Limiting a Regulated Pass-On Exception to Illinois Buick

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LIMITING A REGULATED PASS-ON EXCEPTION TO ILLINOIS BRICK

Under section 4 of the Clayton Act1 (the "Act"), any person injured by an antitrust violation may sue and, if successful, may be entitled to treble damages, costs, and reasonable attorneys' fees.2 Despite the broad language of the Act,3 the courts have refused to extend treble damages to every ripple of injury caused by antitrust violations4 and have developed three doctrines limiting the right to sue: antitrust standing,5 the antitrust injury doctrine,6 and, the fo-

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3 See Associated Gen. Contractors v. California State Council of Carpenters, 459 U.S. 519, 529 (1983); Berger & Bernstein, An Analytical Framework for Antitrust Standing, 86 YALE L.J. 809, 810 (1977). In Associated General Contractors, the Supreme Court recognized that if section 4 of the Clayton Act were interpreted literally, it would allow recovery for all direct and indirect consequences of antitrust violations. 459 U.S. at 529.
4 Hawaii v. Standard Oil Co., 405 U.S. 251, 263 n.14 (1972). See generally R. Bork, The Antitrust Paradox 50-71 (1978) (discussing congressional goals of antitrust legislation). The Court in Standard Oil noted that "[t]he lower courts have been virtually unanimous in concluding that Congress did not intend the antitrust laws to provide a remedy in damages for all injuries that might conceivably be traced to an antitrust violation." 405 U.S. at 263 n.14. The Supreme Court has repeatedly taken this position. See, e.g., Associated Gen. Contractors, 459 U.S. at 534-35 (union denied recovery for lost dues after antitrust violation caused membership to decline); Blue Shield v. McCready, 457 U.S. 465, 477 (1982) ("Congress did not intend to allow every person tangentially affected by an antitrust violation to maintain an action to recover treble damages for the injury to his business or property.").
5 See Amey, Inc. v. Gulf Abstract & Title, 758 F.2d 1486, 1493-97 (11th Cir. 1985), cert. denied, 475 U.S. 1107 (1986); Berger & Bernstein, supra note 3, at 813-45. Traditionally, antitrust standing has been measured by the "direct injury" rule whereby an antitrust injury is actionable only if it has been proximately caused by the defendant's alleged anticompetitive behavior. Id. at 813; see, e.g., Loeb v. Eastman Kodak Co., 183 F. 704, 709 (3d Cir. 1910). In this sense, antitrust standing is distinguishable from constitutional standing, which centers on the injury rather than its cause. See Associated Gen. Contractors, 459 U.S. at 535 n.31. In developing a test for antitrust standing, the Court has utilized a balancing approach weighing such factors as causation, intent to cause harm, nature of the injury,
cur of this Note, the direct purchaser rule of Illinois Brick Co. v. Illinois. 7

In Illinois Brick, the United States Supreme Court held that only direct purchasers from price-fixers could sue for a section 4 recovery even though others further in the chain of distribution may have had the overcharges “passed on” 8 to them through reactive rate increases by the direct purchasers. 9 While the Court recognized the potential harshness of its ruling 10 and rejected attempts by the indirect purchasers to carve out exceptions for particular market situations, 11 it expressly recognized two other situations which might constitute exceptions to the general direct purchaser rule. 12

One of the express possible exceptions to the rule of Illinois Brick is when overcharges are passed on to the indirect purchaser through a pre-existing cost-plus contract which fixes both price and quantity, thus protecting the direct purchaser from a potential
directness or indirectness of the injury in the chain of causation, and the difficulty of accurately gauging the damages in a reasonable time and with reasonable cost. Id. at 536-45.

Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc., 429 U.S. 477, 489 (1977); see Page, Antitrust Damages and Economic Efficiency: An Approach to Antitrust Injury, 47 U. Chi. L. Rev. 467, 467-72 (1980). In Brunswick, the Supreme Court established the requirement that to collect section 4 treble damages antitrust “[p]laintiffs must prove antitrust injury, which is to say injury of the type the antitrust laws were intended to prevent and that flows from that which makes defendants’ acts unlawful.” 429 U.S. at 489. The doctrine of antitrust injury, while similar to antitrust standing, has been described as a hurdle that must be overcome before the court will employ the standing analysis. See Page, supra, at 497.

Illinois Brick, 431 U.S. 720 (1977); see infra notes 23-34 and accompanying text (description of direct purchaser rule of Illinois Brick). The Supreme Court in Illinois Brick expressly stated that its decision was not founded on the issue of standing. 431 U.S. at 728 n.7. At least two commentators have questioned the accuracy of this disclaimer and have treated Illinois Brick as merely a subcategory of standing. See Berger & Bernstein, supra note 3, at 811 n.8.

“Pass-on” is a term of art describing the process by which direct purchasers who are victims of a seller’s anticompetitive prices channel part or all of the antitrust injuries they suffer on to the next purchaser by charging a higher price for the goods. See Cavanagh, Illinois Brick Revisited: An Analysis of a Developing Antitrust Jurisprudence, 17 Val. U.L. Rev. 63, 64 n.5 (1983). “Pass-on” is also used to describe the actual injury absorbed by indirect purchasers. “Offensive pass-on” refers to the theory by which indirect purchasers who have suffered pass-on injuries claim a cause of action against antitrust defendants. See, e.g., Illinois Brick, 431 U.S. at 726-27. “Defensive pass-on” refers to the theory by which antitrust defendants claim that plaintiffs cannot recover for injuries which they have transferred further along the chain of distribution. See, e.g., Hanover Shoe, Inc. v. United Shoe Mach. Corp., 392 U.S. 481, 487-88 (1968).


See id. at 746.

Id. at 743-45; see infra note 46 (discussing exceptions rejected by Illinois Brick).

Illinois Brick, 431 U.S. at 736 & n.16, 745; see infra notes 13-15 and accompanying text.
drop in price or volume of indirect sales due to the price-fixing. The Court explained that under this type of contract the pass-on is predetermined "without reference to the interaction of supply and demand" which normally complicates matters. The other possible exception announced by the Illinois Brick Court is when the indirect purchaser owns or controls the direct purchaser, which the Court characterized as "[a]nother situation in which market forces have been superseded." If, as some circuits have suggested, these express possible exceptions to the Illinois Brick rule are not exclusive, then a question arises whether a pass-on that is mandated

13 Illinois Brick, 431 U.S. at 736. While recognizing the "pre-existing cost-plus contract" from Hanover Shoe, Inc. v. United Shoe Machinery Corp., 392 U.S. 481, 494 (1968), the Illinois Brick Court clearly indicated that it viewed such contracts, for the purpose of the exception, as containing a "fixed quantity." Illinois Brick, 431 U.S. at 736. The Court stated:

In such a situation, the purchaser is insulated from any decrease in its sales as a result of attempting to pass on the overcharge, because its customer is committed to buying a fixed quantity regardless of price. The effect of the overcharge is essentially determined in advance, without reference to the interaction of supply and demand that complicates the determination in the general case. Id.

This exception has been widely accepted and has become the subject of much litigation, see, e.g., Jewish Hosp. Ass'n v. Stewart Mechanical Enters., 628 F.2d 971, 975-77 (6th Cir. 1980), cert. denied, 450 U.S. 966 (1981); Mid-West Paper Prods. Co. v. Continental Group, 596 F.2d 573, 578-80 (3d Cir. 1979), particularly in regard to the "fixed quantity" element of the exception. See infra note 16 (discussing "functional equivalency" debate).

14 Illinois Brick, 431 U.S. at 736.

15 Id. at 736 n.16. Lower courts have accepted this possible exception but applied it narrowly. See, e.g., Jewish Hosp. Ass'n, 628 F.2d at 975 (court established functional unity standard); In re Toilet Seat Antitrust Litig., 1977-2 Trade Cas. (CCH) ¶ 61,601, at 72,496-97 (E.D. Mich. 1977) (exception applied when indirect purchaser utilized agent to procure goods).

16 See, e.g., Royal Printing Co. v. Kimberly-Clark Corp., 621 F.2d 323, 326 n.4 (9th Cir. 1980) (Illinois Brick's express possible exception for cost-plus contract is "only illustrative"); In re Beef Indus. Antitrust Litig., 600 F.2d 1148, 1163 (5th Cir. 1979) (cost-plus contract exception can apply to functionally equivalent situations), cert. denied, 449 U.S. 905 (1980); In re Mid-Atlantic Toyota Antitrust Litig., 516 F. Supp. 1287, 1293 & n.14 (D. Md. 1981) ("highly unlikely" for Supreme Court in dicta to list every possible exception to rule). In In re Beef Industry, the Fifth Circuit created an exception for the "functional equivalent" of a fixed-quantity pre-existing cost-plus contract when the direct purchaser passes on an overcharge through a longstanding, rigidly-applied formula in an inelastic market—conditions which it believed to be similarly uninfluenced by market dynamics. 600 F.2d at 1163-67; see also Note, Scaling the Illinois Brick Wall: The Future of Indirect Purchasers in Antitrust Litigation, 63 CORNELL L. REV. 309, 330 & n.93 (1978) (suggesting functional equivalency). But see In re Beef Indus. Antitrust Litig., 1982-2 Trade Cas. (CCH) ¶ 64,815, at 72,049 (N.D. Tex. 1982) (on remand, plaintiffs unable to prove their case); Cavanagh, supra note 8, at 80-92 (in depth criticism of In re Beef Industry's functional equivalency); infra notes 50-55 and accompanying text (criticizing functional equivalency).

Other exceptions have also been litigated. More common than the "control" exception
by law—a so-called "regulated pass-on"—may create situations where market dynamics are suspended and the direct purchaser rule is inapplicable.\(^\text{17}\)

suggested in *Illinois Brick*, 431 U.S. at 736 n.16, is the situation in which the indirect purchaser alleges that the antitrust defendant controls the direct purchaser. See, e.g., *Royal Printing Co.*, 621 F.2d at 324, 326 (indirect purchaser buying through subsidiary or division of defendant); *Beckers v. International Snowmobile Indus.*, 581 F.2d 1308, 1310 (8th Cir. 1978) (indirect purchasers claimed manufacturers, distributors, and trade association controlled sales practices of retailers), *cert. denied*, 440 U.S. 986 (1979); *In re Sugar Indus. Antitrust Litig.*, 579 F.2d 13, 18-19 (3d Cir. 1978) (purchase through subsidiary of defendant). When the indirect purchaser claims the overcharge has passed through an innocent intermediary controlled by the defendant, the degree of control must be such that the transaction from defendant to subsidiary to indirect purchaser can be deemed one sale. See *Jewish Hosp. Ass'n*, 628 F.2d at 975 (functional unity test); see also *Mid-West Paper*, 596 F.2d at 589 (domination by parent corporation must be proven even when middleman is subsidiary).

Indirect purchasers after *Illinois Brick* have also sued for treble damages under the "co-conspirator" or "vertical conspiracy" theory, whereby the direct purchaser is alleged to have conspired with the antitrust defendant. See *Link v. Mercedes-Benz of N. Am.*, 788 F.2d 918, 929 (3d Cir. 1986). Since this theory may be easily abused to circumvent *Illinois Brick*, most courts require the alleged co-conspirator to be a named party before the indirect purchaser can assert a vertical conspiracy. See *id.* at 931-33; *In re Petroleum Prods. Antitrust Litig.*, 691 F.2d 1335, 1342 (9th Cir. 1982), *cert. denied*, 464 U.S. 1068 (1984). But see *Fontana Aviation, Inc. v. Cessna Aircraft Co.*, 617 F.2d 478, 479, 481 (7th Cir. 1980) (vertical conspiracy theory valid without co-conspirator as named party). Although the vertical conspiracy is called an "exception" by the courts, technically it does not involve pass-on damages because the so-called "indirect purchaser" is the party directly injured by the antitrust violation. *Arizona v. Shamrock Foods Co.*, 729 F.2d 1208, 1211 (9th Cir. 1984), *cert. denied*, 469 U.S. 1197 (1985); see *In re Wyoming Tight Sands Antitrust Cases*, 695 F. Supp. 1109, 1117 (D. Kan. 1988), *aff'd*, Nos. 88-2158, 88-2159 (10th Cir. Jan. 31, 1989) (LEXIS, Genfed library, Usapp file). For a general discussion of the "co-conspirator" exception, see Cavanagh, *supra* note 8, at 95-98.

Additionally, the rule of *Illinois Brick* may be avoided by assignment of the direct purchaser's claim to the indirect purchaser to whom antitrust injury has been passed. See *In re Fine Paper Litig.*, 632 F.2d 1081, 1089-90 (3d Cir. 1980). A question also exists as to whether *Illinois Brick* applies to state antitrust laws as well as section 4 federal claims. See Cavanagh, *The Illinois Brick Dilemma: Is There a Legislative Solution?*, 48 ABA J. Rev. 273, 308-10 (1984) [hereinafter Cavanagh, *Legislative Solution*] (problems of state legislation contrary to *Illinois Brick*). Compare *Alton Box Bd. Co. v. Esprit de Corp.*, 682 F.2d 1267, 1273-74 (9th Cir. 1982) (state claims may survive) and *In re Sugar Antitrust Litig.*, 588 F.2d 1270, 1273 n.6 (9th Cir. 1978) (indirect purchasers may have legitimate state antitrust law actions when barred from federal forum by *Illinois Brick*), *cert. denied*, 441 U.S. 932 (1979) with *In re Cement & Concrete Antitrust Litig.*, 817 F.2d 1435, 1446 (9th Cir. 1987) (*Illinois Brick* preempts indirect purchasers from state claims except, possibly, when state action accrues after federal statute of limitations has expired), *prob. juris. noted sub nom.* California v. ARC Am. Corp., 109 S. Ct. 51 (1988). The Supreme Court, upon appeal of California and the attorneys general of twenty states, has recently agreed to determine whether such state laws are federally preempted. California v. ARC Am. Corp., 109 S. Ct. 51 (1988).

\(^{17}\) See, e.g., *In re Wyoming Tight Sands Antitrust Cases*, Nos. 88-2158, 88-2159 (10th Cir. Jan. 31, 1989) (LEXIS, Genfed library, Usapp file) ("most or all" of alleged inflated inflated
This Note will address the effect of the *Illinois Brick* rule on indirect purchasers from utilities and other regulated industries. Initially, the Note will discuss the broad policies which underlie the Supreme Court's decision in *Illinois Brick*. It will then examine the exclusivity of the express possible exceptions in *Illinois Brick*. Finally, it will evaluate the merits of a regulated pass-on exception to the *Illinois Brick* doctrine when a regulated industry, by virtue of statutory mandate, passes on antitrust damages to its customers.

**Policies Underlying *Illinois Brick***

Almost a decade before *Illinois Brick* was decided, the Supreme Court laid the foundation for pass-on jurisprudence in *Hanover Shoe, Inc. v. United Shoe Machinery Corp.*, which rejected the "defensive" use of pass-on theories by antitrust defendants who claim that section 4 plaintiffs are not entitled to treble damages for injuries passed on to their customers. The *Hanover Shoe* Court feared that preventing direct purchasers from suing for the entire overcharge would both burden antitrust proceedings with complex fact determinations and allow antitrust violators to ef-

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19 Id. at 487-89. In *Hanover Shoe*, a manufacturer of machines for producing shoes monopolized the market through a "lease only" policy whereby plaintiffs, shoe manufacturers, became dependent on machines they could not buy. *Id.* at 486-87. The defendants claimed that the shoe manufacturers were able to recoup their losses by charging their customers more for the shoes and, thus, did not suffer injury to the extent of the recovery. *Id.* at 487-88. The Court, however, indicated that the plaintiff's actions to recover loss after the injury were irrelevant and referred to the words of Justice Holmes: "The general tendency of the law, in regard to damages at least, is not to go beyond the first step." *Id.* at 490 & n.8 (quoting Southern Pac. Co. v. Darnell-Taenzer Lumber Co., 245 U.S. 531, 533 (1918)); see also Carter v. Berger, 777 F.2d 1173, 1174-75 (7th Cir. 1985) (analogizing to *Hanover Shoe* in denying pass-on of RICO's treble damages). Therefore, although the plaintiff may have been able to pass on his injury to his customers, the Court was unwilling to accept this as a defense for the defendant causing the injury. *Hanover Shoe*, 392 U.S. at 489.
20 392 U.S. at 492-93. In addition to the burden of "long and complicated proceedings involving massive evidence and complicated theories," the Court believed that the inadequacies of classroom economics applied to the real world would "normally prove insur-
effectively escape liability when the illegal overcharges have been passed on by victims of antitrust violations to parties with claims too minor to prosecute.\textsuperscript{21} Therefore, in order to prevent antitrust defendants from short-circuiting section 4 treble damage actions, the Court held that the pass-on defense is invalid except possibly for "situations," such as the pre-existing cost-plus contract, in which it is "easy to prove" that the direct purchaser has not been damaged and the underlying policy barring the defensive use of pass-on theories is inapplicable.\textsuperscript{22}

In \textit{Illinois Brick}, indirect purchasers attempted to use the pass-on theory "offensively" to recover treble damages for injuries passed on to them through cost-based construction bids.\textsuperscript{23} Relying heavily on the precedent it had set down in \textit{Hanover Shoe},\textsuperscript{24} the Court held that judicial consistency required barring indirect pur-

\textsuperscript{21} Id. at 494. In the case before the Court, the pass-on defense could have potentially been used against the entire chain of commerce, leaving only the final purchasers of the shoes with small, but valid, claims. \textit{Id.} The Court felt that the small size of the claims would fail to spur a class action and the antitrust violators would keep "the fruits of their illegality" without anyone willing or able to sue them. \textit{Id.; see infra} note 34 (discussing ineffectiveness of class actions in compensating antitrust victims).

\textsuperscript{22} \textit{Hanover Shoe}, 392 U.S. at 494.

\textsuperscript{23} \textit{Illinois Brick}, 431 U.S. at 726-27. The State of Illinois, acting on the behalf of itself and several local governmental entities, brought suit against manufacturers of concrete block. \textit{Id.} According to the state's pass-on theory, masonry contractors passed on the overcharge by basing their bids on the manufacturer's illegally inflated price, and the general contractors passed this on to the plaintiffs by basing their bids on the inflated bids of the masonry contractors. \textit{Id.} From the portions of the opinion rejecting the plaintiffs' argument, it can be inferred that the bidding process involved cost-based pricing. \textit{See id.} at 744.

Prior to the \textit{Illinois Brick} decision, courts differed on the question of whether indirect purchasers were barred by \textit{Hanover Shoe} from suing antitrust violators. \textit{Compare} \textit{In re Western Liquid Asphalt Cases}, 487 F.2d 191, 198-99 (9th Cir. 1973) (indirect purchasers may sue), \textit{cert. denied}, 415 U.S. 919 (1974) with \textit{Donson Stores, Inc. v. American Bakeries Co.}, 58 F.R.D. 481, 484-85 (S.D.N.Y. 1973) (indirect purchasers barred from suit by \textit{Hanover Shoe}).

\textsuperscript{24} \textit{Illinois Brick}, 431 U.S. at 736-37. According to the Court, "considerations of \textit{stare decisis} weigh heavily in the area of statutory construction, where Congress is free to change this Court's interpretation of its legislation." \textit{Id.} at 736; \textit{see also} \textit{Square D Co. v. Niagara Frontier Tariff Bureau}, 476 U.S. 409, 424 n.34 (1986) (quoting \textit{Illinois Brick}); \textit{Copperweld Corp. v. Independence Tube Corp.}, 467 U.S. 752, 784 (1984) (Stevens, J., dissenting) (same). Although both \textit{Illinois Brick} and \textit{Hanover Shoe} interpret the scope of section 4 of the Clayton Act, neither decision is based on the language of the Act, which literally would grant treble damages for any consequential harm. \textit{See supra} notes 1 & 3 and accompanying text. Rather, since \textit{Hanover Shoe} was largely based on policy, \textit{Illinois Brick} in effect adopted its policy rationale. In light of the \textit{Illinois Brick} Court's reliance on Congress to correct any misunderstanding by the Court, \textit{id.} at 736, it is interesting to note that several congressional efforts to reverse the impact of the \textit{Illinois Brick} direct purchaser rule have been unsuccessful. \textit{See Cavanagh, Legislative Solution, supra} note 16, at 290-307.
chasers from using the theory of pass-on offensively when *Hanover Shoe* would prevent the defendants from using the doctrine defensively in an action by direct purchasers.\textsuperscript{26} Permitting offensive pass-on while prohibiting defensive pass-on could potentially lead to "sixfold or more damages" because antitrust violators would be exposed to possible multiple recovery for the same injury and to potential inconsistent judgments from separate lawsuits.\textsuperscript{26} Furthermore, as with defensive pass-on,\textsuperscript{27} determinations of offensive pass-on would tangle trial courts in the excessively complex questions of

\textsuperscript{26} *Illinois Brick*, 431 U.S. at 728. The Court in *Illinois Brick* had the difficult choice of effectively overruling *Hanover Shoe*, restricting *Hanover Shoe* to its facts, or barring from recovery indirect purchasers who had arguably suffered antitrust injury. See *id.* at 728-29, 736. The Court held that any pass-on rule must "apply equally to plaintiffs and defendants," *id.* at 728, and rejected a partial abandonment of *Hanover Shoe*. *Id.* at 744. Then, after weighing policy considerations, the Court decided to retain the established and efficient rule of *Hanover Shoe*. *Id.* at 746. The Court realized that to remain consistent with *Hanover Shoe* the application of exceptions to the rule barring the use of pass-on defensively must be equally applied to the bar of offensive pass-on. Therefore, the Court expressly adhered to the "narrow scope of exemption indicated by *Hanover Shoe*." *Id.* at 745; see also *In re Beef Indus. Antitrust Litig.*, 600 F.2d 1148, 1157 (5th Cir. 1979) (principle of mutuality: rejection of defensive pass-on precludes offensive pass-on), *cert. denied*, 449 U.S. 905 (1980).

\textsuperscript{27} *Illinois Brick*, 431 U.S. at 730-31 & n.11. One-sided application of pass-on could naturally lead to multiple liability if an indirect purchaser could use pass-on offensively to recover for the same injuries as a direct purchaser whose claim is protected from defensive pass-on by *Hanover Shoe*. *Illinois Brick*, 431 U.S. at 730-31; see also *Associated Gen. Contractors v. California State Council of Carpenters*, 459 U.S. 519, 549-50 (1983) (Marshall, J., dissenting) (duplicative recovery problem is important policy behind barring offensive pass-on); *Blue Shield v. McCready*, 457 U.S. 465, 474-75 (1982) (*Illinois Brick* distinguished where there is no risk of multiple recovery). See generally *Cavanagh*, supra note 8, at 72-73 (discussing risk of multiple liability). However, the Court also rejected the more limited threat of multiple recovery that would arise if the pass-on defense was extended to situations in which indirect purchasers were allowed to assert offensive pass-on. *Illinois Brick*, 431 U.S. at 731 n.11. The Court claimed that the procedural devices available, such as the Multistate Litigation Act, 28 U.S.C. § 1407, and statutory interpleader, 28 U.S.C. § 1335, were inadequate to avoid the risk of multiple liability when the direct purchasers havefinalized their full claim prior to those of the indirect purchasers. *Illinois Brick*, 431 U.S. at 731 n.11; see Comment, *Standing to Sue in Antitrust Cases: The Offensive Use of Passing-On*, 123 U. Pa. L. Rev. 976, 994 (1975) (statutory interpleader only represents partial answer to problem of multiple recovery). The Court rejected the argument that "'a little slopover on the shoulders of the wrongdoers . . . is acceptable.'" *Illinois Brick*, 431 U.S. at 731 n.11 (quoting and rejecting respondent's oral argument).

In regard to the enrichment of direct purchasers who receive treble damages for injuries which they have largely passed on, the courts have determined that policy considerations provide justification. See, e.g., *Royal Printing Co. v. Kimberly-Clark Corp.*, 621 F.2d 323, 327 (9th Cir. 1980) (vindication of antitrust laws outweighs possible windfall recovery where potential for multiple liability is small); *City of Cleveland v. Cleveland Elec. Illuminating Co.*, 538 F. Supp. 1320, 1325 (N.D. Ohio 1980) (same).

\textsuperscript{27} See supra note 20 and accompanying text.
tracing the overcharge,\textsuperscript{28} determining the extent of the direct purchaser's lost sales from the inflated price,\textsuperscript{29} computing the damage intentionally absorbed by the direct purchaser,\textsuperscript{30} and speculating on whether the direct purchaser would have raised its price in the absence of an overcharge.\textsuperscript{31} These complexities would multiply in situations when the overcharge has been passed on through a series of successive transactions.\textsuperscript{32} Finally, the Court reasoned that Congress' goal of creating a class of "private attorneys general"\textsuperscript{33} to enforce the antitrust laws would be more effectively reached by removing the burden of litigating the amount of damages resulting from pass-on and concentrating the full recovery in the direct

\textsuperscript{28} Illinois Brick, 431 U.S. at 732-33 & n.13, 741. See generally Cavanagh, Legislative Solution, supra note 16, at 278-79 (discussion of tracing problems); Landes & Posner, Should Indirect Purchasers Have Standing to Sue Under the Antitrust Laws? An Economic Analysis of the Rule of Illinois Brick, 46 U. Chi. L. Rev. 602, 615-21 (1979) (economics of calculating pass-on). The Illinois Brick Court noted the possibility that remote indirect purchasers could be parties to almost every treble damage action. 431 U.S. at 741.

\textsuperscript{29} Illinois Brick, 431 U.S. at 742. The tendency of consumers to alter their purchasing practices as market prices change is described in economics under the theory of elasticity. The more "elastic" a market is, the greater consumer response will vary to price changes. Although economists attempt to calculate this relationship in the classroom through a number of presumptions, in the real market, elasticity is extremely difficult to calculate. Id.; Easterbrook, Predatory Strategies and Counterstrategies, 48 U. Chi. L. Rev. 263, 302-03 (1981); Landes & Posner, supra note 28, at 615-21.

\textsuperscript{30} See Jewish Hosp. Ass'n v. Stewart Mechanical Enters., 628 F.2d 971, 977 (6th Cir. 1980), cert. denied, 450 U.S. 966 (1981); cf. Cleveland Elec., 538 F. Supp. at 1324 (citing Jewish Hospital Association for proposition that under cost-plus exception there is no incentive to absorb).

\textsuperscript{31} Hanover Shoe, 392 U.S. at 492-93. Often plaintiffs may be damaged in imperceptible ways even though they continue to turn a profit. See TV Signal Co. v. AT&T, 617 F.2d 1302, 1306 n.5 (8th Cir. 1980).

\textsuperscript{32} Illinois Brick, 431 U.S. at 732-33. In the words of Justice White:

Indeed, the evidentiary complexities and uncertainties involved in the defensive use of pass-on against a direct purchaser are multiplied in the offensive use of pass-on by a plaintiff several steps removed from the defendant in the chain of distribution. The demonstration of how much of the overcharge was passed on by the first purchaser must be repeated at each point at which the price-fixed goods changed hands before they reached the plaintiff.

\textit{Id.} at 732-33.

The Court believed the overall complexity of calculating offensive pass-on would be a strong reason to retain the rule of \textit{Hanover Shoe} even without the risk of multiple liability to the antitrust defendant. \textit{Illinois Brick}, 431 U.S. at 731 n.11.

purchaser.\textsuperscript{34}

\textsuperscript{34} Illinois Brick, 431 U.S. at 745-46. The Court expressly referred to the problem addressed in Hanover Shoe with de minimus pass-on claims would rarely pursue them. \textit{Id. at 747}; see supra note 21 and accompanying text. While the Hanover Shoe Court feared that ultimate consumers might not have enough incentive to bring a class action if their claims were negligible, 392 U.S. at 494, the Illinois Brick Court expressed concern that even if a class action was successfully brought, very few class members would be likely to come forward for compensation. \textit{Illinois Brick}, 431 U.S. at 747. See generally Handler, \textit{The Shift from Substantive to Procedural Innovations in Antitrust Suits—The Twenty-Third Annual Antitrust Review}, 71 COLUM. L. REV. 1, 9-10 (1971) (benefit accruing to individual class member in antitrust suit is frequently negligible); Kirkham, \textit{Complex Civil Litigation—Have Good Intentions Gone Aury?}, 70 F.R.D. 199, 206-07 (1976) (questioning whether consumers truly benefit from small sums derived from large class actions); Wheeler, \textit{Antitrust Treble-Damage Actions: Do They Work?}, 61 CALIF. L. REV. 1319, 1325 (1973) (deterrent force of treble-damage actions diminished by failure of class members to participate in or take advantage of class action awards).

Although there is a risk that the directly injured party will be unwilling to prosecute the claim, see \textit{Illinois Brick}, 431 U.S. at 746, the directly injured party is more likely to have superior knowledge of the violation than the indirectly injured party; therefore, increasing his state may improve overall efficiency. See Carter v. Berger, 777 F.2d 1173, 1176 (7th Cir. 1985). In \textit{Carter}, taxpayers sought treble damages under RICO, claiming injury had been passed on to them by the county through higher taxes after the defendants illegally obtained lower real property assessments from the county. \textit{Id. at 1174-75}. The court, by analogy, referred to \textit{Illinois Brick} and \textit{Hanover Shoe} to demonstrate that deterrence is increased by concentrating the recovery in the most directly injured party. \textit{Id. at 1176}. The court noted that “[t]he person with the best opportunity to uncover a violation is the one directly injured; he has access to the essential facts that may be concealed from others.” \textit{Id.}

The complexity of the fact determinations in most antitrust actions burdens efficient adjudication even without calculating the injuries passed on to indirect purchasers. See \textit{Associated Gen. Contractors v. California State Council of Carpenters}, 459 U.S. 519, 544-45 (1983) (courts burdened and effectiveness of treble-damage suits undermined by massive and complex damages litigation); W. Schwarzer, \textit{MANAGING ANTITRUST AND OTHER COMPLEX LITIGATION} 14 (1982) (discussing burdens imposed on federal courts by antitrust actions); Page, \textit{The Scope of Liability for Antitrust Violations}, 37 STAN. L. REV. 1445, 1446-46 & n.5 (1985) (“Antitrust cases represent fewer than 1 percent of the civil cases filed in federal court, but, in 1980, represented 4.1 percent of federal cases pending more than three years and 24 percent of federal cases requiring over 20 days of trial.”). The added complexity and delay which pass-on determinations would introduce into antitrust suits would decrease a potential plaintiff’s incentive to sue by increasing legal expenses while decreasing both the amount recoverable and the certainty of proving it. \textit{See Illinois Brick}, 431 U.S. at 745. Accordingly, to maintain efficiency the Court rejected proposals for compulsory joinder as a method of avoiding duplicative recoveries should offensive use of pass-on be permitted. \textit{Id. at 738-41}.

The Court in *Illinois Brick* realized that the decision to bar offensive pass-on would be imperfect to the extent it failed to compensate "indirect purchasers who may have been actually injured," and to the extent that some direct purchasers might be unwilling to play the role of "private attorneys general." However, when problems of evidentiary proof and complex economic theories are not implicated, the Court suggested that exceptions to the bar might exist—namely, situations involving fixed-quantity pre-existing cost-plus contracts and instances when the direct purchaser is "owned or controlled" by the indirect purchaser. The Court balanced these concessions with an emphatic adherence to "the narrow scope of exemption" created by *Hanover Shoe*.

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35 *Illinois Brick*, 431 U.S. at 746.
36 Id. Although *Illinois Brick* may bar indirect purchasers from becoming private attorneys general, the private sector will not be completely defenseless against antitrust violators when direct purchasers fail to act since indirect purchasers may still seek injunctive relief under section 16 of the Clayton Act. 15 U.S.C. § 26 (1982); see also Merican, Inc. v. Caterpillar Tractor Co., 713 F.2d 958, 962 n.6 (3d Cir. 1983) (*Illinois Brick* does not bar injunctive relief), cert. denied, 465 U.S. 1024 (1984); *In re Beef Indus. Antitrust Litig.*, 600 F.2d 1148, 1167 (5th Cir. 1979) (injunctive relief not barred for indirect purchasers because no risk of duplicative liability), cert. denied, 449 U.S. 905 (1980). The Supreme Court has indicated that a standing analysis under section 16 may be treated differently than *Illinois Brick* because neither double recovery nor complex apportionment is involved. *Cargill*, Inc. v. *Monfort of Colorado*, Inc., 479 U.S. 104, 111 n.6 (1986).

37 *Illinois Brick*, 431 U.S. at 736; see supra note 13-14 and accompanying text (description of exception). Under a fixed-quantity pre-existing cost-plus contract, the court need not resolve intricate economic questions because "complex market interactions" are "circumvented," *Illinois Brick*, 431 U.S. at 736, and "[t]he effect of the overcharge is essentially determined in advance, without reference to the interaction of supply and demand that complicates the determination in the general case." Id. The evidentiary problems of apportionment are not a problem because the direct purchaser is "insulated from any decrease in its sales as a result of attempting to pass on the overcharge," id., and it is "easy to prove" that the direct purchaser was not injured. Id. at 732 n.12 (quoting *Hanover Shoe*, Inc. v. United Shoe Mach. Corp., 392 U.S. 481, 494 (1968)). The direct purchaser may actually reap a profit from the illegal overcharge if the sale is completely fixed and the direct purchaser's markup is based on a percentage of its costs. Pollack, *Standing to Sue, Remoteness of Injury, and the Passing On Doctrine*, 32 Antitrust L.J. 5, 23-26 (1966). While it is true that the direct purchaser may be threatened by the loss of potential customers who are dissuaded from entering new contracts because of the inflated cost, it is submitted that these damages would generally be too speculative to determine. Cf. *Bigelow v. RKO Radio Pictures*, 327 U.S. 251, 264 (1946) ("jury may not render a verdict based on speculation or guesswork").

38 *Illinois Brick*, 431 U.S. at 736 n.16. The Court described this as "[a]nother situation in which market forces have been superseded and the pass-on defense might be permitted." Id.
39 Id. at 745.
and rejected any “attempts to carve out exceptions . . . for particular types of markets.”

The Hanover Shoe Court had expressed the exemption’s scope by stating: “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.” Since the possible exception for a pre-existing cost-plus contract was only a “for instance,” it is submitted that the Supreme Court did not intend to create an exclusive list. This view is supported by the Illinois Brick Court’s suggestion that another exception might exist when the indirect purchaser owns or controls the direct purchaser—a situation in which the policy considerations underlying the rule barring offensive and defensive pass-on are inapplicable. Similarly, although never specifically described in Illinois Brick, lower courts have found an exception when the price-fixer owns or controls the direct purchaser. It is submitted that in each of these situations, as modified by the Court, the pass-on may be determined without reference to the direct purchaser’s injury and, thus, without the evidentiary difficulties and complex economic theories which the direct purchaser rule seeks to avoid.

The Court has expressly rejected possible exceptions for special market situations because allowing such exceptions would require litigation to determine whether the economics of a particular submarket independently outweigh the Illinois Brick and Hanover Shoe policy considerations. Furthermore, the Illinois Brick Court

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40 Id. at 744; see infra note 46 (market types rejected by Court).
41 Hanover Shoe, 392 U.S. at 494.
42 See, e.g., cases cited supra note 16 (holding that Illinois Brick’s listed exceptions are not exclusive).
43 See supra note 38.
44 See supra note 16 (listing courts recognizing this exception).
45 See supra notes 37-38.
46 Illinois Brick, 431 U.S. at 743-45. The respondents in Illinois Brick argued that the direct purchaser rule should be relaxed in certain situations where most of the antitrust damages are likely to be passed on to indirect purchasers and the amount of the pass-on can be determined without difficulty. See id. at 735, 743. As it had done previously in Hanover Shoe, 392 U.S. at 488, the Court reaffirmed its rejection of a broad theoretical exception when the direct purchaser does not alter the goods before selling them to the indirect purchaser. Illinois Brick, 431 U.S. at 735-36. The Court also rejected exceptions for contracting bids based on a “fixed percentage markup” of the cost of materials, and for other situations where overcharges may be passed on to indirect purchasers through “cost-based rules of thumb,” which the Court characterized as “not adhered to rigidly.” Id. at 743, 744. Simi-
stated that the pre-existing cost-plus contract described in Hanover Shoe could only constitute an exception if it fixed quantity as well as price, thus superseding the market forces.\textsuperscript{47} Therefore, it is suggested that valid exceptions can only exist under conditions where the market forces affecting both price and quantity have been completely eliminated.

An example of what the Court sought to avoid is provided by In re Beef Industry Antitrust Litigation.\textsuperscript{48} In this case, the United States Court of Appeals for the Fifth Circuit held that the “functional equivalent” of the cost-plus contract exception should suffice when a direct purchaser passes on an illegal overcharge in a “highly inelastic” market in which price is determined by a habitually-employed, rigidly-applied formula.\textsuperscript{49} However, other cases,\textsuperscript{50} as larly, the Court refused to create an exception for markets in which “a price-fixed good is a small but vital input into a much larger product, making the demand for the price-fixed good highly inelastic.” \textit{Id.} at 743-44.

After rejecting these specific examples, the Court indicated that such potential exceptions do not merit a day in court:

More generally, the process of classifying various market situations according to the amount of pass-on likely to be involved and its susceptibility of proof in a judicial forum would entail the very problems that the Hanover Shoe rule was meant to avoid. The litigation over where the line should be drawn in a particular class of cases would inject the same “massive evidence and complicated theories” into treble-damages proceedings, albeit at a somewhat higher level of generality. \ldots Hanover Shoe itself implicitly discouraged the creation of exceptions to its rule barring pass-on defenses, and we adhere to the narrow scope of exemption indicated by our decision there.

\textit{Id.} at 744-45.

\textsuperscript{47} Illinois Brick, 431 U.S. at 736.

\textsuperscript{48} 600 F.2d 1148 (5th Cir. 1979), cert. denied, 449 U.S. 905 (1980).

\textsuperscript{49} \textit{Id.} at 1163-67. In \textit{In re Beef Industry}, producers who sold their beef to wholesalers claimed retail stores were able to deflate the price they paid wholesalers, and ultimately the price wholesalers paid producers, by controlling trade publication listings which were part of a strict wholesale pricing formula. \textit{Id.} at 1153. The court held that although the case involved an oligopsony (i.e., indirect purchasers illegally manipulating rates of sellers), the rule of Illinois Brick, which involved a monopolistic price-fixing scheme, was fully applicable. \textit{Id.} at 1158-59; see also Zinser v. Continental Grain Co., 660 F.2d 754, 760 (10th Cir. 1981) (\textit{Illinois Brick} applied to oligopsony), cert. denied, 455 U.S. 941 (1982).

Although the Illinois Brick Court expressly described the potential cost-plus contract exception as one in which the direct purchaser is “insulated from any decrease in its sales,” Illinois Brick, 431 U.S. at 736, the Fifth Circuit indicated that “functional equivalence” did not require fixed-quantity because “[t]he middleman’s loss of volume and the indirect purchaser’s absorption of the overcharge are wholly separable items of damage.” \textit{In re Beef Indus.}, 600 F.2d at 1164; see also Illinois ex rel. Hartigan v. Panhandle E. Pipe Line Co., 852 F.2d 891, 896 (7th Cir.) (en banc) (loss of sales to utility treated as “separate transaction” from pass-on to utility’s consumers), cert. denied, 109 S. Ct. 543 (1988). The “pre-existing” and “cost-plus contract” elements were deemed by the court to be functionally equalled respectively by the price-settling effect of the alleged “highly inelastic” short-term
well as In re Beef Industry on remand,51 indicate that the very
process of determining whether a particular market situation
constitutes the functional equivalent of a cost-plus contract embroils
the courts in the same type of complex economic fact determina-
tions that the Supreme Court has expressly rejected.52 Furthermore,
the uncertainty of how courts will define and apply func-
tional equivalency creates a threat of inconsistent judgments and
multiple liability for the antitrust violator.53 While the Supreme
Court did not intend to create an exclusive list of exceptions to the
direct purchaser rule,54 it is submitted that potential exceptions
which attempt to build off those suggested by the Court must be
more than mere substantial substitutes—rather, they must pre-
cisely reflect the established exceptions in regard to the economic
complexity of litigating the damages passed on.55

supply of cattle and the “rigid formula pricing.” In re Beef Indus., 600 F.2d at 1165-66. It is
submitted that, taking the court’s reasoning one step further, the inelastic short-term sup-
ply of cattle could be weighed to some degree as the functional equivalent of a “fixed-quantity”
for the equation to be more complete.
50 See, e.g., In re Plywood Antitrust Litig., 655 F.2d 627, 639-41 (5th Cir. Unit A Sept.
1981) (functional equivalence attempted without pre-existing or fixed-quantity elements al-
leged), cert. dismissed, 462 U.S. 1125 (1983); Jewish Hosp. Ass’n v. Stewart Mechanical
Enter., 623 F.2d 971, 976 (6th Cir. 1980) (functional equivalence argument rejected because of
uncertainty that direct purchaser passed on entire overcharge), cert. denied, 450 U.S. 966
1979) (per curiam) (functional equivalence theory insufficient as matter of law without proof
of pre-existing nature of arrangement).
51 In re Beef Indus. Antitrust Litig., 1982-2 Trade Cas. (CCH) ¶ 64,815, at 72,049 (N.D.
Tex. 1982). After a lengthy and difficult fact determination, the district court found that the
requirements for functional equivalence were not met. Id.
52 Illinois Brick, 431 U.S. at 744-45; see supra note 46 and accompanying text. Unlike the
“easy to prove” exceptions which Illinois Brick and Hanover Shoe suggest, claims of
functional equivalency—which, more often than not, do not satisfy most courts’ rigid re-
quirements—are difficult to dismiss without a long discovery period during which legal fees
build for both parties. Cavanagh, supra note 8, at 91-92.
53 Cavanagh, supra note 8, at 90.
54 See supra notes 16, 42-43 and accompanying text.
55 Situations occasionally arise which fail to fit within the Supreme Court’s established
possible exceptions, yet the overcharge seems to have clearly passed through without any
real threat of economic injury to the middleman. See, e.g., County of Oakland v. City of
Detroit, 628 F. Supp. 610, 613 (E.D. Mich. 1986) (“cost plus cost” contract under which
middleman always received expenses regardless of demand—thereby making “fixed-quant-
(permitting “functional equivalence” where contracts were obtained before costs of then-
unknown subcontractor’s bids were added).

As a practical matter, attorneys must be aware that the courts differ regarding the ac-
ceptability of “functional equivalence” and what the “narrow scope” of Illinois Brick
n.9 (3d Cir. 1979) (“fixed-quantity” is necessary for cost-plus contract exception) and
In cases subsequent to Illinois Brick, both antitrust plaintiffs and defendants have argued that the rule barring pass-on should not apply to regulated industries because they are passive conduits through which pass-on is easily determinable without reference to the interaction of supply and demand. This position is in harmony with the traditional view that regulated industries are natural monopolies, immunized from antitrust treatment. Indeed, immunity is expressly granted to some regulated industries by statute. Where statutory protection is not available, a regulated industry may be protected by the state action doctrine deeming regulated actions as a governmental activity, wholly immune from federal antitrust laws. However, traditional antitrust immunity is quickly vanishing under deregulation, while the remaining regu-
lated industries are increasingly perceived as competitive forces influenced by and active in the economy. Generally, the immunity still enjoyed by regulated industries is limited to the extent these industries are regulated and, as a result, minor exertions of the monopoly power outside the scope of regulation will expose the industry to antitrust liability. As regulated industries become increasingly treated as competitive and independent market entities, it is submitted that they are less likely to be considered by the courts as passive conduits of antitrust injury to which the general rule of *Illinois Brick* barring pass-on is inapplicable.

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61 See *Otter Tail Power Co. v. United States*, 410 U.S. 366, 374-76 (1973); Georgia v. Pennsylvania R.R., 324 U.S. 439, 456 (1945) ("[r]egulated industries are not *per se* exempt"). In *Otter Tail*, the Supreme Court denied antitrust immunity to an electric utility which refused to wholesale or transfer power for municipal utilities. 410 U.S. at 372-75. Despite the fact that the utility was not venturing into a new area of enterprise, *see infra* note 62 and accompanying text, the Court found the antitrust laws to be applicable when a regulated industry engages in anticompetitive activity which is not compelled by law. 410 U.S. at 374; *see also* City of Cleveland v. Cleveland Elec., Illuminating Co., 538 F. Supp. 1320, 1321 (N.D. Ohio 1980) (municipality alleging unlawful monopolization by large private utility refusing to transfer power); Town of Massena v. Niagara Mohawk Power Corp., 1980-2 Trade Cas. (CCH) ¶ 63,526, at 76,802 (N.D.N.Y. 1979) (same).

While most regulated industries have leeway to exercise business judgment in an anticompetitive manner within the bounds of regulation, the *Otter Tail* decision effectively increases their exposure to antitrust liability for a wide range of activities. *See, e.g.*, Dym & Sussman, *supra* note 57, at 70 ("regulatory requirements, while extensive, do not control all phases of utility operations"). For example, under electric regulation, private industries have considerable control over wholesale pricing. *See id.* at 75 (FERC merely applies "just and reasonable" standard for wholesale price approval). Where this power has been used to "squeeze out" a municipal utility by charging the municipality a higher wholesale price than the retail price paid by its own customers, the Seventh Circuit has found antitrust liability. City of Mishawaka v. Indiana & Mich. Elec. Co., 560 F.2d 1314, 1325 (7th Cir. 1977), cert. denied, 436 U.S. 922 (1978). *See generally* Joskow, *Mixing Regulatory and Antitrust Policies in the Electric Power Industry: The Price Squeeze and Retail Market Competition*, in *ANTITRUST AND REGULATION: ESSAYs IN MEMORY OF JOHN J. MCGOWAN* 173-239 (F. Fisher ed. 1985).

62 *See, e.g.*, Cantor v. Detroit Edison Co., 428 U.S. 579, 596 (1976). In *Cantor*, a utility which gained approval from the Michigan Public Service Commission for the distribution of free light bulbs—presumably so that consumers would use more electricity—was held to have lost its immunity when exerting itself in competitive areas of the economy. Id.

In describing the potential risk a power utility will face by even limited participation in the field of residential solar energy, one author wrote:

[A] utility is, by law, given monopolistic power within its service area, and that power is one key element of a section 2 violation. Hence, virtually any action that a utility takes in the area of solar marketing, manufacturing, or financing conceivably constitutes an attempt to exercise that power and extend it into another area where the utility does not have monopoly power.

The first difficulty for a regulated pass-on exception is that regulated industries have incentive to voluntarily absorb overcharges in competitive markets. When a regulated direct purchaser has absorbed an indeterminable portion of an antitrust injury, the same market complexities exist which *Hanover Shoe* and *Illinois Brick* seek to avoid. Thus, it is submitted that whenever a regulated industry as a direct purchaser may have voluntarily absorbed overcharges, the direct purchaser rule should prevent any use of the pass-on theory.

Other situations may arise under which pass-on of the entire overcharge is arguably complete because either a regulated industry's natural monopoly removes the financial incentive to absorb or because the law requires the overcharges to be passed on to consumers. In regard to situations where it is claimed that a regulated industry has voluntarily absorbed overcharges, the direct purchaser rule should prevent any use of the pass-on theory.

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See, e.g., *Cleveland Elec.*, 538 F. Supp. at 1324-25; Northern Ariz. Gas Serv. v. Petroleum Trans., 145 Ariz. 467, 476, 702 P.2d 696, 705 (Ct. App. 1984) (dicta) (only maximum price regulated). In *Cleveland Electric*, the City of Cleveland sued a privately owned utility for antitrust damages when the private utility refused to transfer electricity from New York to the municipal utility. 538 F. Supp. at 1321; see also supra note 61. When the city, on a pretrial motion, sought to bar the private utility from defensively asserting that the municipal utility had passed on the antitrust injury it had suffered to the consuming public, *Cleveland Elec.*, 538 F. Supp. at 1321, the court agreed that a regulated pass-on exception to *Hanover Shoe* should not be created because the municipality had reason to absorb at least part of the overcharge in order to keep its prices competitive with the private sector. Id. at 1324-25.

See *Illinois ex rel. Hartigan v. Panhandle E. Pipe Line Co.*, 852 F.2d 891, 895, 898 (7th Cir.) (en banc), cert. denied, 109 S. Ct. 543 (1988); *Cleveland Elec.*, 538 F. Supp. at 1324; see also *Jewish Hosp. Ass'n v. Stewart Mechanical Enters.*, 628 F.2d 971, 976 (6th Cir. 1980) (*Illinois Brick's* policy to avoid determination of direct purchaser's absorption), cert. denied, 450 U.S. 966 (1981); supra note 30 and accompanying text (same). In *Panhandle*, consumers using natural gas, who had the ability to switch to alternate sources of energy when overcharges were being passed on to them, compelled the regulated direct purchaser to absorb the overcharge by obtaining permission to reduce the portion of its bill reflecting profit. 852 F.2d at 895. Although an automatic fuel pass-through provision caused the entire overcharge to be passed on to the consumers, and the sales could easily have been split between the cost of gas and the utility's lost profit, the court refused to "complicate the administration of *Illinois Brick*" by "apportioning losses on the same sales." Id. at 898.

See *Panhandle*, 852 F.2d at 895-96. Although the regulatory pass-on was complete because the utility was compelled to pass on the overcharge dollar for dollar by regulation in *Panhandle*, the court further suggested that the utility had "unused monopoly power" in regard to its residential customers for whom it did not request a lower rate of profit as it had done for its industrial consumers. Id. at 895-96. Assuming "profit-maximizing" by a regulated industry operating below its optimum rate (i.e., the rate which the utility would charge in the absence of regulation), the court found the utility had "every incentive to raise its price by the full amount allowed." Id. at 896.

See id. at 896; *In re Wyoming Tight Sands Antitrust Cases*, 695 F. Supp. 1109, 1116 (D. Kan. 1989), aff'd, Nos. 88-2158, 88-2159 (10th Cir. Jan. 31, 1989) (LEXIS, Genfed library, Usapp file); *In re New Mexico Natural Gas Antitrust Litig.*, 1982-1 Trade Cas. (CCH)
lated industry's natural monopoly removes its financial incentive to absorb an overcharge, it is submitted that a pass-on theory must fail because the nature of the direct purchaser's natural monopoly and its incentive to absorb overcharges can only be determined through the type of complex economic litigation barred by *Illinois Brick.* However, when a pre-existing regulation—over which the regulated direct purchaser does not exercise control—requires it to pass on the overcharge to its customers, the suspension of economic forces essentially mirrors the economic consequences of a pre-existing cost-plus contract. As with pre-existing cost-plus contracts in which the quantity is not fixed, however, total pass-on of an overcharge through a regulated direct purchaser can create a loss of sales in reaction to the inflated price. In light of *Illinois Brick,* 64,685, at 73,717 (D.N.M. 1982).

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1 See supra note 46 and accompanying text (Supreme Court's rejection of market-type exceptions requiring litigation to determine their validity). Creating an exception where regulated industries pass on overcharges while operating below their optimum rate would essentially open the door to complex economic optimum rate litigation since optimum rate cannot always be assumed. See *Report on Regulatory Reform,* supra note 60, at 518 (suggesting regulation leads to higher prices than free market interaction with antitrust policing). Although the facts in the *Panhandle* case may have suggested an exception for unused monopoly power, 852 F.2d at 895, the *Illinois Brick* Court expressly rejected situations that would require litigation to determine the boundaries of the potential exception. *Illinois Brick,* 431 U.S. at 744-45.

68 *Panhandle,* 852 F.2d at 894, 896, 897. The court in *Panhandle* expressly distinguished *In re Beef Industry,* stating that regulated pass-on is true "formal cost-plus pricing," not just its "functional equivalent." Id. at 894; see supra notes 48-55 and accompanying text (*In re Beef Industry*'s "functional equivalency" analysis rejected).

69 *Illinois ex rel. Hartigan v. Panhandle E. Pipe Line,* 852 F.2d at 891, 895, 896 (7th Cir.). By passing on overcharges to their customers, regulated energy industries can lose sales due to both consumer conservation and the use of alternate sources of energy. See *Wyoming Tight Sands,* Nos. 88-2158, 88-2159 (10th Cir. Jan 31, 1989) (LEXIS, Genfed library, Usapp file). The difficulty of calculating the response of consumers to a regulated overcharge is complicated by such factors as weather changes, population shifts, economic conditions, and technological changes. See Dym & Sussman, supra note 57, at 72. In *U.S. Oil Co. v. Koch Refining Co.,* 518 F. Supp. 957 (E.D. Wis. 1981), an oil company used the pass-on defense, claiming that the plaintiff refinery was required by law to pass on damages since the price of...
Brick's description of the narrow possible exception for pre-existing cost-plus contracts which shield the direct purchaser from lost sales by fixing quantity, a possible exception for pass-on through regulation will only be viable if purchasers from the regulated industry are committed through regulation, contract, or otherwise to purchasing a fixed quantity. As with the "pre-existing" and "cost-plus contract" elements, a fixed quantity must also be established without resorting to complex economic theories.

Admittedly, the scope of a potential regulated pass-on exception outlined in this Note is very narrow. However, through con-

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sistent adherence to the narrow scope of exemption in the area of regulated pass-on, where the regulating authority will most likely require the regulated industry to compensate injured indirect purchasers out of any recovery, both direct and indirect purchasers will benefit from knowing that the proper plaintiff is in court instead of wondering whether the court is going to create a new borderline exception.

Conclusion

Although Illinois Brick's examples of possible exemptions from the rule barring pass-on were intended to be illustrative rather than exhaustive, the language of the Supreme Court indicates that other exceptions should be permitted only in those rare instances when market forces have been fully superseded and the pass-on can be easily determined without reference to complicated economic theories—whether the determination involves the actual amount of the pass-on or an evaluation of the relevance of the general policies of Illinois Brick in special market situations. One method of judging whether a particular situation is a viable exception is to examine whether the economic impact of the pass-on pre-

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74 See In re Wyoming Tight Sands Antitrust Cases, Nos. 88-2158, 88-2159 (10th Cir. Jan. 31, 1989) (LEXIS, Genfed library, Usapp file); Illinois ex rel. Hartigan v. Panhandle E. Pipe Line, 852 F.2d 891, 895 (7th Cir.) (en banc), cert. denied, 109 S. Ct. 543 (1988); Virginia Elec. & Power Co. v. International Bhd. of Boilermakers, 103 L.R.R.M. (BNA) 3144, 3164 (N.D.W. Va. 1980); G. Turner, Trends and Topics in Utility Regulation 299-300 (1969). In Panhandle, the court indicated that this would give the public utility less incentive to sue. Panhandle, 852 F.2d at 895; see also Wyoming Tight Sands, Nos. 88-2158, 88-2159 (discussing lost incentive argument). However, in his concurrence Judge Cudahy reasoned that the utility would have an incentive to sue since liability might exist if they failed to do so. Panhandle, 852 F.2d at 899 (Cudahy, J., concurring).

75 The current lack of clarity is indicated by Panhandle, where the Seventh Circuit's panel decision was vacated and reversed in a 5-1-4 decision by the en banc court, and by the recent result reached by the Tenth Circuit in Wyoming Tight Sands. Compare Panhandle, 852 F.2d at 899 (en banc) (permitting regulated pass-on exception without contractually or statutorily fixed quantity), vacating & rev'g 839 F.2d 1206 with Wyoming Tight Sands, Nos. 88-2158, 88-2159 (rejecting regulated pass-on exception). Although the Wyoming Tight Sands court distinguished its ruling from the Panhandle court's, where overcharges were clearly and fully passed on, see Wyoming Tight Sands, Nos. 88-2158, 88-2159, the Tenth Circuit stated in dicta that even assuming "perfect and provable pass-on of the alleged illegal overcharge," the narrow scope of the exception would remain unsatisfied. Id.
cisely mirrors one of the Supreme Court's illustrations. Functional equivalence merely attempting to approximate the economic impact is not enough. By comparing the economic impact of a potential exception for regulated pass-on to *Illinois Brick*’s possible exception for a fixed-quantity cost-plus contract, this Note has suggested that an exception for regulated pass-on can only occur in the very rare situation in which both the quantity and the regulated price are fixed prior to the passing on of overcharges.

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