislation Congress may enact on this subject, within the limits of its authority, will prove of little value unless the States shall supplement it by such auxiliary and proper legislation as may be within their legislative authority.

H. R. Rep. No. 1707, 51st Cong., 1st Sess. 1 (1890).

The intent of Congress to leave state antitrust enforcement intact resulted, of course, in antitrust enforcement at both federal and state levels.

After the turn of the century, federal prosecution of antitrust cases increased dramatically despite persistent opposition. However, for three decades after the adoption of the Sherman Act, state antitrust efforts complemented federal law in responding to problems of industrial combination, collusion and predation. See *May, Antitrust Practice and Procedure in the Formative Era*, 135 Penn.L.Rev. 495, 592 (1987). Eventually state enforcement actions were vastly outnumbered by federal cases, but the body of state antitrust law continued to influence antitrust jurisprudence. Federal judges struggling to develop federal antitrust law often relied on pertinent state opinions.

Expansion of state antitrust law encountered determined opposition, however. State regulation was repeatedly at-

tacked as violative of the commerce clause of the U.S. Constitution. Debate on the constitutionality of state antitrust power centered on the effect of state law beyond a state's borders. Federal and state courts held that states could no longer constitutionally regulate activities that were in interstate commerce or had an effect on interstate commerce.

For a half-century after enactment of the Sherman Act, the magnitude and relative significance of state antitrust activity gradually declined. State laws were limited to local anticompetitive restraints; restraints that affected interstate commerce were prosecuted under federal law.

This has all changed in the past 20 years. The Supreme Court now upholds state antitrust laws. The cases now hold that such laws do not interfere with the interstate flow of goods and do not discriminate against interstate commerce.

Since the early 1970's, the Supreme Court has gradually restricted the scope of federal antitrust liability. The federal courts, largely influenced by the work of the "Chicago School" of economics, have decided cases that reduce the importance of federal antitrust law. State courts and state attorneys general, on the other hand, have not widely embraced the "Chicago School" theory. To fill the void left by the federal courts, states have broadened the scope of their antitrust laws and many plaintiffs now choose state courts as their forums. State antitrust law may be enforced against antitrust violations that occur anywhere in the nation, provided that there are sufficient harmful effects within the state itself. However, where the federal and state statutes are inconsistent or provide different remedies, further aggressive enforcement under state antitrust law could create chaos in the federal-state antitrust scheme.

Under the supremacy clause, federal law preempts state law when (1) Congress evidences an intent to occupy a given field, or (2) the state law actually conflicts with federal law, that is, when it is impossible to comply with both state and federal law "or where the state law stands as an obstacle to the accomplishment of the full purposes and objectives of Congress." *Silkwood v. Kerr-McGee Corp.*, 464 U.S. 238, 248 (1984).

There is no tradition of preemption by federal antitrust law. Even state statutes contrary to the policies of the Sherman Act have been upheld. Because of the original congressional intent to maintain a two-tiered antitrust enforcement system, the Supreme Court has been extremely reluctant to hold that state antitrust laws have been preempted by federal law. To show preemption of state antitrust law, it is not sufficient to merely assert that federal law occupies the field. The Supreme Court has held that preemption will be found only if there is clear evidence of actual conflict, which requires that compliance with the state law would force the defendant to disobey the federal law. See *Exxon Corp. v. Governor of Md.*, 437 U.S. 117, 130 (1978).

The instant case, *California v. ARC America Corporation*, forces the Supreme Court to decide the extent to which state antitrust statutes may supplement federal statutes. The Court must decide whether the existence of a federal remedy

under Section 4 of the Clayton Act precludes the states from authorizing a remedy for indirect victims injured by anticompetitive conduct that is condemned by both federal and state law. The Court must determine whether state remedial provisions reduce or impair the effectiveness of the treble damages provision of the Clayton Act.

Critical to the decision in this case will be the Court's reading of *Hanover Shoe Inc. v. United Shoe Machinery Corp.*, 392 U.S. 481 (1968), and *Illinois Brick v. Illinois*, 431 U.S. 720 (1977).

In *Hanover Shoe* the Supreme Court held that a defendant in an antitrust suit cannot assert as a defense that the plaintiff did not suffer damages because the plaintiff passed the defendant's illegal overcharges on to the plaintiff's customers (the indirect purchasers). The Court rejected this defense because proving the amount of a passed-on overcharge "would often require additional long and complicated theories." 392 U.S. at 493. *Hanover Shoe* was greeted generally with approval. It reduced plaintiffs' costs of litigating a price-fixing case by eliminating the need to fight a defendant's passing-on claim.

The *Illinois Brick* decision brought forth a flood of protests and became, perhaps, the single most significant legal reason for the declining number of antitrust lawsuits in federal courts. In *Illinois Brick*, the Supreme Court reaffirmed the holding of *Hanover Shoe* and then went on to hold that indirect purchasers are not entitled to recover treble damages against antitrust violators under Section 4 of the Clayton Act, except in special circumstances.

The defendant manufacturers and distributors in *Illinois Brick* conspired to fix the price of concrete block in the Greater Chicago area at an artificially high level in violation of the Sherman Act, 15 U.S.C. § 1. The masonry contractors who purchased the block passed on the resulting overcharge to the general contractors in the form of higher prices for masonry structures. The plaintiffs were injured when these general contractors, in turn, incorporated this overcharge into the prices charged to the plaintiffs for the completed buildings. However, the Court held that indirect damages were not available to them. Many cases have elaborated on the decision and have created some exceptions to the rule. Areeda & Hovenkamp, *Antitrust Law*, Sec. 337.2 (Supp. 1988).

Newspaper editorials called *Illinois Brick* unjust to consumers. More than a dozen state statutes were amended to provide that injured indirect purchasers could recover under state law. Bills designed to overturn the *Illinois Brick* rule were introduced in at least four sessions of Congress. A number of articles in academic and professional journals have argued that indirect purchasers should have standing to sue for damages. A thorough article on the benefits and costs of changing the *Illinois Brick* rule has been published by George J. Benston: *Indirect Purchasers' Standing to Claim Damages in Price Fixing Antitrust Actions: A Benefit/Cost Analysis of Proposals to Change the Illinois Brick Rule*, 55 *Antitrust L.J.* 213 (1986).

Although *Illinois Brick* stands for the general proposition that indirect purchasers are barred from recovery under Section 4 of the Clayton Act, the question remains whether the rationale of *Illinois Brick* will preclude states from providing remedies for those indirectly injured by anticompetitive conduct under state law. See Note, *Indirect Purchaser Suits Under State Antitrust Laws: A Detour Around the Illinois Brick Wall*, 34 *Stanford L.Rev.* 203 (1981).

Together *Hanover Shoe* and *Illinois Brick* define three objectives of federal antitrust law in the context of the present case: (1) avoiding unnecessarily complex litigation; (2) providing incentives to direct purchasers to bring private damages actions; and (3) avoiding multiple liability for defendants. The Supreme Court will now have an opportunity to decide whether these objectives outweigh the rights of states to provide state remedies for indirect purchasers.

In *California v. ARC America Corp.*, the Supreme Court could decide to limit the power of the states to provide independent antitrust remedies that supplement federal remedies. On the other hand, some commentators find no inexorable trend toward greater federal intrusion into state antitrust regulation. Many recent cases reflect an increasing deference toward state regulation. See Garland, *Antitrust and State Action*, 96 *Yale L.J.* 486 (1987). A number of commentators argue that state statutes that provide remedies for indirect purchasers should not be preempted by the federal antitrust laws. See Note, *State Indirect Purchaser Statutes: The Preemptive Power of Illinois Brick*, 62 *Boston U.L.Rev.* 1241 (1982).

In *California v. ARC America Corp.*, the Supreme Court must carefully consider what it means to say that federal and state antitrust laws are designed to reinforce and supplement each other. See Hovenkamp, *State Antitrust in the Federal Scheme*, 58 *Ind. L.J.* 375, 404 (1983). States are entitled to their own antitrust laws, even if they differ from federal law.

The Supreme Court is unlikely to overrule the *Illinois Brick* case in *California v. ARC America Corp.* The states have not asked for this. Should the Court decide that indirect purchasers may get damages under state statutes, the Court would find this to be an exception to the *Illinois Brick* rule. Such a result would benefit thousands of consumers who are injured because of upstream antitrust violations.

## ARGUMENTS

***For the States of California, Alabama, Arizona and Minnesota (Counsel of Record, Thomas Greene, Supervising Deputy Attorney General, State of California, 1515 K St., Suite 511, Sacramento, CA 95814; telephone (916) 324-7874):***

1. State protection of downstream victims of anticompetitive conduct is an appropriate and lawful exercise of traditional state police power.
2. The legislative record of the federal antitrust laws unequivocally supports the validity of the remedial provisions of the states' laws.
3. The remedial provisions of the states' antitrust laws do not

conflict with the federal enforcement scheme.

4. The remedial provisions of the states' laws advance important congressional purposes.
5. The downstream-purchaser remedies of the states' laws properly supplement federal antitrust law.

**For ARC America Corporation** (*Counsel of Record, Theodore B. Olson and Phillip H. Rudolph, 1050 Connecticut Ave., N.W., Washington, DC 20036; telephone (202) 955-8500*):

1. State statutes are preempted by federal law when they stand as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.
2. The Supreme Court in *Illinois Brick* concluded that Congress' principal purpose in enacting Section 4 of the Clayton Act was not to make victims whole, but to encourage private enforcement of the federal antitrust laws.
3. The 9th Circuit properly held that the indirect-purchaser statutes at issue in this case stand as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.
4. Congressional silence does not support an inference that Congress intended to allow the states to enact antitrust laws that present an obstacle to the accomplishment and execution of the goals of the federal antitrust laws.

**For Class Members Allied Concrete, et al.** (*Counsel of Record, David J. Leonard, P. O. Box 191, 155 West Council St., Tucson, AZ 85702; telephone (602) 622-7733*):

1. Indirect-purchaser sharing in the settlement fund would require a new, incredibly complex and expensive round of litigation.

#### **AMICUS BRIEFS**

***In Support of the States of California, Alabama, Arizona and Minnesota***

Five separate amicus briefs were filed on behalf of the states. In one brief, the U.S. Department of Justice argued that Congress did not preempt state statutes affording damage remedies to indirect purchasers because it did not intend to interfere with the broad authority of the states to enact and

enforce antitrust laws in aid of their police powers. Such laws do not irreconcilably conflict with federal law.

Thirty-five states and the District of Columbia filed a brief arguing that Congress has implicitly validated state indirect-purchaser statutes by sanctioning the District of Columbia's antitrust act. Also, traditional state police powers are not preempted unless Congress exhibits a clear and manifest purpose to preempt them.

Twenty of the above states filed a brief arguing that *Hanover Shoe* and *Illinois Brick* did not state the purposes and objectives of Congress embodied in Section 4 of the Clayton Act.

The National Conference of State Legislatures, the National League of Cities, the National Governors' Association, the U.S. Conference of Mayors, the Council of State Governments, the International City Management Association and the National Association of Counties filed a collective brief arguing that the decision of the 9th Circuit in this case was contrary to the Rules of Decision Act, 28 U.S.C. § 1652. That Act directs that the laws of the several states, except where the U.S. Constitution or statutes otherwise require, are the rules of decision in civil actions in U.S. courts.

The Consumers Union of the United States argued that allowing indirect purchasers to recover damages caused by monopoly overcharges is consistent with sound antitrust policy.

#### ***In Support of ARC America Corporation***

Three amicus curiae briefs supported ARC America. The Business Roundtable argued that experience with state indirect-purchaser statutes demonstrates that they undermine federal antitrust policy.

The Chamber of Commerce of the United States argued that the state indirect-purchaser statutes' inevitable impairment of the federal treble damages scheme dictates preemption of such statutes under accepted supremacy clause principles.

Finally, the National Association of Manufacturers argued that federal antitrust policy prohibits multiple liability in suits by direct and indirect purchasers and therefore state indirect-purchaser statutes are preempted.