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# Assessing Conflict, Impact, and Common Methods of Proof in Intermediate Indirect-Purchaser Class Action Litigation

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### Introduction

To certify a class in cases involving indirect-purchasers, specific legal standards, which in practice vary a fair amount across states, must be satisfied. State courts have determined generally that a class can be certified if it meets five key requirements of state analogues to Federal Rules 23(a) and 23(b)(3), which stipulate the following provisions:

- *Numerosity*: the class is so numerous that joinder of all members is impractical
- *Commonality*: questions of law or fact are common to the class
- *Typicality*: the claims or defenses of the representative parties are typical of the claims or defenses of the class
- *Adequacy*: the representative parties will fairly and adequately protect the interests of the class
- *Predominance/Superiority*: questions of law or fact common across members of the class predominate over any questions affecting only individual members; and a class

action is superior to other available methods for fair and efficient adjudication of the controversy.

Economists do not often opine on the legal concept of numerosity. However, the economic issues associated with typicality, commonality, adequacy, and predominance are frequently pivotal to class certification in both direct- and indirect-purchaser litigations. Typicality, adequacy, and predominance must be analyzed to determine whether a common method exists to assess impact to all class members, and potential conflicts among class members (commonality is largely subsumed under predominance). In cases in which the putative class excludes end-consumers but consists of other indirect-purchasers at different levels of the distribution chain, these issues present multiple challenges.

We begin our discussion by positioning these economic arguments within the broader context of varying state laws. Neither the standing of indirect-purchasers as plaintiffs, nor the permissibility, scale, or scope of pass-through arguments (claims of overcharge being passed through different points of the distribution chain) is treated uniformly across jurisdictions.

### Legal Background

In 1977, the Supreme Court's decision in *Illinois Brick Co. v. Illinois* simplified private antitrust suits by denying indirect-purchasers the right to sue in federal court.<sup>1</sup> The Court stated that antitrust laws would be "more effectively enforced by concentrating the full recovery for the overcharge in the direct purchasers rather than by allowing every plaintiff potentially affected by the overcharge to sue for only the amount it could show was absorbed by it."<sup>2</sup> Supporters of the decision have argued that deterrence is a primary goal of antitrust law and that the

direct-purchaser suit is the most efficient way to impose such a penalty. Opponents claim that the ruling denies compensation to those who most often suffer damages from overcharge by manufacturers with market power, namely consumers.

Following *Illinois Brick*, a number of states enacted statutes that explicitly repeal the case ruling or have interpreted pre-existing antitrust statutes to authorize indirect-purchaser suits. “*Illinois Brick* repealer” provisions have been passed in Alabama, California, the District of Columbia, Hawaii, Idaho, Illinois, Kansas, Maine, Maryland, Michigan, Minnesota, Mississippi, Nevada, New Mexico, New York, Oregon, Rhode Island, South Dakota, Vermont, and Wisconsin. Other states have permitted recovery on behalf of consumers, either in the form of restitution or damages under state consumer protection laws or state unfair trade practices statutes.

The Supreme Court legitimized states’ repeals of *Illinois Brick* in *California v. ARC America Corp* (1989), ruling that the repealer statutes are not preempted by federal law, notwithstanding the federal bar of indirect-purchaser suits.<sup>3</sup> Since then many but not all of these suits have been filed as class actions, since indirect-purchasers tend to be numerous and their individual (alleged) harms small. Many cases settle prior to trial, often even before a complete assessment of whether a class should be certified. The uncertain legal terrain, potential damage exposure and cost of litigation, and risk aversion of parties involved often contribute to early settlements.

Among the approximately 20 states with *Illinois Brick* repealer statutes, the extent to which defendants can use downstream pass-through as a defense to refute the fact of injury or to reduce indirect-purchaser

damages varies considerably.<sup>4</sup> Consideration of downstream pass-through arguments adds to the complexity of the damages analysis; yet to ignore this important determinant of economic relationships can often lead to duplicative recovery of damages.

The variation among states in the treatment of downstream pass-through as a defense may be lessened by the passage of the Class Action Fairness Act (“CAFA”) of 2005. CAFA enables state-based class action suits to be removed to federal court in many circumstances. Once in federal court, the issue of class certification is governed by federal procedure (Fed R. Civ. Proc. 23) as opposed to state procedure.

### **Economic Analysis**

Whether viewed under federal or state standards for class certification, the relevant economic questions are similar: Were all or substantially all class members in fact injured? Are there significant conflicts among class members? Can these issues be investigated using a common method?

Injury is largely determined by the rate at which an alleged overcharge would be transmitted (passed through) from one level of purchasers to the next. These pass-through rates are important determinants of potential damage both “upstream” – the overcharge paid by an indirect-purchaser at the time of purchase – and “downstream” – the overcharge transmitted by the indirect-purchaser to the next entity in the production/distribution chain. Similarly, pass-through analysis will help determine the extent of conflict among class members who transact with each other and, as a result, may transmit (or incur) an alleged overcharge. Finally, because pass-through is often determined by idiosyncratic and localized conditions as well as transaction-specific circumstances, investigating pass-

through will help determine the likelihood that a common method of proof can determine impact and damages on a class-wide basis. Plaintiffs and Defendants have developed a complex set of economic and legal arguments to evaluate upstream and downstream pass-through in the context of assessing the existence (or not) of impact on all class members, of potential conflicts among class members, and of common methods of proof to derive potential damages.

*Pass-Through Analysis and Impact*

Plaintiff experts who assert that all indirect class members are injured by an alleged overcharge and that damages can be calculated using a common method have often faced significant challenges from the courts. Judicial reluctance to concur with Plaintiffs is illustrated, for example, by the Illinois District Court's certification of a class of direct purchasers under federal antitrust laws, and refusal in the same matter to certify a class of indirect-purchasers under an Alabama statute.<sup>5</sup> The court linked the issue of impact with that of pass-through within the distribution chain, and determined that tracking an overcharge from manufacturers to wholesalers and on to retailers and consumers was a difficult, individualized process that could not be completed class-wide.

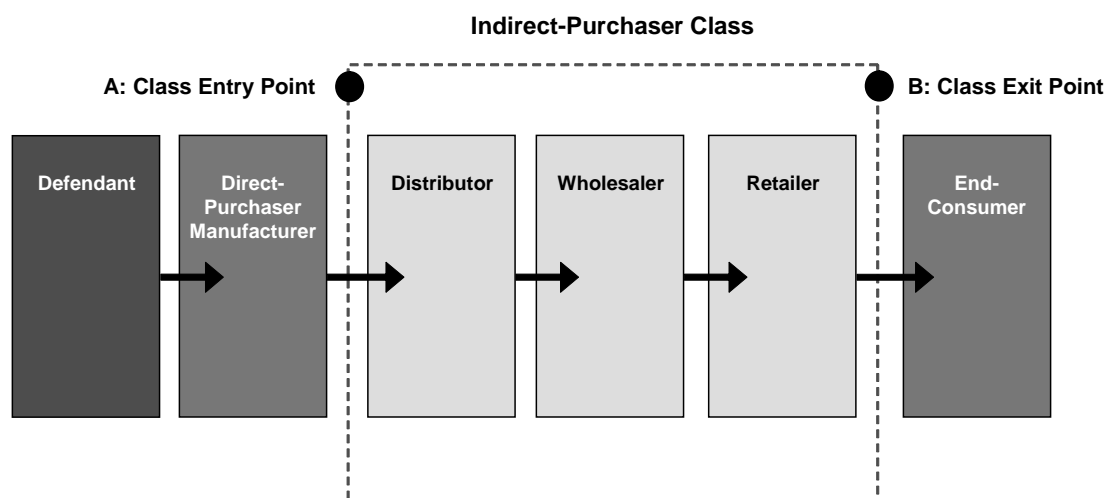
In the hypothetical distribution chain shown in Figure 1, the class may encompass multiple, distinct layers including distributors, wholesalers, and retailers. Plaintiffs would need to argue that all class members were injured by the overcharge (thereby establishing impact) and that transactions among class members were

limited or non-existent (reducing or eliminating conflict). Plaintiffs' impact argument becomes increasingly difficult to sustain, however, as the number of levels in the distribution chain increases. As a result, Plaintiffs may minimize the distinction among levels in the distribution chain within the proposed class or limit the class definition to include only a clearly identifiable layer in the chain (e.g., distributors).

Defendants, on the other hand, would likely emphasize the distinctions among class members. They would argue that for all members to be damaged, the initial overcharge would have to be partially absorbed at each level of the chain and partially passed through from wholesalers to ultimately reach retailers. Defendants would further argue that although an overcharge may pass-through the first two layers of class members, if pass-through does not stop with the third layer, only those purchasers situated further downstream would incur damage, leaving the Plaintiff class without a cause for action.

Differing levels of competition within the distribution chain will also influence Plaintiffs' impact argument. If upstream pass-through (Point A on Figure 1) is high, resulting in a large portion of the overcharge reaching the class members, Plaintiffs' expert will need to show that downstream pass-through (Point B on Figure 1) is low. When downstream pass-through is high, the overcharge that reaches the plaintiff class will flow out of the plaintiff class, leaving end consumers with the bulk of the damage claim. Of course a low upstream pass-through would reduce the amount of overcharge extending to the class.

Figure 1: Sample Distribution Chain



Under a scenario in Figure 1, determination of multiple pass-through among class members and pass-through into and out of the proposed class will typically present significant opportunities for Defendants to argue that individual inquiry is most appropriate. However, certain jurisdictions (Minnesota, for example) frown upon downstream pass-through arguments, at least at the class certification stage.<sup>6</sup> Other jurisdictions (Iowa, for example) recognize the importance of downstream pass-through defenses, but have shifted the burden of proof to the Defendants, thereby significantly complicating the Defendants' arguments.<sup>7</sup>

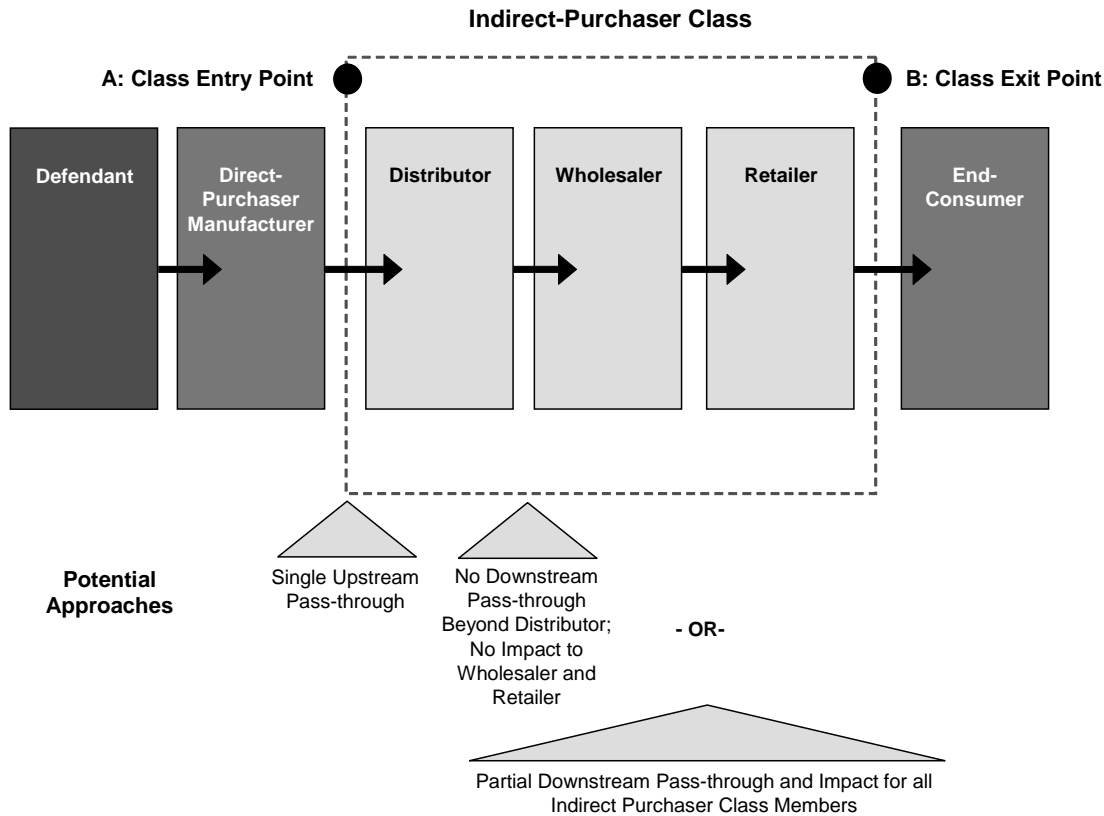
#### *Pass-through Analysis and Conflict*

Beyond the issues associated with analysis of impact, cases involving multiple layers of distribution within a class also raise significant issues of conflict among members of the class. If Plaintiff counsel must choose among alternative strategies that materially favor one subgroup within the putative class over another, the adequacy of representation can fairly be questioned. This would be the case if, for example, members of the Plaintiff class transact with each other. If such transactions result in the

seller passing the overcharge on to the buyer, the buyer is damaged and the seller will have reduced or eliminated any damage. If, on the other hand, the seller is unable to pass the overcharge on to the buyer, the overcharge and associated damage will be borne entirely by the seller. Experts may reasonably disagree on the extent of the pass-through and, therefore, may offer different opinions on the degree of damages to each class member.

Given the product distribution chain in Figure 1, Defendants are likely to emphasize significant potential conflicts among putative class members whereas Plaintiffs will downplay levels of distribution within the chain to avoid any potential conflict among members. For example, in an *Illinois Brick* repealer state without limitations on pass-through analysis, Plaintiff experts may argue that market conditions imply full pass-through up to, but not beyond, the class. However, if Plaintiffs argue that distributors were affected by the full overcharge without any pass-through to downstream levels, wholesale and retail members of the class arguably will not suffer impact. But if Plaintiffs argue that partial pass-through characterizes each level of the chain of distribution, *all* members of the class may

Figure 2: Plaintiff Approach



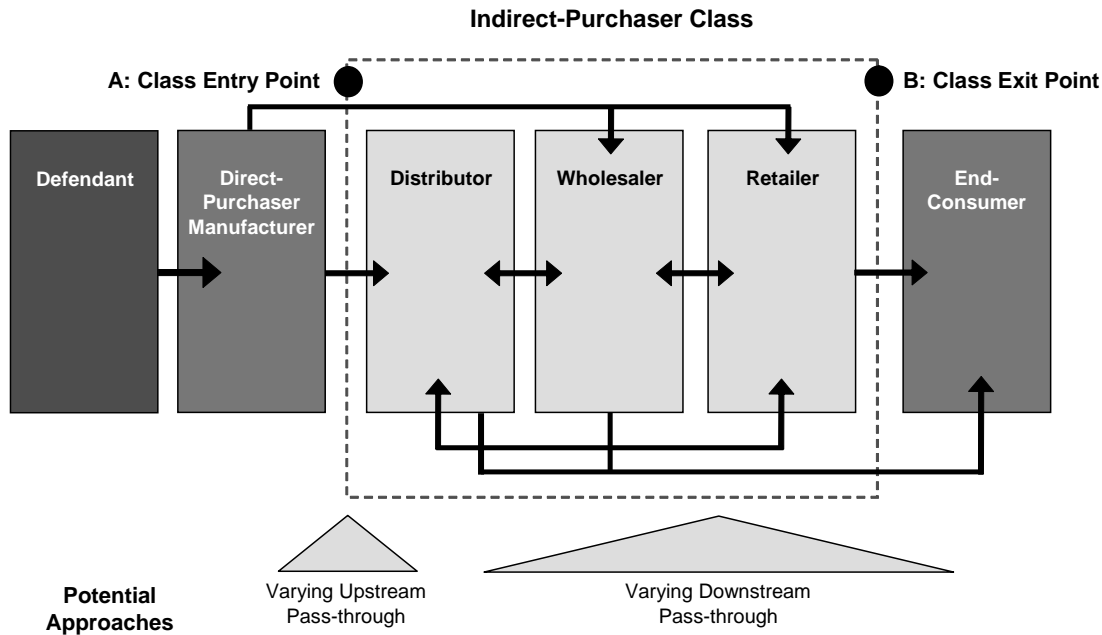
claim damages resulting from a fraction of the initial overcharge. Distributors would then have lower claims, all else being held equal, than if Plaintiff experts argued that 100 percent of the overcharge passed through to the distributor level and remained at that level (see Figure 2). These reasonable alternatives could significantly affect the distribution of damage awards among class members as well as the total award claimed, thus presenting challenges for Plaintiff counsel.

In contrast, Defendant experts may present a scenario characterized by varying levels of pass-through among class members, which requires individualized inquiry (illustrated in Figure 3). Conflict over alleged damages among potential class members is likely in this scenario, and certain class members may lack standing. Upstream pass-through

for any given member is likely to vary with, among other things, its position in the distribution chain. An expert may find it difficult to identify common methods to calculate pass-through and determine damages.

Defendants could use Plaintiff discovery (interviews, deposition testimony, and review of individual transactions) to demonstrate a complex distribution chain. This, in turn, could help Defendants show idiosyncratic pass-through across multiple levels of distribution. However, Plaintiffs could use tools such as regression analysis to demonstrate that pass-through can be easily calculated at each level of the chain using a class-wide approach. Diagnostic tests to ensure that a single regression analysis is appropriate across class members would be useful in determining the accuracy

Figure 3: Defendant Approach



of the pass-through rates suggested by the regression approach.

When a putative class includes members who trade with one another, Plaintiffs are likely to face challenges in proving impact as well as adequacy, unless pass-through is unambiguously identifiable up and down the chain of distribution. In past cases, evidence of such transactions among class members has at times resulted in denial of class certification.<sup>8</sup>

*Pass-through and Common Method of Proof*

From an economic perspective, for a class to be certified, a common method of proof must be used to evaluate the likelihood and extent of impact as well as conflict among Plaintiffs. Furthermore, the existence of a common method to calculate actual damages to class members must also be demonstrated. On all three dimensions (conflict, impact, and extent of damage), the issue of pass-through will be a central determinant of class standing.

In the Plaintiffs' ideal scenario, class members do not trade with each other, upstream pass-through is equal to (or very near) "one," and downstream pass-through is equal to (or very near) "zero." Further, Plaintiffs can establish this ideal scenario using standard, common methods. This state of the world may not often be observed in indirect-purchaser suits initiated by intermediaries, because transaction patterns among class members are often complex and upstream and downstream pass-through rates are likely to be similar. If both pass-through rates are high, end-consumers experience most of the overcharge; if both are low, direct purchasers bear most of the injury.

In the Defendants' ideal scenario, class members would buy and sell to one another, and both upstream and downstream pass-through rates will be near either "one" or "zero." To the extent this scenario is more likely to occur in reality, common methods of proof would fail and certifying a class should therefore be more difficult. The complexity of intra-class transactions often



requires an individualized inquiry (e.g., a review of actual transactions, one at a time). Moreover, the extent of pass-through is likely to vary across class members; this may require a review of transactions to track an overcharge through the production/distribution process.

## Conclusion

The key economic issues for determining class certification in intermediate indirect-purchaser lawsuits correlate with the legal standards of adequacy, typicality, commonality, and predominance. These issues involve the amount of overcharge passed on to class members (upstream pass-through), and the extent to which class members pass on their overcharge to end-consumers (downstream pass-through). State laws differ as to whether and how pass-through may be analyzed to determine impact and measure damages. Clearly, analysis of pass-through can be complex, and is further complicated when class members transact with one another because of the increased likelihood of conflicts among them.

By carefully considering the nature of interactions among class members and integrating legal and economic concepts effectively, Plaintiffs and Defendants are more likely to achieve decisions consistent

with the characteristics of the market and the pattern of transactions. Doing so successfully, however, requires that litigators understand and invoke the economic underpinnings of class certification arguments, including the often complicated issues associated with upstream and downstream pass-through.

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<sup>1</sup> Illinois Brick Co. v. Illinois, 431 U.S. 720 (1977).

<sup>2</sup> Id at 735.

<sup>3</sup> California v. ARC America Corp., 490 U.S. 93 (1989).

<sup>4</sup> For a discussion of the varying state standards for class certification, see Page, William H. "Class Certification in the Microsoft Indirect Purchaser Litigation," 1 J. Competition Law & Econ. 303 (2005) Available at SSRN: <http://ssrn.com/abstract=671048> or DOI: 10.2139/ssrn.671048.

<sup>5</sup> Coutroulis, Chris S. and D. Matthew Allen, "The Pass-On Problem in Indirect Purchaser Class Litigation." *The Antitrust Bulletin*, vol. XLIV, no. 1, Spring 1999, pp. 189-190.

<sup>6</sup> Gordon v. Microsoft Corp., No. 00-59994, 2001 WL 366432, \*5, 11 (Minn. Dist. Ct. Mar. 30, 2001).

<sup>7</sup> Farmers Coop. Elev. Co. v. Akzo Nobel, Inc., No. LA-CV-35453, Op. at 18 (Iowa Dist. Court Carroll County Mar. 12, 2004).

<sup>8</sup> Sugai Prods. v. Kona Kai Farms, No. 97-00043, 1997 WL 824022, 1997-2 Trade Cases P 72,008, (D. Hawai'i, November 19, 1997).

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