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Passing-On Theory in Antitrust Treble Damage Actions: An Economic and Legal Analysis

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The concept of passing-on has plagued several courts since the Supreme Court last considered its effects upon the ability of claimants to recover treble damages under the antitrust laws. Policies that were persuasive to the Court have been obscured by frequent attempts to promote often conflicting goals or to resolve damage claims with glib analysis. Fear of imposing excessive civil liability upon antitrust defendants has caused courts to limit standing to sue by the use of arbitrary legal rules supported by little more than ease of application. Nevertheless, the intent of the Supreme Court to promote the civil damage action as an effective deterrent to antitrust violations remains unquestioned, necessitating an accommodation of that policy with the developing passing-on rules.

The legal question raised by the passing-on concept involves the admissibility of evidence offered to prove damage resulting from an antitrust violator's illegal action. Because the excess charge imposed by a price-fixer or a monopolist upon the goods he sells resembles a tax imposed by the wrongdoer, effects of such an overcharge can be analyzed by reference to economic tax incidence theory. These principles identify market characteristics that control the incidence of a tax, and hence an illegal overcharge, imposed upon goods, enabling courts to determine with great accuracy in many situations who has borne the additional cost. Moreover, some situations will be found in which these estimates can be made readily with little need for extensive evidentiary inquiry, thereby greatly facilitating the attempts of courts to compensate truly injured claimants. Blending the use of this economic evidence with appropriate policies of antitrust deterrence would enable courts to de-
velop rules that can attain both the compensatory and the deterrent objectives of treble damage litigation.

Tax incidence theory, therefore, will provide a framework for this study of the passing-on question. Also fundamental is an understanding of the significant policies that indicate the proper role of treble damages in antitrust enforcement. With these bases established, a statement of acceptable rules can be made, to be followed by an analysis of several recurring antitrust fact patterns in which these rules can be applied readily. The basic incidence and policy considerations also will help illustrate instances in which courts, unguided by those considerations, have mishandled passing-on problems. A final look at some potential objections to these rules will dispel any doubt that they not only are proper, but indeed necessary to resolve passing-on issues.

Hanover Shoe, Inc.: Supreme Court Groundwork

The concept of "passing-on," expressing the notion that changes in the costs of producing a good will be reflected in the price paid for that good by the ultimate consumer, appears primarily in two contexts in civil antitrust litigation. A defendant-seller may raise the concept as a defense by asserting that a plaintiff who purchased directly from him suffered no damage from the purported violation because the plaintiff passed on to his own customers any overcharge imposed upon the plaintiff by the defendant. Contrariwise, a remote purchaser, one not purchasing directly from the alleged violator, might use the passing-on concept offensively by arguing that the illegal overcharge was passed on to him by intermediate purchasers. Although the same economic factors govern passing-on whether the concept is asserted offensively or defensively, different policy considerations may require the use of different rules to determine what evidence of passing-on may be admitted at trial, depend-

3. Passing-on issues also may arise in cases dealing with section 2(a) of the Robinson-Patman Act, 15 U.S.C. § 13(a) (1970). For example, in Perkins v. Standard Oil Co., 295 U.S. 642 (1969), the Supreme Court held that a jury could award damages to a retail service station operator who sued on the theory that the defendant had granted an illegal discount to a distributor that served a competitor, and that the discount had been passed on, thereby permitting the competitor to undersell the plaintiff; the Court required only that a causal connection between the discount and plaintiff's injury be shown.

ing upon which party asserts that passing-on has occurred. By considering the theory only in its defensive context, the Supreme Court has provided limited guidance for its application in other circumstances.

In *Hanover Shoe, Inc. v. United Shoe Machinery Corp.* the plaintiff shoe manufacturer instituted a treble damage suit against United Shoe Machinery Corp., which in an earlier civil suit by the United States had been found to have monopolized the shoe machinery market. The district court in the government case had found that United's "lease-only" policy for certain important machinery was a substantial factor contributing to United's monopolization. Relying upon this finding, Hanover contended that it had been injured to the extent that its rental payments exceeded the purchase price it would have paid but for United's practice. United, however, claimed that because the overcharge had been borne uniformly by Hanover's competitors and because the demand for shoes was inelastic, Hanover had been able to raise its price for shoes to pass on the overcharge to its customers. The Supreme Court rejected United's passing-on defense, holding that Hanover had proved both the fact and the amount of its injury by demon-

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   Any person who shall be injured in his business or property by reason of anything forbidden in the antitrust laws may sue therefor in any district court of the United States in the district in which the defendant resides or is found or has an agent, without respect to the amount in controversy, and shall recover threefold the damages by him sustained, and the cost of suit, including a reasonable attorney's fee.


8. Section 2 of the Sherman Act, 15 U.S.C. § 2 (1970), makes it unlawful for any person to "monopolize, or attempt to monopolize . . . any part of the trade or commerce among the several States . . . ."


10. 15 U.S.C. § 16(a) (1970), provides in part:

   A final judgment or decree . . . rendered in any civil or criminal proceeding brought by or on behalf of the United States under the antitrust laws to the effect that a defendant has violated said laws shall be prima facie evidence against such defendant in any action or proceeding brought by any other party against such defendant under said laws . . . as to all matters respecting which said judgment or decree would be an estoppel as between the parties thereto

11. 392 U.S. at 487.

12. *Id.* at 491-92.
Stratifying that it had been overcharged in a determinable amount.\textsuperscript{13} To support its conclusion, the Court cited "the nearly insuperable difficulty" a defendant would encounter in attempting to establish that the direct buyer "could not or would not have raised his price absent the overcharge or maintained the higher price had the overcharge been discontinued."\textsuperscript{14} In the Court’s view, the difficulty of establishing the passing-on defense, coupled with the proclivity of defendants to assert it if permitted, would necessitate "long and complicated proceedings involving massive evidence and complicated theories" in civil antitrust actions.\textsuperscript{15} Moreover, the Court feared that, if the defense were permitted, section 4 of the Clayton Act would be emasculated: antitrust violators could retain illegally obtained profits because each intermediary would have to meet the passing-on defense. If recovery were to be possible, consumers would have to sue,\textsuperscript{16} an alternative the Court believed unlikely.\textsuperscript{17}

Significantly, however, the Court did not ban the passing-on defense in all cases, expressly stating in dictum 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."\textsuperscript{18} Because the defense therefore might be available to certain defendants, it is imperative that proper standards of applicability, grounded in economic theory, be developed. Perhaps more important is a sound premise from which the passing-on concept can be asserted offensively.

\textsuperscript{13} Id. at 494.  
\textsuperscript{14} Id. at 493.  
\textsuperscript{15} Id.  
\textsuperscript{16} Complete recovery by the ultimate consumer, however, theoretically should be possible only when the defendant can demonstrate that each middleman had passed on the entire overcharge. Although complete shifting of this burden through each level of the chain of distribution might be possible in some situations, the extent to which each middleman will be able to pass on the overcharge is affected by several economic factors. See notes 19-66 infra & accompanying text.  
\textsuperscript{17} 392 U.S. at 494. One commentator has argued that the Court's skepticism regarding the likelihood of consumer class actions was unwarranted, noting that substantial attorneys' fees may be awarded to successful plaintiffs and that several antitrust class actions had been brought by consumers. McGuire, The Passing-on Defense and the Right of Remote Purchasers To Recover Treble Damages Under Hanover Shoe, 33 U. Pitt. L. Rev. 177, 189-91 (1971).  
\textsuperscript{18} 392 U.S. at 494.
The Economics of Passing-On: Incidence of Monopoly Costs

There is scarcely any economic principle which cannot be aptly illustrated by a discussion of the shifting of the effects of some tax...19

Economic analysis of the passing-on concept is aided greatly by the existence of a vast body of tax incidence theory inasmuch as the exaction by a violator of the antitrust laws of a greater-than-competitive price is equivalent to the imposition of an excise tax20 upon his customers. Tax incidence theory can be employed to determine when, and to what extent, a direct purchaser can transfer the burden of the overcharge to his own customers by charging higher prices.21 Whether the increased cost to the intermediate purchaser is a government-imposed tax or an overcharge imposed by a monopolist or price-fixer, the ability of the intermediate purchaser to pass the added burden down the distributive chain will depend greatly upon the relative elasticities of supply and demand for his product, that is, the responsiveness to price changes of quantities supplied and demanded.22 An examination of the extreme situations of perfect elasticity and inelasticity of supply and demand will indicate when the burden of the added cost is borne completely by the intermediate purchaser or passed on entirely to the more remote purchaser.

22. "Elasticity" is a concept used by economists to compare the responsiveness of one variable to a given change in another variable while avoiding problems posed by the arbitrariness of the economic dimensions in which either variable is stated. Elasticity of supply, for example, measures the responsiveness of the quantity of a commodity supplied to changes in the price of that commodity without reference to either units of output or dollars. Elasticity of supply \( E_s = \frac{\text{relative change in quantity supplied}}{\text{relative change in price}} \), or, stated more formally, for infinitesimally small changes, \( E_s = \frac{(dq/q)}{dp} \frac{dp}{dq} = \frac{dq}{dp} \frac{p}{q} \) where \( q \) = quantity supplied, \( p \) = price, and \( dq \) and \( dp \) are infinitely small changes in quantity supplied and price, respectively. Supply is perfectly elastic when elasticity equals infinity; the market will supply an infinite amount of goods at a particular price; that is, an infinite increase in supply would result from any increase in price, no matter how small. See G. Stigler, The Theory of Price 326-29 (3d ed. 1966). For a discussion of elasticity of demand and a sample calculation of elasticity, see note 27 infra.
Under competitive conditions, the buyer will be forced to bear the burden of an excise tax if the supply of the taxed good is perfectly elastic. Market demand \((D)\) and supply \((S)\) curves are depicted in Figure 1 for a market with perfectly elastic supply before the imposition of an excise tax; when the tax is imposed the supply curve will rise by the amount of the tax, \(\text{tax}^4\) becoming \(S'\). Imposition of the tax has caused the price of the goods to rise in an amount equal to the tax, from \(P_0\) to \(P_1\). Moreover, the same price rise will result regard-

Figure 1

23. The demand curve represents the quantity of a good demanded at different prices; similarly, the supply curve represents the quantity that will be supplied at different prices. Each curve represents a demand or supply function, with all factors affecting demand or supply, except price, constant. See generally E. Shows & R. Burton, Microeconomics 28-31 (1972).

24. See note 36 infra.

25. When supply is perfectly elastic and the cost of goods to the supplier is increased by
less of the elasticity of the demand curve, as is shown in Figure 1 by rotating the demand curve around the point of initial equilibrium to either \(D'\) or \(D''\).

If, however, the demand curve rather than the supply curve is imposed of a tax or overcharge, the revenue necessary to induce supply of those goods in the same quantity as before the cost hike must increase in an amount equal to the tax or overcharge. Thus, an increase in the cost of goods is accompanied by a vertical shift in the supply curve to reflect the needed revenue increase. See E. Shows & R. Burton, supra note 23, at 279-303. If the supply curve is not horizontal, or perfectly elastic, the upward shift will not result in an equal rise in price unless the demand curve is vertical, or perfectly inelastic, because the demand curve will intersect the new supply curve at a point that represents less than the original quantity demanded and less than the full cost increase. The following figure illustrates a market in which neither supply nor demand is perfectly elastic or inelastic:

An increase in cost shifts the supply curve from \(S\) to \(S'\), a vertical shift of \(P_1 - P_2\), but the new equilibrium price, determined by the intersection of \(D\) and \(S'_1\), is only \(P_1\).

26. Elasticity of demand measures the relative change in the quantity demanded in relation to the relative change in price.
perfectly elastic, the seller will bear the entire tax burden. As illustrated in Figure 2, the price of the good at initial equilibrium is $P_0$ and the quantity demanded is $Q_0$. Imposition of the tax shifts the supply curve to $S'$, but, because the demand curve is perfectly elastic, there is no change in the market price ($P_0$). Instead, the quantity sold is reduced from $Q_0$ to $Q_1$, indicating that, by selling fewer units at the same price but with increased costs, the seller

Figure 2

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27. Point elasticity of demand ($E_d$) may be calculated as follows:

$$E_d = \frac{(dq/q)}{(dp/p)} = \frac{dq}{dp} \cdot \frac{p}{q}$$
bears the tax burden. Buyers, of course, receive fewer units, but because their resources are freed to purchase other goods, they suffer no loss.23

Perfect inelasticity of supply and demand induce opposite tax incidence: when supply is perfectly inelastic, the seller will bear the entire burden of an excise tax, while perfectly inelastic demand means that the burden will fall wholly on the buyer.23 Perfectly inelastic supply,23 as shown by the supply curve (S) in Figure 3, indicates that sellers will supply the same output \( (Q_o) \) at all prices; because the curve is vertical, implying that it is impossible to vary the quantity supplied, imposition of a tax causes no shift that could move the market from its initial equilibrium price \((P_o)\) and quantity \((Q_o)\). By selling the same quantity at the same price while incurring increased costs, the seller thus bears the entire tax burden.

where \( q \) is quantity demanded, \( dq \) is an infinitely small change in quantity demanded, \( p \) is price, and \( dp \) is an infinitely small change in price. Because \( dq \) will be a negative number whenever \( dp \) is positive, and vice versa, \( E_d \) always is expressed as a negative number. See G. Stigler, supra note 22, at 329. When data concerning the effect of infinitesimal changes in price and quantity is not available, approximate elasticity may be computed as follows:

\[
E_d = \frac{q_o - q_1}{q_o + q_1} \cdot \frac{P_o + P_1}{P_o - P_1}.
\]

See id. at 331-33. To illustrate the computation of elasticity using this formula, assume a rise in the price of a good from \$10 to \$12 per unit, causing sales to decline from 200 units to 175 units. The calculation would be as follows:

\[
E_d = \frac{200-175}{200+175} \cdot \frac{10+12}{10-12} = \frac{25}{375} \cdot \frac{22}{-2} = -.737.
\]

When the absolute value of \( E_d \) is greater than one, demand is said to be elastic; when, as in the example, the absolute value is less than one, demand is inelastic. If absolute value of \( E_d \) equals one, demand is unitarily elastic, and when \( E_d \) equals infinity, demand is perfectly elastic (that is, an unlimited amount of goods will be demanded at a particular price) and increases in the quantity demanded can be had with no reduction of price, where

\[
E_d = \frac{dq}{dp} \cdot \frac{p}{q} = \infty.
\]

23. A perfectly elastic demand curve implies that perfect substitutes are available. Because purchasers thus are able to obtain substitute goods that yield the same utility at a comparable price, they suffer no welfare loss.

29. See C. Shoup, supra note 20, at 274.

30. Perfect inelasticity of supply is zero, indicating that no change in quantity supplied will result from changes in price.

\[
E_s = \frac{0}{dp} \cdot \frac{p}{q} = 0.
\]
Figure 3 illustrates a market in which demand is perfectly inelastic.\textsuperscript{31} In such a market, the full burden of an excise tax is passed on to the buyer; after the shift of the supply curve from $S$ to $S'$, reflecting the increased costs incurred by the seller because of the tax, the quantity demanded ($Q_o$) is the same as before the tax. Regardless of the price increase from $P_0$ to $P_1$, the same quantity is demanded with the result that the entire tax burden is shifted to the buyer.

\textsuperscript{31} Perfect inelasticity of demand is zero; the same quantity will be demanded regardless of the price charged.
Although instances of either perfect elasticity or perfect inelasticity of either supply or demand may be rare, the tax incidences found in such market conditions also suggest the relative burdens borne by the buyer or seller in situations of intermediate elasticities. Generally, as supply becomes more elastic or as demand moves toward perfect inelasticity, more of the tax burden will be passed on to the buyer. Conversely, as demand becomes more elastic and supply becomes more inelastic, the seller bears a larger portion of the burden. A general theorem describes the effects of the interplay of elasticity of supply and demand upon the shifting of tax incidence by stating that the buyer and seller will share the burden of the tax in the ratio of elasticity of supply to elasticity of demand.\(^2\)

The preceding analysis did not identify the supply or demand curves as long-run or short-run curves; time, however, is an important determinant of the extent to which a tax burden is shifted. To illustrate, assume a retail seller operating in a competitive market, whose expenditures for the taxed goods are reflected in his cost

\[ \frac{dp}{(t-dp)} = \frac{E_s}{E_d}, \]

32. C. Shoup, supra note 20, at 273-74. The theorem may be expressed as follows:
structure by changes in variable costs.33 Before imposition of the tax, this seller was in equilibrium, producing quantity $q_0$, which sold at price $P_0$, and his costs were presented by average ($AC$)34 and marginal ($MC$)35 cost curves, as shown in Figure 5.35

Price Figure 5

![Diagram showing price and cost relationship for a firm and industry with supply and demand curves]

where $t$ is the amount of the tax, $dp$ is the rise in price (buyer's share), $(t-dp)$ is the portion of the tax not passed on (seller's share), $E_s$ is the elasticity of supply, and $E_d$ is the elasticity of demand. Id. at 274 n.11. As a corollary, the buyer's share of the tax burden may be expressed as a percentage of the tax:

$$\frac{dp}{t} = \frac{E_s}{(E_s + E_d)}.$$

See id. See also R. Musgrave, supra note 21, at 290-91 (use of slopes of demand and supply curves to determine amount of shifting).

33. "Variable costs" are those costs that will change with the level of output in the short run. They are, of course, payments for "variable resources," which are defined as those resources the quantities of which can be varied within the short run without a significant change in their price. See G. Stigler, supra note 22, at 134-35.

34. Average cost equals total cost, including normal profits, divided by total output. See id. at 136, 140-41.

35. Marginal cost is the increase in total cost divided by a corresponding increase in output. Changes in marginal cost reflect changes in variable costs. See id. at 136.

36. A competitive firm's supply curve is the portion of the marginal cost curve ($MC$) that
Once the tax is imposed, the firm's cost curves shift upward to $AC'$ and $MC'$, and there is an immediate corresponding shift in the industry supply curve to $S'$. A new short-run price ($P_1$) is established, and at least part of the tax burden thus is shifted forward in the short run. At price $P_1$, however, because each firm is sustaining a loss, firms will begin to leave the industry in the long run. As firms leave, the industry supply curve will continue to shift to the left; in the long run, a new equilibrium price ($P_2$) and output ($Q_2$) will be established with the rise in price being equal to the tax.

Although in Figure 5, the entire tax was passed on to the customers in the form of a price increase, the entire burden need not

lies above the average variable cost curve; each point on the marginal cost curve represents the increased cost for an additional unit of output, which in turn indicates the additional revenue that the firm must receive to cause it to produce an additional unit. See E. Shows & R. Burton, supra note 23, at 288-91. The average variable cost curve, which does not appear in Figure 5, lies below the average cost curve (AC), because the average cost curve represents both variable and fixed costs. See G. Stigler, supra note 22, at 136. Therefore, in Figure 5, the firm's supply curve is the marginal cost curve (MC), at least at levels above the average cost curve.

In the short run, the individual competitive firm's demand curve is perfectly elastic at the industry's equilibrium price: the firm can sell any quantity at the industry-determined price. In Figure 5, the firm's demand curve ($D$) is a horizontal line at the price level determined by the intersection of the industry supply ($S$) and demand ($D_1$) curves. The firm's equilibrium output ($q_1$) and price ($P_1$) are determined by the intersection of the firm's marginal cost ($MC$) and demand ($D$) curves. Because the firm can sell all that it wishes at $P_1$, the demand curve is also the firm's marginal revenue ($MR$) curve, depicting the revenue obtained from selling one additional unit.

37. The industry supply curve is the horizontal summation of the marginal cost curves, above average variable cost, of the several firms. Consequently, any change that causes the firms' marginal cost curve to shift will induce a similar shifting of the industry supply curve. See E. Shows & R. Burton, supra note 23, at 288-91.

38. Although not definable precisely, the "short-run" is the period within which some inputs are not variable. See G. Stigler, supra note 22, at 135.

39. At price $P_1$, the firm sells a total of $q_1$ units of output, giving it total revenue of $q_1 \cdot P_1$, which is represented in Figure 5 by the rectangle $P_1Aq'0$. The firm's total cost is its average cost per unit ($C_1$), multiplied by the number of units produced ($q_1$), as shown by the larger rectangle $C_1Bq_0$. Because total cost thus exceeds total revenue, a loss is sustained.

40. During the "long run" all resources are variable. See G. Stigler, supra note 22, at 134-35.

41. The industry supply curve is the horizontal summation of the individual member firms' supply curves. See note 37 supra. As firms exit, the horizontal sum of quantities supplied is reduced at each price level, as represented by a shift of the industry supply curve to the left.

42. At price $P_1$ the individual firm's total revenue and total cost are equal, as represented by the rectangle $P_1Bq_1$. Losses no longer are being sustained, removing the incentive to leave the industry.

43. The price increase to the new equilibrium ($P_2-P_1$) equals the amount of the tax, which is represented by the vertical difference between the new and old marginal cost curves ($MC'-Mc$), a difference equal to $EF$. 
always be shifted. Implicit in the foregoing analysis was the assumption that firms were in an industry characterized by constant costs; though a decline in industry output lowered demand for the factors of production, factor prices remained constant. A constant-cost assumption, which is proper if resources can enter or leave the industry without suffering a reduced return, implies that the industry's long-run supply curve is perfectly elastic. If, however, factor prices were assumed to decrease as industry output decreased, which undoubtedly would be a realistic assumption if the firms employed some specialized resources that would earn a lower return elsewhere were they to leave the industry, then the ultimate price rise to the industry's consumers would be somewhat less than the entire amount of the tax. Part of the tax burden would be placed on the factors of production, as would be reflected by a downward shift of the average and marginal cost curves in Figure 5 from $AC'$ and $MC'$ to some intermediate point above $AC$ and $MC$ the original cost curves. Equilibrium then would be achieved at the intersection of the industry demand curve and an industry supply curve below and to the right of $S''$. Such an industry, in which the long-run supply curve would have a positive slope, is denominated an increasing-cost industry.

The difference between long-run and short-run tax incidence would be more marked if the firm's tax costs were assumed to be fixed costs rather than variable costs. Under this assumption, al-

44. C. Showp, supra note 20, at 274-75. If factors of production were "specialized" and therefore unable to earn the same return elsewhere, they would continue to compete for the reduced volume of production in the taxed market, thereby driving down the cost of factors.

45. See Figure 1 supra. The long-run supply curve represents the quantities of a good that will be supplied over time at various prices, or the locus of points of intersection of an infinite series of short-run supply curves and market demand curves. The slope of the long-run supply curve will depend upon whether the costs of factors of production increase, decrease, or remain constant in response to an increased demand for them. If factor costs remain constant and the price sufficient to cover costs for all levels of output also is constant, the industry long-run supply curve will be horizontal (perfectly elastic). See generally E. Shows & R. Burton, supra note 23, at 295-300; R. Leftwich, supra note 21, at 194-99.

46. See C. Showp, supra note 20, at 275.

47. See R. Musgrave, supra note 21, at 289.

48. See Figure 2 supra.

49. There is a third possibility regarding long-run tax incidence: if the industry were characterized by decreasing costs, the price rise to consumers would be greater than the amount of the tax because factor prices would increase as a result of reduced industry output. See R. Leftwich, supra note 21, at 198-99. Such industries, however, probably are rare. Id.

50. "Fixed costs," those costs that will not vary with the level of output in the short run, represent expenditures for resources that are not variable during the short run. See G.
though the average-cost curve would shift upward with the imposition of the tax, the marginal-cost curve would not be affected. The firm's price and output would remain at the initial equilibrium levels of $P_0$ and $q_0$; in the long run firms sustaining losses would exit, causing the industry supply curve to shift upward and to the left. The portion of the tax passed on as a price increase to consumers would be determined, as it was when variable costs were increased, by whether the industry was characterized by constant or increasing costs.

The tax incidence principles that have been outlined apply similarly to a cost increase imposed on a firm by an antitrust violator, such as a supplier who is charging prices above those that would be determined under competitive conditions, perhaps because of a price-fixing agreement or a monopolization of the supplier's industry. The "tax" imposed by the monopolist or price-fixer, whether considered a fixed or variable cost, would be passed on to the firm's customers in the degree determined by market elasticities and by whether constant or increasing costs characterize the industry.

**Incidence and Derived Demand**

The foregoing analysis has dealt with situations in which sales were made directly between the wrongdoer and a direct purchaser. In many situations, however, the direct purchaser resells the product, either as purchased or incorporated into another product, to a more forward link in the distributive chain. In these situations, incidence theory indicates that in most cases at least part of the illegal overcharge will be passed on by intermediate purchasers to remote consumers. Only if the intermediate purchaser's supply curve is perfectly inelastic or if demand for his product is perfectly elastic will he bear the entire overcharge. Moreover, antitrust violations seem especially likely to occur when an intermediate purchaser can pass the resulting overcharge on to his customers or shift

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Stigler, * supra* note 22, at 135-36. To illustrate the concept of fixed costs, assume that a widget retailer rents his place of business under a lease obligating him to pay $600 rent per month for a specified period of time. During the term of the lease the merchant's rent is a fixed cost; his rental expenses will remain constant whether he sells one widget in a month or several thousand.

51. The individual firm's supply curve is that portion of its marginal cost curve that lies above the average variable cost curve. See * supra* note 36. Changes in fixed costs do not affect marginal cost, average variable cost, or demand; intersection of the firm's supply and demand curves thus remains at the same point as before imposition of the tax.
it to his other suppliers. If an intermediate purchaser is unable to pass on an illegal overcharge, motive to discover a violation will be joined with his superior opportunity to make the discovery,\textsuperscript{52} with the result that a potential antitrust violator may be dissuaded from his illegal scheme by fear of detection.

In addition to minimizing the direct purchaser's incentive to discover illegal overcharges, inelasticity of demand for the final product also may encourage antitrust violations by affecting their profitability. Commentators have observed that a price-fixing agreement is more likely for a product that is subject to inelastic demand because greater profits can be exacted under such market conditions.\textsuperscript{53} To appraise this theory it is helpful to distinguish two different industry demand curves, the demand curve for the final product and the derived demand curve for the price-fixed good.\textsuperscript{54} In antitrust cases, the firm purchasing directly from the wrongdoer frequently resells to another intermediary,\textsuperscript{55} in which case the industry demand curve facing the direct purchaser will represent derived demand. Although the theorem that tax incidence will be apportioned according to the ratio of elasticity of supply to elasticity of demand\textsuperscript{56} will apply in this situation, the elasticity of derived demand has significant additional characteristics. The elasticity of derived demand for a factor of production will be affected by four conditions: the ease with which other factors may be substituted for it in the production process, the elasticity of demand for the final product, the volume of resources that an intermediate purchaser will be induced to expend to detect a violation should be determined by the absolute dollar amount of the overcharge he is forced to bear, rather than by a percentage figure.

\textsuperscript{52} The volume of resources that an intermediate purchaser will be induced to expend to detect a violation should be determined by the absolute dollar amount of the overcharge he is forced to bear, rather than by a percentage figure.


\textsuperscript{54} "Derived demand" indicates that the demand for a factor of production depends upon the demand for the final good to be produced. See G. Stigler, supra note 22, at 242. For example, although there is independent demand for automobiles, there would be no demand for automobile workers that would be independent of the demand for automobiles.


\textsuperscript{56} See note 32 supra \\& accompanying text.
the elasticity of supply of substitute factors, and the portion of the total cost of the final product attributable to the cost of the factor.57 Economists have developed four rules that express the relationship between each of these conditions and the elasticity of derived demand: (1) as other factors become more substitutable for a particular factor, derived demand becomes more elastic; (2) as demand for the final product becomes more elastic, derived demand becomes more elastic; (3) the elasticity of derived demand increases as the elasticity of supply of substitute factors increases; and (4) derived demand for a factor will become more inelastic as the portion of the total cost of the final product attributable to it decreases.58 Several of these principles affect the extent to which a wrongdoer's illegal overcharge will be shifted forward to remote purchasers.

Would-be price-fixers will find the illegal scheme more profitable if both derived and final demand curves are inelastic.59 Inelastic derived demand is desirable because under that condition the price rise resulting from the unlawful agreement will cause a relatively small decline in the quantity demanded of the price-fixed commodity; the more inelastic the derived demand, the smaller the drop in quantity demanded. Moreover, price-fixers will favor inelastic demand for the final product for two reasons. First, inelastic demand for the final product often will foster inelastic derived demand for components of the final product.60 Second, because inelastic demand for the final product better enables intermediate purchasers to pass on an illegal overcharge,61 such purchasers will have less incentive to detect an antitrust violation. Consequently, it is not surprising that the fragmentary evidence available indicates a correlation between price-fixing conspiracies and inelasticity of demand for the final product.62

57. See G. Stigler, supra note 22, at 243-44.
58. See id. For a formula for the calculation of elasticity of derived demand, see id. at 346 (mathematical n.14).
59. If there are several intermediate stages between the price-fixer and the ultimate consumer, the price-fixer will be interested in the derived demand curve for each stage, preferring each curve to be as inelastic as possible.
60. Assuming perfectly competitive factor markets, the demand for a component factor of production should be more inelastic when the demand for the final product is more inelastic. J. Hicks, THE THEORY OF WAGES 242, 245 (2d ed. 1966). This proposition first was suggested by the nineteenth-century economist Alfred Marshall.
61. See notes 31-32 supra & accompanying text.
62. Two commentators were able to find estimates of demand elasticity for the final prod-
Significantly influencing the elasticity of demand for a component is the ease or difficulty with which it can be replaced by a substitute in the manufacture of the final product: as substitution becomes more difficult, derived demand becomes more inelastic. A corollary, which encompasses many price-fixing cases, may be stated: if a component is vital to the production of the final product (that is, if substitution is difficult) derived demand for the component will be more inelastic as the proportion of the final product's total cost attributable to that component decreases. Moreover, the underlying logic of this proposition compels the further observation that an increase in the price of an irreplaceable, but relatively inexpensive, component most likely will be passed on to consumers of the final product; because the cost of the component constitutes but a small fraction of the final product's price, demand for the final product will be unresponsive (inelastic) to changes in the component's cost. Hence, price-fixing should be especially profitable for a vital component of a final product the price of which greatly exceeds the component's cost.

63. J. Hicks, supra note 60, at 242-45. Ease of substitution for a factor of production can be expressed as the "elasticity of substitution." That substitutability thus affects derived demand first was suggested by Alfred Marshall. In like fashion, consumer demand will be more elastic for goods with close substitutes than for those without such substitutes, because consumers will turn to substitutes as the price of a good rises. C. Ferguson, Microeconomic Theory 84 (1969).

64. J. Hicks, supra note 60, at 242-45. For example, the derived demand for plumbing fixtures to be used in new houses will tend towards inelasticity: although new houses without plumbing fixtures would be difficult to sell, that component represents a relatively small part of the total cost of house construction.

65. An increase in the price of plumbing fixtures will cause a relatively minor increase in the price of a new home. Little change in the quantity of new homes demanded will result, even though the price increase for the vital component will be passed on to the purchasers of the final product. The example of new house plumbing fixtures is suggested by Philadelphia Housing Authority v. American Radiator & Standard Sanitary Corp., 50 F.R.D. 13 (E.D. Pa. 1970), aff'd sub nom. Mangano v. American Radiator & Standard Sanitary Corp., 438 F.2d 1187 (3d Cir. 1971); see notes 149-58 infra & accompanying text.

66. This characteristic would appear to describe a number of the price-fixing conspiracies examined by Hay & Kelley, supra note 62, at 29-38, including, for example, conspiracies involving the following products: drill jig bushings sold to machinists (especially aircraft manufacturers); stainless steel welding electrodes; vitreous china plumbing fixtures sold to building contractors; and tickets sold to amusement parks and transportation companies.
The Profit-Maximization Assumption

Several recurrent situations have been isolated in which at least part of an illegal overcharge will be passed on by intermediate purchasers to more forward links in the productive chain. Orthodox economic theory, however, assumes that businesses will adjust prices and allocate resources to maximize profits; the preceding incidence theory shared this assumption. Thus, it was assumed that establishment of a new price after imposition of a tax or overcharge was achieved by equating marginal revenue and marginal cost. If the profit-maximization assumption is sound, then the extent to which an illegal overcharge will be passed on by an intermediate purchaser will depend solely upon the market in which he sells. A determination of the validity of this crucial assumption and the extent to which it should constrain proof of damages in antitrust litigation therefore is appropriate.

A passage from Hanover indicates that a court should not rely upon the profit-maximization assumption:

A wide range of factors influence a company's pricing policies. Normally the impact of a single change in the relevant conditions cannot be measured after the fact; indeed a businessman may be unable to state whether, had one fact been different (a single supply less expensive, general economic conditions more buoyant, or the labor market tighter, for example), he would have chosen a different price. Equally difficult to determine, in the real economic world rather than an economist's hypothetical model, is what effect a change in a company's price will have on its total sales. Finally, costs per unit for a different volume of total sales are hard to estimate. Even if it could be shown that the buyer raised his price in response to, and in the amount of, the overcharge and that his margin of profit and total sales had not thereafter declined, there would remain the nearly insuperable difficulty of demonstrating that the particular plaintiff could not or would not have raised his prices absent the overcharge or maintained the higher price had the overcharge been discontinued. Since establishing the applicability of the passing-on defense would require a convincing showing of each of these virtually unascertainable figures, the task would normally prove insurmountable.

67. See notes 33-43 supra & accompanying text.
68. 392 U.S. at 492-93 (emphasis supplied). The Court added:

The mere fact that a price rise followed an unlawful cost increase does not
The italicized language clearly questions the appropriateness of assuming that an intermediate purchaser maximizes his profits in response to the imposition of an illegal overcharge by suggesting that if a passing-on defense were permitted the defendant would have to prove that his purchaser had been maximizing profits before the violation occurred. This allocation of the burden of proof, however, is closely related to the factual context before the Court. The guilty defendant in Hanover was seeking to establish an affirmative defense against an innocent direct purchaser, and the principle used to resolve doubt about what the Court believed to be a questionable assertion resembled the maxim often invoked to place upon a defendant "the risk of the uncertainty which his own wrong has created."

Unlike the situation in Hanover is one in which a plaintiff asserts
passing-on offensively as an element of proof that he has sustained damages; in such cases the plaintiff should not be disadvantaged by the same uncertainty because of the Supreme Court’s general practice of relaxing a plaintiff’s standard of proof in antitrust litigation to promote the strong public policy of deterring antitrust violations.\(^7\) Thus, if the contest is between a guilty monopolist or price-fixer and a direct purchaser, \textit{Hanover} would place a heavy, in fact “nearly insuperable” burden upon the guilty party to dispel all doubt concerning the profit-maximization assumption. On the other hand, when an innocent remote purchaser offensively alleges against a monopolist or price-fixer that the intermediate purchaser has passed on the overcharge, the exacting standard for proof of profit-maximization imposed upon the defendant in \textit{Hanover} should not apply.

When two innocent parties, such as an intermediate purchaser and a remote consumer, seek to allocate damages between them in a joint suit against a monopolist, they must measure the extent to which the defendant’s unlawful tax has been shifted; in such a case different considerations should determine the appropriate standard of proof regarding profit maximization. Initially, because the intermediate purchaser possesses more information about whether he had refrained from maximizing profits before the overcharge was imposed, he would be in a superior position to prove that no passing-on in fact had occurred. Moreover, to place the burden on the remote purchaser to prove profit maximization might permit the intermediate purchaser to benefit from the possibility that he has not maximized profits, a circumstance that is inconsistent with efficient use of resources.\(^2\) Finally, to presume profit maximization, in the absence of preponderant contrary proof by the intermediate purchaser, would be consistent with the “yardstick” method, an accepted method of proving damages in antitrust litigation.\(^3\) By comparing a plaintiff’s profits with those experienced by firms similar to the plaintiff but unharmed by defendant’s conduct, the yardstick

\(\text{\small 71. See D. Dobbs, Law of Remedies 152-53 (1973); cf. note 88 infra & accompanying text.}\)
\(\text{\small 72. Profit maximization induces firms to produce those goods most highly valued by consumers, while minimizing the costs of production. R. Posner, supra note 21, at 186.}\)
\(\text{\small 73. See Treble Damage Actions, supra note 69, at 1575. Because the yardstick cases may involve contests between innocent plaintiffs and wrongdoing defendants, rather than two innocent claimants, those cases may reflect a policy of resolving doubts against the wrongdoer. See, e.g., William Goldman Theatres, Inc. v. Loew’s, Inc., 69 F. Supp. 103, 105-09 (E.D. Pa. 1946); notes 70-71 supra & accompanying text.}\)
method implicitly assumes that the plaintiff either maximizes profits or at least exploits his profit opportunities to the same extent as the yardstick firm.

The policy arguments that favor an assumption of profit maximization when allocating damages between innocent purchasers on the intermediate and remote levels, or when a remote purchaser separately sues a wrongdoer, are supported by a review of the theoretical and empirical debate concerning whether businessmen actually maximize profits. The debate began with studies of businessmen who typically did not describe themselves as following marginal rules for profit maximization, utilizing instead "full-cost" pricing with a markup that reflected a profit "target." Several alternative interpretations of this evidence have been advanced, either reconciling it with the profit-maximization assumption or asserting that the assumption in some circumstances should be modified.

It has been argued, for example, that businessmen may follow a profit-maximizing strategy unknowingly. Some responses by businessmen, while asserting a profit-target approach to pricing, specify targets sufficiently vague to be consistent with profit maximization or sufficiently high to be reached only by profit maximization. A study of "excellently managed" companies, moreover, concluded that the policies of those companies resembled the marginal rule of profit maximization. Although some businessmen purportedly use a "rule of thumb" for decisionmaking, that "rule of thumb," as tested by experience, may approximate a profit-maximizing strategy, while use of target levels for "satisfactory" profits may repre-

75. Economists admittedly have a vested interest in the profit-maximization hypothesis, which simplifies greatly their problem-solving task. Cf. T. Kuhn, The Structure of Scientific Revolutions 18-19, 37, 40, 42 (2d ed. 1970) (reluctance of scientists to reject hypotheses that they long have found fruitful); R. Bellman, Some Vistas of Modern Mathematics 17-18 (1968) (intellectual tendency to transform a problem into one with a known solution rather than solving the original problem). Indeed, when courts structure passing-on issues to turn upon "cost-plus" or "consumer-middleman" distinctions (see notes 168-189 infra & accompanying text), they may exemplify the tendency to transform issues into possibly irrelevant but easily resolvable questions. To paraphrase a joke of Less's, one might call this approach, "Occam's butcher-knife." Cf. Lef's, Injury, Ignorance and Spite—The Dynamics of Coercive Collection, 86 Yale L.J. 1, 20 n.62 (1970).
78. See Baumol & Quandt, Rules of Thumb and Optimally Imperfect Decisions, 54 Am. Econ. Rev. 23 (1954).
sent a profit-maximizing approach tempered by uncertainty concerning what profits are optimal. A related view emphasizes the pressure upon firms in a competitive industry to adopt profit-maximizing behavior, even if unplanned, to ensure survival. In an industry with many participants, firms that exhibit, though only accidentally, a profit-maximizing response to a cost increase will prosper; competitive pressures then cause other firms to imitate the profit-maximizers.

Market coercion therefore makes nonmaximizing behavior unlikely in a competitive industry, causing critics of the profit-maximization postulate to turn to oligopolistic markets for their analysis. An alternative to the profit-maximization assumption is the "full cost" hypothesis under which firms set prices by adding to their direct manufacturing costs a satisfactory percentage to reflect overhead and profit. Other theories have been premised upon the potential divergence of interests between management and stockholders, noting that, subject to the constraint that the owners must be satisfied with a minimum level of reported profits, management largely pursues its own goals, perhaps maximizing sales revenue or emoluments to management.

Nevertheless, the unconvincing showing that businesses do not in fact seek to maximize profits, coupled with the recognition that passing-on will occur to an equal or greater extent even under many

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84. O. Williamson, supra note 81, at 129-34. Assuming that either sales revenue or management emoluments are maximized, a firm would respond to increased variable costs, just as if it were maximizing profits, by increasing selling prices. See id. at 82. Unlike profit-maximizing firms, moreover, such firms will tend to pass on fixed-cost increases. K. Cohen & R. Cyert, Theory of the Firm: Resource Allocation in a Market Economy 361-62, 380 (1965).
of the suggested alternative theories of business decisionmaking, leaves the profit-maximization assumption as a sound theoretical base from which to resolve passing-on disputes. A court will be presented with evidence of any changes in an intermediate purchaser's prices after imposition of an illegal overcharge, and, as suggested in *Hanover*, alternative causes for any price increase can be explored. Confluence of public policy and business reality, however, supports adoption of a profit-maximization presumption when the disputants are both innocent parties; similarly, mere suspicion of other causes should not excuse a court from an inquiry into the true explanation for a price rise when that fact is alleged offensively as proof of damages, rather than by an admitted antitrust violator. That this latter policy is especially significant appears readily from an examination of the deterrent purpose of civil antitrust damages.

**Offensive Use of Passing-On: The Deterrent Effect**

The importance of private treble damage actions as a deterrent to antitrust violation was emphasized by the Supreme Court in *Hanover*:

[U]ltimate consumers, in today's case the buyers of single pairs of shoes, would have only a tiny stake in a lawsuit and little interest in attempting a class action. In consequence, those who violate the antitrust laws by price fixing or monopolizing would retain the fruits of their illegality because no one was available who would bring suit against them. Treble-damage actions, the importance of which the Court has many times emphasized, would be substantially reduced in effectiveness.

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85. See notes 82, 84 supra.

86. In *Wall Prods. Co. v. National Gypsum Co.*, 357 F. Supp. 382 (N.D. Cal. 1973), the court noted that the defendant had introduced exhibits comparing manufacturers' price changes with plaintiffs' (direct purchasers) price changes during the first year of the conspiracy. The court found a "substantial difference" in those changes and after consideration of other evidence concluded that no passing-on had been demonstrated. For a discussion of considerations in that case suggesting a different conclusion, see notes 159-63 infra & accompanying text.

87. See note 68 supra & accompanying text. When assessing antitrust damages, courts consider whether part or all of the increase in a defendant's price was caused by changes in economic conditions rather than by the defendant's illegal actions. *See*, e.g., *Ohio Valley Elec. Corp. v. General Elec. Co.*, 244 F. Supp. 914-48 (S.D.N.Y. 1965); cf. *E.V. Prentice Mach. Co. v. Associated Plywood Mills, Inc.*, 252 F.2d 473, 477-79 (9th Cir. 1958) (plaintiff's loss of business found to have been caused by factors other than defendants' antitrust violations).

88. 392 U.S. at 494.
Because of the relative insignificance of other available sanctions when compared with the enormous profits obtainable from illegal monopolization or price-fixing, treble damage suits must bear the heaviest deterrence burden. The maximum corporate fine that may be imposed for a violation of the Sherman Act is one million dollars,99 far less than the hundreds of millions of dollars that can be reaped by such violations. Moreover, courts often are reluctant to impose the maximum fine: in the electrical equipment conspiracy cases,99 although the judge indicated at the time of sentencing that heavy fines were appropriate,91 only one of the 108 corporate fines equaled the statutory maximum then in existence.92 Also illustrative of the treble damage action's predominance as a deterrent is a comparison of the total of all corporate and individual fines in the electrical equipment conspiracy cases, $1,924,500, with the $160,000,000 paid by a single corporate defendant, General Electric, to settle 90 percent of the private damage claims against it.93

Similarly, although sections 1 and 2 of the Sherman Act provide for imprisonment of corporate officers responsible for or participating in an offense,94 such sentences rarely are imposed. The 30-day sentences imposed upon seven corporate officials in the electrical equipment cases are famous largely because they highlighted the common expectation in business and legal circles that criminal penalties will be imposed only infrequently, even for per se antitrust violations. Other evidence corroborates this perception: from 1960 until 1969 criminal convictions were obtained in 110 cases; in only three were unsuspended prison sentences imposed, the maximum penalty being 60 days.95

90. For the history of these cases, see C. BANE, supra note 69; J. HERLING, THE GREAT PRICE CONSPIRACY: THE STORY OF THE ANTITRUST VIOLATIONS IN THE ELECTRICAL INDUSTRY (1962); C. WALTON & F. CLEVELAND, CORPORATIONS ON TRIAL: THE ELECTRIC CASES (1965).
91. See C. BANE, supra note 69, at 15.
92. Id. at 15 n.6.
93. Id. at 20, 250.
95. Posner, A Statistical Study of Antitrust Enforcement, 13 J. Law & Econ. 365, 369, 391 (1970). Posner’s study was conducted before recent amendments to the Sherman Act that increased criminal penalties substantially. Act of Dec. 21, 1974, Pub. L. No. 93-528 § 3, 88 Stat. 1706, amending 15 U.S.C. §§ 1-3 (1970) (maximum corporate fine increased from $50,000 to $1,000,000; maximum individual fine increased from $50,000 to $100,000; maximum period of imprisonment increased from one year to three years). Nevertheless, minimal employment of criminal sanctions in the past leaves some doubt about the effectiveness of
Deterrence by the Threat of Damages

The limited effectiveness of civil and criminal sanctions suggests the need to determine the degree of deterrence that should be achieved by the civil damage remedy. Consideration of some theoretical aspects of remedy by damages, particularly the treble damage remedy, will emphasize the impact of a damage award upon the wrongdoer's expected profits as a determinant of the deterrence value of the damage remedy. An understanding of this concept will facilitate subsequent analysis of problems of multiple liability and overdeterrence because it will become apparent that it may not always be desirable that damages assessed against a wrongdoer equal his profits from the illicit activity.

Pecuniary damages do of course depend upon their adverse effect on profits for their deterrence value. Indeed, when the proscribed activity is so pernicious and so devoid of social benefit that the activity should be deterred under all circumstances, a damage remedy that at least forces the miscreant to disgorge his profits would be appropriate. Certain antitrust violations, such as price fixing, generally are perceived to have these undesirable characteristics. Moreover, in such cases there would appear to be little detriment to society if the damages established exceed the monopolist's profits or the social costs of his activity. Finally, if it is desired in such

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96. The term "expected profits" is used to indicate that the defendants' actual profits must be adjusted to reflect the fact that the violation may not be detected and successfully pursued. See R. Posner, supra note 21, at 360.


99. But cf. R. Posner, supra note 21, at 358 (even thievery should be tolerated when benefit to thief greater than all relevant costs). Professor Posner also recognizes, however, that criminal sanctions such as imprisonment for conversion or rape are valid examples of situations in which the punishment inflicted is unrelated to the actual harm done. Id.

Presumably, the absence of redeeming virtues in the type of antitrust violation for which
cases that the damage remedy not only deter potential price-fixers, but also fully compensate victims, then the damages awarded must exceed the monopolist’s gain.¹⁰⁰

criminal prosecutions would be undertaken underlies a recent proposal to impose a fine equal to a stated portion of the defendant’s profits, a sum possibly much greater than the harm to others caused by the violation. See Breit & Elzinga, Antitrust Penalties and Attitudes Toward Risk: An Economic Analysis, 86 Harv. L. Rev. 693 (1973). A significant disadvantage of the Breit-Elzinga proposal, however, is the lack of correlation between the penalty and the harm caused by the violation and the nature of the violation. Although the fine justifiably might be excessive, it also might be too small because corporate profits may not measure accurately the damages inflicted by an antitrust violator. For example, an unlawful overcharge may have been imposed by one division of a generally unprofitable entity. Moreover, “deadweight loss” will not be reflected in corporate profits. See note 100 infra.

Profits also can understate the harm to others when a defendant’s costs increase because of conspiracy-related inefficiencies; for example, during the bleacher conspiracy, illegal overcharges were estimated to be more than 30 percent, but much of the excess return was dissipated by a rise in costs of at least 20 percent. Erickson, Economics of Price Fixing, 2 Antitrust L. & Econ. Rev., Spring 1969, at 83, 104.

¹⁰⁰. The social costs of an antitrust violation include not only the wrongdoer’s unlawful profits, but also an additional economic cost, “deadweight” loss, a term that denotes excess consumer losses from monopolistic activity. To illustrate this concept, assume that line D in the following graph represents the market demand curve for a consumer good. In a competitive market, equilibrium would be at price $P_c$ and output level $Q_c$; consumers can purchase up to $Q_c$ units at a price of $P_c$ per unit.
Even though an activity is unlawful, however, it is not necessarily advantageous to seek its complete eradication.\textsuperscript{101} Some illegal monopolies produce a mixture of social benefits and harms. Forcing the perpetrators of such violations to surrender all of their unlawfully obtained profits would constitute overdeterrence, that is, the discouragement of activities which produce net social benefits. In these cases, the proper approach is to found the amount of the damage award upon the cost of the proscribed activity to others.

But this demand curve indicates that consumers would be willing to pay higher prices if lesser quantities of the good were available. For example, to obtain $Q_1$ units consumers would pay price $P_1$; similarly, consumers would pay $P_m$ per unit to purchase quantity $Q_m$. The area of triangle $AP_mB$ thus represents the "consumer surplus," which is the difference between what consumers are willing to pay for all quantities less than the competitive equilibrium output ($Q_c$) and the amount they actually must pay under competitive conditions.

The same curve ($D$) also depicts the demand facing a monopolist, but because he would maximize his profits where marginal cost (MC) equals marginal revenue (MR), the equilibrium price ($P_m$) would be greater, and the equilibrium output ($Q_m$) smaller, than in a competitive market. Consequently, consumer surplus is reduced to $AP_mE$. Of the total consumer surplus lost ($P_mP_mE$), only the amount represented by the rectangle ($P_mP_mE$) is transformed into gains for the monopolist; the excess, represented by the triangle $ECB$, is "deadweight" loss. See generally Mueller, Lawyer's Guide to 'Welfare-Loss' Concept: An Introduction, 5 ANTITRUST L. & ECON. REV., Spring 1972, at 75.

Total deadweight loss may be expressed mathematically as $\frac{1}{2}r^2q_k$, where $r_i$ is the percentage deviation of price from costs, including normal profits, $q_i$ is the quantity, and $k_i$ is the elasticity of demand. Harberger, Monopoly and Resource Allocation, 44 AM. ECON. REV. 77, 81 n.7 (1954). A variation of this formula has been used to evaluate governmental antitrust activity. See Long, Schraun & Tollsion, The Economic Determinants of Antitrust Activity, 16 J. Law & Econ. 351 (1973). The deadweight loss under the monopolist's derived demand curve also represents the total welfare cost to society of the antitrust violation. See Kamekson & Wallace, The Costs of Monopoly, 17 ANTITRUST BULL. 485 (1972); Wisecarver, The Social Costs of Input-Market Distortions, 64 AM. ECON. REV. 359 (1974). For other examples of the application of deadweight loss to economic problems, see Green, Welfare Losses from Monopoly in the Drug Industry: The Oklahoma 'Antisubstitution' Law, 5 ANTITRUST L. & ECON. REV., Spring 1972, at 97; Hotelling, The General Welfare in Relation to Problems of Taxation and of Railway and Utility Rates, 6 ECONOMETRICA 242 (1938). See also Harberger, Three Basic Postulates for Applied Welfare Economics, 9 J. ECON. LITERATURE 785 (1971).

101. See R. Posner, supra note 21, at 361. The implications of this statement extend well beyond the area of antitrust law. For example, by designing cushioned roadways, requiring automobile protective devices similar to those provided in jet aircraft, and imposing very low speed limits, injuries from traffic accidents might be eliminated. The benefits of convenience and economy, however, that would be forfeited require allowance of a level of traffic accidents that is greater than zero. See Valavanis, Traffic Safety from an Economist's Point of View, 72 Q.J. ECON. 477 (1958).

such as the treble damage provision, that uses the harm caused to others as the basis for the damage award is less likely to discourage violations which continue to be profitable undertakings despite the potential liability because they produce benefits such as increased efficiency. In short, such a damage mechanism, if functioning properly, will tend to produce an optimum level of antitrust violations.103

Because the maintenance of this optimal level of infractions yields net social benefits, proper resolution of the passing-on question requires an assessment of the possibility of overdeterrence arising from liberalized standing rules premised upon incidence principles. The proper application of incidence principles to passing-on problems should promote attainment of the optimal level of antitrust violations by facilitating calculation of the actual costs borne by the remote purchaser and by giving the ability to bring suit to the party with the most incentive to do so. It is conceivable, nonetheless, that the level of violations would be reduced below the optimum level by the deterrent effects of automatically trebled damages and of multiple liability arising from suits by both direct and remote purchasers. Although a number of procedural devices may be employed to minimize the risk of multiple liability,104 even a slight likelihood of multiple liability may be undesirable if, when coupled with automatic trebling, it renders “desirable” violations of antitrust law unprofitable; the effect of trebling damages therefore should be examined closely.

Underdeterrence in Present Law

The statutory provision for trebling antitrust damage awards seemingly ensures that a defendant’s liability will exceed his wrongful profits. Reflecting this belief, some courts have suggested that the confusion in the law of standing in antitrust cases was engendered by courts hoping to temper the impact of treble damages.105

103. See R. Posner, supra note 21, at 361.
104. See notes 194-219 infra & accompanying text.

We must confess at the outset that we find antitrust standing cases more than a little confusing and certainly beyond our powers of reconciliation. The statutory provision about which there exists so much uncertainty itself seems straightforward: . . . [quoting section 4 of the Clayton Act].

This language suggests that to bring a private action for violation of the
In fact, however, even treble damages are unlikely to equal a defendant's wrongful profits. Any of several factors may make antitrust violations profitable, despite the facially liberal damage provision. One such factor is the interpretation of the Clayton Act that denies recovery of prejudgment interest.¹⁰⁶ Because of the long delays that typically intervene between violation and final judgment, the benefit from interest-free use of ill-gotten gains may far exceed the treble damages ultimately awarded.¹⁰⁷ If all antitrust violations were detected and all civil and criminal claims prosecuted fully, denial of prejudgment interest still might render violation profitable.¹⁰⁸

Another cause of possible underdeterrence is the realization that antitrust laws a litigant need only allege that he has been injured, or is threatened with injury, by conduct which violates an antitrust law. However, because a treble damages award can be a severe penalty for a defendant and a "windfall" for a plaintiff, numerous federal courts have developed rules designed to limit the classes of plaintiffs which can assert an antitrust violation.

See also Boshes v. General Motors Corp., 59 F.R.D. 589, 595 n.7 (N.D. Ill. 1973).


¹⁰⁷ For a numerical example, see note 210 infra. See also Parker, Treble Damage Actions—A Financial Deterrent to Antitrust Violations?, 16 ANTitrust Bull. 483, 486-92 (1973); Wheeler, Antitrust Treble Damage Actions: Do They Work?, 61 CALIF. L. Rev. 1319, 1323 (1973). During periods of inflation or high interest rates, the interest-free use of money will be especially valuable. The effect also will be pronounced when a violation is not detected for a long period.

¹⁰⁸ Several other factors may affect the relationship between the treble damages assessed and the harm caused to others by the violation. First, it has been suggested that when juries are told that damages will be trebled, a form of "jury nullification" may result: juries may respond by reducing the amount of damages they award. Parker, supra note 107, at 499-501. Such caution by jurors would be analogous to judicial caution in the face of the trebling provision; Wheeler, supra note 107, at 1328-24 & nn.19-22. See note 105 supra. Underdeterrence also can result because civil defendants may deduct from federal income taxes as a business expense the full amount of trebled damages, unless the corporation previously has been convicted in a criminal action premised upon the same facts, in which case one-third of the treble damage award is deductible. See INT. Rev. CODE OF 1954, § 162(g); Parker, supra note 107, at 495-98; Wheeler, supra note 107, at 1322-23. This factor must be qualified, however, because the profits from antitrust violations constitute taxable income.

Additionally, damages awarded may not approximate the harm to society because of a failure of proof. This weakness, however, also might permit excessive damages, with the result that the defendant incurs some risk in antitrust litigation. If defendants prefer to avoid risk, the deterrent goal of antitrust penalties thereby is attained. For evidence that businessmen typically are risk-avoiders, see Breit & Elzinga, supra note 59, at 704-06. Ironically, the argument of Breit and Elzinga that potential antitrust violators are risk-avoiders undercuts to some extent their emphasis on the need for more severe penalties, because a smaller risk is needed to deter risk avoiders than to deter risk-preferrers.
not all violations will be discovered or punished; imposition of penalties greater than the harm to others is needed to compensate for violations that will escape detection and prosecution. The nature of antitrust violations makes this problem especially acute. A conspiracy to fix or stabilize prices, for example, may cause price changes difficult to distinguish from normal price movement, and documentary evidence may be destroyed or nonexistent. Direct purchasers, in the best position to detect a violation, may escape injury by passing on an illegal overcharge or may be related so intimately to the violator that they have no desire to pursue private law enforcement. Moreover, the limited budget of the Justice Department's Antitrust Division and the overwhelming complexity and cost of private litigation without a prior criminal judgment to rely upon also provide a degree of impunity for antitrust violators. Even successful detection and criminal prosecution may not pave the way for potential civil claimants who, because the possible recovery is less than the costs of suit or because of restrictive notions of standing, are unwilling or unable to sue.

Also limiting the deterrent effects of present civil damage concepts is a reluctance by direct purchasers to sue their suppliers, a serious flaw in a damage scheme that, by curtailing offensive use of the passing-on principle, places the heaviest enforcement burden upon those perhaps least willing to sue. Such hesitancy exists for

112. Between 1950 and 1972, the growth rate for the Antitrust Division's professional staff of lawyers and economists was much less than that of the economy. M. Green, B. Moore & B. Wasserstein, supra note 95, at 123.
113. Posner, supra note 95, at 372; Wheeler, supra note 107. See P. Areeda, supra note 98, ¶ 160, at 74-77. Underdeterrence also may result if those who do sue fail, because of the statute of limitations or problems of proof, to recover for every sale that was burdened by an illegal overcharge. See Erickson, The Profitability of Violating the Antitrust Laws: Dissolution and Treble Damages in Private Antitrust Litigation, 5 ANTITRUST L. & ECON. REV., Spring 1972, at 101, 108-09.
114. See notes 176-93 infra & accompanying text.
115. This fact has not escaped judicial notice. In In re Western Liquid Asphalt Cases, 487 F.2d 191, 198 (9th Cir. 1973), cert. denied, 94 S. Ct. 1419 (1974), the court noted:

It is understandable that [the direct purchasers] might not sue, in view of
(1) their alleged dependence upon [the defendants] for their supply of asphalt,
(2) the possibility that they earned a percentage profit on the overcharges, and
(3) the control and interdependence alleged between appellees and the contrac-
many reasons. Direct purchasers may be dependent upon their suppliers and wary of retaliation, while others may be unwilling to jeopardize longstanding, profitable relationships with the wrongdoers. Some purchasers may have benefitted from the illegal overcharge, and those intermediate purchasers who believe they have passed the burden forward may lack motivation to sue, despite their general ability to do so under *Hanover*. There may be a belief held by some direct purchasers that only their own customers have a moral right to recover. If the class of direct purchasers is larger than certain classes of remote purchasers, an individual remote purchaser might have more to gain from bringing suit than would an individual direct purchaser. Thus, many direct purchasers may not seek damages for antitrust violations committed by their suppliers, or they may accept in settlement sums grossly inadequate to establish antitrust violations but were precluded from recovering, no one else would sue, and [defendants] would retain their assumedly illegal profits.


117. See Wheeler, supra note 107, at 1331-32 & nn.56-57. Fear of retaliation or of jeopardizing business relationships may influence indirect purchasers as well as direct purchasers. Id.

118. For example, the electrical equipment price-fixing conspiracies may have benefitted electrical utilities in jurisdictions where the regulatory agencies use reproduction-cost valuation to measure the rate base. In those jurisdictions, payment of a higher price for a new piece of equipment may lead to an increased valuation for a utility's entire stock of previously purchased equipment. Emery, Regulated Utilities and Equipment Manufacturer's Conspiracies in the Electrical Power Industry, 4 BELL J. ECON. & MGMT. SCI. 322, 323-29 (1973); Westfield, Regulation and Conspiracy, 55 AM. ECON. REV. 424 (1965). A statistical test of this theory found that during the period embracing the conduct of the conspiracies (1956 to 1959), electrical utilities in states using reproduction-cost valuation paid higher prices for electrical equipment than electrical utilities in other states. The economist who performed the test, however, was unwilling to rule out the possibility that this price differential occurred simply by chance because the relationship did not prove statistically significant at the five-percent level. Emery, supra, at 332-36. But the relationship is statistically significant at the five-percent level if Missouri, a state whose classification was uncertain, is treated as using the reproduction-cost method. Id. at 334. Moreover, the statistical technique employed by Emery, first analyzing the effect of all other variables on equipment prices, then correlating the residuals with the type of rate base used in each state, may have induced a biased estimate, obscuring any significant relationship between the residuals and the rate bases. See P. Rao & L. Miller, supra note 69, at 29-32, 115-116 (1971).

119. Wheeler, supra note 107, at 1325 & n.28.

120. For example, in In re Western Liquid Asphalt Cases, 487 F.2d 191 (9th Cir. 1973), cert. denied, 94 S. Ct. 1419 (1974), five states purchased indirectly through numerous contractors. Id. at 194 n.1.

121. See id. at 198 (only four contractors had filed claims); Wheeler, supra note 107, at 1325, citing West Virginia v. Chas. Pfizer & Co., 314 F. Supp. 710, 746 (S.D.N.Y. 1970), aff'd, 440 F.2d 1079 (2d Cir.), cert. denied, 404 U.S. 871 (1971) (only eight percent of 55,000 direct
in comparison to the potential damage award.\textsuperscript{122}

Because the criminal and civil penalties heretofore applied have proved inadequate deterrents, and because the burden of private enforcement currently is ineffectively placed upon the direct purchaser by some of the progeny of \textit{Hanover}, the ameliorative effects of liberalized offensive use of a passing-on theory by remote purchasers to prove damages are apparent. Confining the passing-on defense to economically limited situations likewise is necessary. By examining the benefits of this approach in more detail, with special emphasis upon situations in which its rationale is most compelling and upon instances of fallacious economic reasoning by courts struggling with the \textit{Hanover} rule, the need to permit remote purchasers to bear part of the enforcement responsibility can be demonstrated.

\textbf{Acceptable Rules for Passing-On: Development and Application}

Standard incidence analysis indicates that passing-on will occur rather frequently in antitrust cases; the task of the legal system, therefore, is to accommodate this fact with the policy considerations delineated by the Supreme Court in \textit{Hanover}. Decisional rules should be developed to reflect the pervasiveness of passing-on while molding the treble damage action as an effective antitrust deterrent. This objective can be met with liberal offensive use of the passing-on concept by granting standing to claimants when economic considerations suggest that they in fact shouldered the burden of an illegal overcharge. Not only would this policy enhance the deterrent value of the treble damage suit, but it also would ensure more equitable allocation of compensation for victims of antitrust violations.

Problems of proof do not present insurmountable obstacles to more liberal standing for remote purchasers.\textsuperscript{123} The extent to which an overcharge can be passed on depends upon the elasticity of demand and the elasticity of supply in the market in which the direct

\textsuperscript{122} The extent to which an overcharge can be passed on depends upon the elasticity of demand and the elasticity of supply in the market in which the direct

\textsuperscript{123} For a discussion of problems of multiple liability, see notes 194-219 infra & accompanying text.
Economists are quite capable of dealing with these subjects; expert witnesses could use numerous statistical techniques that have been developed to measure elasticities of demand and supply. Indeed, estimates of elasticity of demand already have been developed in other contexts for some of the final products the prices of which may have been affected by recent price-fixing conspiracies. Moreover, the evidentiary inquiry necessary to resolve a passing-on issue is no more difficult than the usual effort to determine damages in antitrust cases. Because proof of damages in any antitrust case involves complex analysis, the Supreme Court has held that only "a just and reasonable estimate of the damage based on relevant data" is required, even though the estimate is but an approximation.

A more perplexing problem is encountered, however, when attempting to formulate rules consistent with Hanover's rationale for limiting the defensive use of the passing-on doctrine. Despite compelling reasons in many instances to believe that a direct purchaser was able to shift the burden of an illegal overcharge forward, the Hanover decision severely restricted use of the passing-on defense. Dictum in Hanover did indicate, however, a possible exception to the otherwise broad scope of the ruling; the Court foresaw "situations—for instance, when an overcharged buyer has a pre-existing 'cost-plus' contract, thus making it easy to prove that he has not

124. See notes 19-49 supra & accompanying text.  
126. For estimates of the elasticity of demand for milk, see 1 R. Stone, The Measurement of Consumers' Expenditure and Behavior in the United Kingdom, 1920-1938, at 323 (1954). Estimates for bread may be found in id. at 322; H. Wold, Demand Analysis 22, 289 (1953). These estimates suggest that the demand for each product is quite unresponsive to increases in price. For estimates which indicate that the elasticity of residential demand for electricity is low in the short run but substantially higher in the long run, see H. Houthakker & L. Taylor, supra note 125, at 87; Griffin, The Effects of Higher Prices on Electricity Consumption, 5 Bell. J. Econ. & Mgmt. Sci. 515, 523-30 & nn.25-26 (1974). Some of these estimates are for earlier time periods or foreign countries and thus might be inapplicable in a given antitrust suit; experts also may disagree about the appropriate measurement techniques to be used. Nevertheless, methods clearly are available to be adapted for evidentiary purposes in antitrust litigation.  
127. Bigelow v. RKO Radio Pictures, Inc., 327 U.S. 251, 264 (1946). For examples of the use of "benchmarks" and approximations to estimate what prices would have been but for the electrical equipment price-fixing conspiracy, see C. Bane, supra note 69, at 328-38, 369-78.
been damaged—where the considerations requiring that the passing-on defense not be permitted in this case would not be present." Because the Court relied upon the importance of the treble damage suit as an effective antitrust enforcement mechanism, as well as upon problems of proving that passing-on occurred, a rule that satisfies both of these criteria necessarily must restrict the defense greatly.

A properly limited rule would confine the defense to situations in which the direct buyer resold the commodity under a pre-existing, cost-plus, fixed-quantity contract and in which it is fairly certain that remote purchasers would be able to sue. Only by limiting availability of the defense to those situations in which remote purchasers are likely to sue can the deterrent value of the private civil action be preserved. The limitation to cases in which a direct purchaser resells under a pre-existing cost-plus contract that fixes the quantity to be resold provides a situation in which the middleman clearly is not damaged: once the contract is executed the remote purchaser's demand for the commodity is completely inelastic because, although the price may vary depending upon the direct purchaser's costs, the remote purchaser will buy the same quantity at any price, and any overcharges incurred by the direct buyer will be passed on in their entirety. If the quantity to be purchased is not fixed by contract, however, remote purchasers are free to vary the

128. 392 U.S. at 494.

129. Perhaps it could be argued that this rule is unduly restrictive, especially in light of the ease with which incidence principles can be applied to demonstrate that one purchasing under a pre-existing, fixed-quantity, cost-plus contract has not been injured. However, the Court in Hanover did not reject the proffered passing-on defense merely because of the evidentiary burden it would place on defendants; rather, the Court feared that allowance of the defense would inhibit prospective plaintiffs who were not ultimate consumers from bringing suit, thus severely weakening the deterrence value of the treble damage suit. See id. at 492-94. Courts, e.g., Boshes v. General Motors Corp., 59 F.R.D. 589, 594 (N.D. Ill. 1973), and commentators, see Comment, Mangano and Ultimate-Consumer Standing: The Misuse of the Hanover Doctrine, 72 Colum. L. Rev. 394, 408 (1972), have noted the Supreme Court's emphasis upon protecting the effectiveness of the treble damage action as a deterrent. But see Philadelphia Housing Authority v. American Radiator & Standard Sanitary Corp., 50 F.R.D. 13, 29 (E.D. Pa. 1970), aff'd sub nom. Mangano v. American Radiator & Standard Sanitary Corp., 438 F.2d 1187 (3d Cir. 1971). Moreover, the Court in Hanover did not explicitly state that any exception would be available, but merely speculated that where the "considerations requiring that the passing-on defense not be permitted in this case would not be present," an exception might be available. See 392 U.S. at 494. One of the considerations present in Hanover was that ultimate consumers were unlikely to sue. Id.

130. See note 31 supra & accompanying text.
amount of their purchases in response to price changes. Unless the remote purchaser's demand for the commodity otherwise is completely inelastic, probably an unlikely situation, litigation concerning a variable quantity contract would necessitate determination of the elasticities of supply and demand in the resale market to establish the extent, if any, of the direct buyer's injury. Hanover's difficulty-of-proof rationale, coupled with the desire to aid deterrence, suggests that the defendant cannot force this inquiry to be made.

Application of these rules to particular fact situations can be illustrated by analyzing several recent cases that dealt with the passing-on issue. Additionally, this analysis will indicate certain recurring fact patterns in which precise estimates of both supply and demand elasticities are unnecessary; in these situations the nature of the market assures that demand is highly inelastic or that supply is highly elastic, creating the likelihood that nearly all of the overcharge will be passed on. These fact patterns may arise frequently since price-fixing has a greater chance of success for the price-fixer when the intermediate purchaser is able to pass along the overcharge to remote purchasers. They provide three clear and direct applications of incidence rules.

Application One: Multiproduct Retailer

An illegal overcharge will be passed on completely if an intermediate purchaser's supply curve is perfectly elastic. A classic instance of perfectly elastic supply exists when the intermediate purchaser's business handles numerous commodities in addition to a price-fixed commodity. A retail store that carries many items, for example, can reassign the factors employed, such as clerks and shelf space, to other items unless the business can obtain the usual rate of return on the price-fixed item. Notwithstanding this economic fact of life the court in Donson Stores, Inc. v. American Bakeries Co. denied, for lack of standing, a motion by remote consumers to intervene in a treble damage action against four baking compa-
The plaintiffs, retail grocers, alleged that the bakeries had conspired during a three-year period to fix the price of bread in the New York City area. The nature of the intermediate distributor's business as a multiproduct retailer suggests a great likelihood that virtually the entire overcharge was passed on to bread consumers. Even if the retailer had been unable to pass on the overcharge immediately, there can be little doubt that the alleged three-year duration of the conspiracy would have been sufficient to allow reallocation of shelf space and labor to commodities promising a higher return than the price-fixed bread.

The court in Donson held that Hanover not only requires denial of the passing-on defense unless, for example, subsequent sales were on a cost-plus basis, but also that only the initial purchaser may recover unless the case is within a similarly defined exception.

This sweeping assertion, based upon a supposed need to prevent possible multiple liability, ironically denied ultimate consumers the ability to intervene pursuant to rule 24 of the Federal Rules of Civil Procedure, a rule at least partially intended to protect defendants against multiple liability. No other compelling reason to deny intervention was given. If permitted to apply the foregoing economic analysis, however, the bread consumers should have had excellent prospects to prove that they had borne the weight of the conspirators' overcharges.

Cases frequently may arise in which the supply curve for the price-fixed product is highly elastic because of the nature of the

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135. Moreover, the demand for bread may be relatively inelastic, thus facilitating passing-on; it is unnecessary to consider the demand, however, because perfect elasticity of supply in itself implies complete passing-on.

In order to demonstrate that an intermediate purchaser had sufficient time to adjust its use of factors before the beginning of the period for which damages are sought, a remote purchaser may wish to prove that a conspiracy was in effect during a period for which recovery is barred by the statute of limitations.

136. 58 F.R.D. at 484.

137. The court stated: “Fairness dictates that if a price fixer overcharges his customer one dollar, his damage exposure should be limited to that dollar trebled.” Id. at 482. The aggregate costs of an antitrust violation will exceed the amount of the overcharge, however, unless the deadweight loss is zero, a situation that will occur if the derived demand curve for the price-fixed product is perfectly inelastic. See note 100 supra. Ironically, such a demand curve again implies that the entire overcharge will be passed on by the retailer. See note 31 supra & accompanying text.


139. The court stated that Hanover “approved the general principle that the victim of an overcharge is damaged to the extent of the overcharge,” 58 F.R.D. at 483, and later described the retail stores as “more directly injured” than the ultimate consumers, id. at 485.
intermediate purchaser's business.\textsuperscript{140} Examples of commodities sold to multiproduct retailers for resale to the ultimate consumer readily come to mind. In such cases, the likelihood of a highly elastic supply curve in the resale market probably would convince an expert witness that all or most of an illegal overcharge was passed on to the consumers. Concededly, a class of consumers who purchase such a price-fixed good at retail stores may be so large that it is unmanageable.\textsuperscript{141} Indeed, the potential class in \textit{Donson} was estimated to include 20 million persons.\textsuperscript{142} Unmanageability, however, should lead only to refusal to certify the suit as a class action; it should not be an unarticulated reason to introduce an unsound principle of damages into antitrust law.\textsuperscript{143}

\textit{Application Two: Longstanding Violation}

If intermediate purchasers are in a competitive industry and if an antitrust violation continues for a sufficiently long time to permit any factors employed by those purchasers to withdraw from the industry, and withdrawal does not entail a reduced return, the long-run supply curve at the intermediate purchaser level again will be perfectly elastic and the entire illegal overcharge will be passed on.\textsuperscript{144} Ironically, \textit{Hanover} appears to have been just such a case. The illegal overcharge there arose from the defendant's "lease-only" policy for its more complicated and essential shoe machinery,\textsuperscript{145} a policy that had been followed by the defendant and its major competitors since the Civil War.\textsuperscript{146} The long duration of the defendant's

\begin{quotation}
\begin{enumerate}
\item \textsuperscript{140} During a recent 10-year period, 12 of the 65 successful criminal prosecutions for violations of section 1 appear to have involved at least some sales made directly to multiproduct retailers who resold to ultimate consumers. See Hay & Kelley, supra note 62, at 18, 29-38. The 12 cases included women's swimsuits sold through department stores, book matches sold through retail stores, and several instances of dairy products, baked goods, and snack foods sold through grocery stores.
\item \textsuperscript{141} See, e.g., Hackett v. General Host Corp., 455 F.2d 618, 620 (3d Cir.), \textit{cert. denied}, 407 U.S. 925 (1972) (district court held class of 1,500,000 bread purchasers to be unmanageable; appeal dismissed as interlocutory). See generally \textit{Eisen} v. \textit{Carlisle & Jacquelin}, 94 S. Ct. 2140 (1974), \textit{vacating} 479 F.2d 1005 (2d Cir. 1973).
\item \textsuperscript{142} 58 F.R.D. at 482.
\item \textsuperscript{143} See \textit{Boshes} v. General Motors Corp., 59 F.R.D. 589 (N.D. Ill. 1973) (retail consumers of automobiles had standing to sue for alleged overcharges but proposed class of 30 to 40 million car buyers rejected as unmanageable).
\item \textsuperscript{144} See notes 33-51 supra \& accompanying text.
\item \textsuperscript{145} 392 U.S. at 487.
\end{enumerate}
\end{quotation}
monopoly, certainly the "long run" in the economist's sense, provided ample time for shoe manufacturers to adjust their resource use in response to an illegal overcharge on machinery or, if necessary, to withdraw from the industry. In fact, the period was long enough for many firms to enter the industry, apparently in response to increased demand for shoes because of population growth.\(^{147}\) Thus, well before commencement of the period for which damages could be recovered under the antitrust statutes, adjustment of the perfectly elastic long-run supply curve of the shoe industry should have caused the entire illegal overcharge to be passed on.

*Hanover* therefore illustrates another recurrent situation in which economic incidence theory could substantiate a claim that the overcharge of a violator of the antitrust laws was passed on almost entirely to remote purchasers. That the Court did not err, however, when it refused to permit the passing-on defense is evidenced by the absence of any significant possibility of remote consumer suits.\(^{148}\) Only by denial of the defense could the fundamental deterrence objective be achieved. If, however, remote purchaser suits were likely, little reason would exist to deny offensive assertion of a passing-on theory.

**Application Three: The Small-but-Vital Part**

If a price-fixed product is used by an intermediate purchaser as a component of a final product, if that component represents a small portion of the final product's price, and if substitution for the component is difficult, then the derived demand curve for the component will be relatively inelastic.\(^{149}\) The illegal overcharge for the component probably will be passed on to remote purchasers because the relatively small price increase that results will have little effect on the quantity of the final product demanded.\(^{150}\) Because the ability of a direct purchaser to pass on an illegal overcharge is conducive to successful antitrust violation,\(^{151}\) cases of this type should not be infrequent.

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147. The number of shoe factories increased from 1,200 in 1915, to 1,550 in 1927, and to 1,650 in 1947. C. Kaysen, United States v. United Shoe Machinery Corporation 27 (1956).
148. The Court noted that ultimate consumers of shoes "would have only a tiny stake in a lawsuit and little interest in attempting a class action." 392 U.S. at 494.
149. See notes 52-58 supra & accompanying text.
150. See note 65 supra & accompanying text.
151. See note 52 supra & accompanying text.
Philadelphia Housing Authority v. American Radiator & Standard Sanitary Corp. provides an example. In this case homeowners sued for damages following a nolo contendere plea by plumbing equipment manufacturers to a price-fixing indictment. The direct purchaser of the plumbing fixtures was a plumbing wholesaler. Assuming that the price paid by the wholesaler to the manufacturer contained an illegal overcharge, the district court deemed the plaintiffs' claims to rest upon three additional premises: that the overcharge was passed on by the wholesaler to the plumbing contractor; that the plumbing contractor then passed the overcharge on to the builder; and that the builder then passed on the overcharge to the purchasing homeowner. It is probable that passing-on occurred at each of these levels despite the existence of several intermediate distribution levels between the alleged price-fixers and the purchasers of the final product. Each intermediate purchaser could pass on the overcharge without affecting the demand for new houses because the overcharge accounted for only a small part of the price of a new house.

Nevertheless, the district court granted the defendant's motion to dismiss the homeowner plaintiffs' complaint:

[P]laintiffs would have the Court believe that as the result of an overcharge of approximately ten to twenty dollars, a builder selling a twenty, twenty-five, or thirty thousand dollar house raised his price to reflect this overcharge (assuming such overcharge reached the builder). Such a view strikes the Court as incredible. Similarly, plaintiffs' claim rests on the assumption, demonstration of which the Supreme Court in Hanover ... described as raising "insuperable difficulty", that the builder


154. 50 F.R.D. at 19. An additional class of plaintiffs, purchasers of used homes, based its claim upon yet another assertion, that each prior homeowner had passed the overcharge on to succeeding purchasers. Id. at 20. Because much time might elapse between the original purchase of a house and its resale, the standard incidence theory outlined here does not prove this latter assertion.

155. See notes 63-66 supra & accompanying text.

156. Motions to dismiss also were granted against classes of commercial building owners and apartment building owners. 438 F.2d at 1188.
would not have raised his prices absent the overcharge or main-
tained the higher price had the overcharge been discontinued.
It would be incredible if the price of a house were determined
not by the shifts in supply [and] demand in the market for
homes as a whole but rather by a relatively miniscule change
(with respect to the selling price of the house) in the price of the
plumbing fixtures. . . . Accordingly, the Court agrees with de-
fendants that the claims of the plaintiffs under consideration in
their capacity as homeowners are blocked by insurmountable
difficulties of proof.157

In its application of supply-and-demand analysis, however, the
court neglected to consider that the supply curve for new houses
would be shifted upward by an unlawful overcharge, ultimately
shifting the burden to remote purchasers.158 Nor did the significance
of highly inelastic demand enter into the court's analysis.

In another private action, Wall Products Co. v. National Gypsum
Co.,159 the district court found as a fact in the trial of the liability
issue that the demand for gypsum wallboard for new house con-
struction was inelastic because the wallboard's cost constituted only
a small portion of the price of a new house.160 This finding logically
would indicate that the plaintiff wallboard dealers, who had pur-
chased directly from the defendants, faced an inelastic derived de-
mand curve for gypsum wallboard,161 enabling them to pass the

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158. See note 37 supra & accompanying text. The plaintiffs' brief in the district court had
not presented the economic arguments regarding passing-on, apparently relying solely on the
consumer-middleman distinction. See 50 F.R.D. at 27. Ironically, the court of appeals later
affirmed the district court's approval of a settlement, over the objection of certain plaintiffs,
partly because the class to which the objectors belonged probably had been able to pass on
This turn of events prompted Judge Blumenfeld to comment in a later case:

Thus, the defendants in the plumbing fixture cases managed neatly to have it
both ways. They escaped any liability to the ultimate purchasers, and then got
off with reduced damages on the ground that the parties who had suffered
legally cognizable injury had passed on their losses to those same ultimate
purchasers. No result could more effectively undercut the important congres-
sional policy embodied in the Clayton Act, which includes awards of treble
damages as its primary weapon of enforcement.

160. Id. at 300.
161. In a damning internal memorandum, which read like a textbook of oligopoly theory,
the director of market research for one of the defendants described the market for gypsum
wallboard as "a situation where a product is not sensitive to price." Wall Prods. Co. v.
overcharge on to building contractors who in turn could shift it forward to purchasers of new houses. Nevertheless, because no class of home buyers had intervened or, apparently, filed suit, the deterrence policies of Hanover would call for denial of the passing-on defense. By holding that the evidence did not establish the applicability of Hanover's cost-plus exception, the court in Wall Products did reject the defense; ignored by the court's opinion concerning damages, however, were the passing-on implications of the earlier finding of inelastic demand.

In re Master Key Litigation offers a final illustration of the small-but-vital-part principle. In Master Key plaintiff building owners sought damages from lock and door equipment manufacturers, following a civil suit brought by the Department of Justice. The absence of close substitutes for the defendants' component in building construction along with its relatively insignificant cost marked this particular price-fixed good as one perfectly suited for passing-on. Indeed, an expert economist concluded that the demand for such hardware was inelastic because such a minor part of the final cost of a building was attributable to it. The court did not explicitly consider this factor, however; rather it denied the defendants' motion for summary judgment because it believed that material issues of fact existed, including the possibility that the plaintiffs purchased under a cost-plus contract, and that Hanover's policy reasons against inquiry into the issue were inapplicable to offensive use of the theory.

With few exceptions, courts confronting damages questions have neglected to consider relevant principles of economic incidence theory; although sometimes purporting to rely upon "the law of supply and demand," these courts have exhibited a superficial un-

162. Arguably, the Supreme Court's discussion of the "cost-plus" exception in Hanover suggests that the passing-on defense should be permitted when, as in Wall Products, the fact of passing-on may be demonstrated without a complex inquiry. But the Court in Hanover carefully characterized the cost-plus example as only a "possible" exception. 392 U.S. at 494.

163. 326 F. Supp. at 842-44.


165. For a summary of this litigation, see [1961-70 Transfer Binder] TRADE REG. REP. ¶ 45,069, at 52,726-27.

166. 1973-2 Trade Cas. at 94,981. The witness' opinion was included in an affidavit submitted by plaintiffs to prove applicability of a cost-plus exception. Here again, use of the category, "cost-plus exception," distracted the inquiry from more pertinent issues, such as whether the derived demand curve faced by the direct purchaser was inelastic.

167. See 1973-2 Trade Cas. at 94,980-82.
derstanding of economic principles. In the instances identified, however, even a cursory inquiry into market characteristics would demonstrate a significant likelihood that illegally exacted overcharges were passed on to remote purchasers. Others could be adduced in which a more sophisticated evidentiary proof would demonstrate the incidence of the illegal monopolist’s tax. Moreover, the frequency with which cases arise in which such evidence would be beneficial militates strongly in favor of judicial acceptance of such evidence. Perhaps the strongest argument for use of such evidentiary methods comes from observation of the results of the refusal to utilize incidence theory. The absence of a sound theoretical base for the principles associated with Hanover has spawned several fallacies in passing-on theory that warrant examination.

**SOME JUDICIAL FALLACIES**

*The Cost-Plus Fallacy*

By pointing out that the denial of a passing-on defense was not absolute, the Supreme Court in Hanover suggested the possibility of some exceptions to the broad sweep of its holding.\(^\text{168}\) The Court explicitly identified at least one situation in which the principles of Hanover might permit use of the passing-on defense. This cost-plus exception, however, has been expanded by at least one court to an extent that cannot be reconciled with the economic principles that have been outlined. In *Obron v. Union Camp Corp.*\(^\text{169}\) the plaintiff had solicited orders for mesh window bags produced by the defendant, Union Camp; the orders were forwarded to the defendant, who shipped the goods directly to the plaintiff’s customers. A pricing arrangement between the plaintiff and defendants, by which the plaintiff would be billed for the goods at list price less five percent and would bill his customers at list price, was compared by the court to the cost-plus contract mentioned in Hanover, and on the strength of this analogy Union Camp was permitted to assert a passing-on defense.\(^\text{170}\)

That the plaintiff, an intermediate purchaser, employed a cost-plus pricing facsimile, however, does not ensure that the entire ille-

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168. See note 128 supra & accompanying text.
170. Id. at 904-06.
gal overcharge was passed on. Because there was no indication that the bags in *Obron* were resold under pre-existing cost-plus contracts in which the quantity to be sold was fixed, it is quite possible that the plaintiff sustained some damages because of the defendant's alleged antitrust violation. Of course, if the plaintiff employed no specialized resources to resell the bags, the entire charge might have been passed on. Nevertheless, even if the plaintiff had shifted the entire overcharge forward, the defendant did not necessarily overcome both of the reasons advanced in *Hanover* for denial of a passing-on defense: without consideration of whether suit was likely by remote purchasers, an inquiry the court also neglected to make, no determination could be made of whether the defendant would be able to retain his illegal profits if the plaintiff's suit was barred. Not only was the defense thus permitted when economic considerations might have required its denial, the court also ignored an equally significant aspect of the Supreme Court's *Hanover* ruling aimed at preservation of the treble damage action as an effective deterrent.

**The Consumer-Middleman Fallacy**

The cost-plus exception has not been alone as a deceptive talisman of passing-on analysis. Particularly egregious has been the "consumer-middleman" distinction that originated in the first dis-

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171. See notes 130-31 supra & accompanying text.
172. By disregarding the elasticity of the demand curve that confronted the plaintiff in the resale market, the court overlooked a key determinant of the passing-on issue before it. If that demand was relatively elastic, for example, much of the overcharge burden would have remained on the plaintiff. See note 27 supra & accompanying text.
173. See notes 43-45 supra & accompanying text.
174. See 355 F. Supp. at 907-08 (court had "no conception of the efficacy of a class action on the behalf of ultimate consumers or individual ultimate consumers"; court doubted that *Hanover* relied on this consideration).
175. The Court in *Hanover* expressed no opinion as to whether passing-on had occurred, choosing instead to favor the policy considerations weighing against the defense. See 392 U.S. at 488-89, 492-94. Permitting suit by an intermediate purchaser despite a likelihood of passing-on can promote the deterrent objective. Potential multiple liability can be avoided by placing the plaintiff's recovery in an interest-bearing escrow account until the statute of limitations becomes a bar to other possible claims; this fund would be accessible to plaintiffs who sue within the statutory period and establish damages. Cf. SEC v. Texas Gulf Sulphur Co., 446 F.2d 1301 (2d Cir. 1971) (corporate officers who traded with access to inside information required to pay profits into fund; undistributed funds at end of five years to become property of corporation although it was not damaged by the violation). The availability of such a technique in an antitrust action was suggested in Missouri v. Stupp Bros. Bridge Co., 248 F. Supp. 169, 177 (W.D. Mo. 1965).
This distinction differentiates among plaintiffs depending upon what happens to the defendant's product in their hands: if the defendant's product merely was resold by the plaintiff in unaltered form, the passing-on defense might be raised, if with purchasers from the middleman having standing to sue; if the defendant's product was consumed in the manufacturing of a different product, the passing-on defense would be unavailable and purchasers of the final product would be unable to assert passing-on offensively.


The consumer-middleman distinction evolved from the district court's attempt to distinguish the case before it from the "oil jobber" cases: Clark Oil Co. v. Phillips Petroleum Co., 148 F.2d 580 (8th Cir.), cert. denied, 326 U.S. 734 (1945); Northwestern Oil Co. v. Socony-Vacuum Oil Co., 138 F.2d 967 (7th Cir. 1943), cert. denied, 321 U.S. 792 (1944); Twin Ports Oil Co. v. Pure Oil Co., 119 F.2d 747 (8th Cir.), cert. denied, 314 U.S. 644 (1941); Leonard v. Socony-Vacuum Oil Co., 42 F. Supp. 369 (W.D. Wis. 1942). Plaintiffs in the "oil jobber" cases had purchased price-fixed gasoline on the spot market for resale to retail service stations, and defendants were permitted to assert the passing-on defense against them. In Hanover, Judge Goodrich noted that the oil jobbers were merely "middlemen," whereas Hanover Shoe had "consumed" the shoe machinery in the manufacturing process. He concluded: "Where the plaintiff is a consumer of the product, rather than a middleman who resells it, he may recover the excess paid whether or not he has ultimately passed the excess along to his customers." 185 F. Supp. at 831.

177. See Obron v. Union Camp Corp., 355 F. Supp. 902, 906 (E.D. Mich. 1972), aff'd, 477 F.2d 542 (6th Cir. 1973) (distinction found "apt and impressive"). In dictum, the Court of Appeals for the Tenth Circuit approved as consistent with Hanover a jury instruction stating that the defense was available against cost-plus contractors or "a middleman who buys a product then resells same in unchanged form to a consumer under such condition that the original cost and handling charges can be traced with a fair degree of certainty. If, while in the hands of the middleman, the product is processed so as substantially to lose its identity and form and the processing costs are incapable of exact calculation, the defense of 'pass-on' becomes unavailable." Standard Indus., Inc. v. Mobil Oil Corp., 475 F.2d 220, 224 n.1 (10th Cir.), cert. denied, 94 S. Ct. 61 (1973).


Although employed by several courts, the distinction has been criticized judicially and in commentary. The delusive nature of the consumer-middleman distinction is twofold. Initially, it focuses on a fact devoid of economic significance by turning upon changes in the form of the original product as it moves through the distributive chain, while ignoring the crucial impacts of the illegal overcharge upon the intermediary's costs and upon the elasticity of his supply and demand curves. Second, the distinction bears little, if any, relationship to the policy considerations that undergird the rule of Hanover. The distinction is irrelevant to the ease with which the fact of passing-on can be ascertained and to preservation of the treble damage suit as an effective antitrust enforcement mechanism.

183. The determination that an intermediate purchaser could not or would not have raised the price for its product arguably might be simpler if costs of additional components for a final product need not be considered. But even when this purchaser is merely a “middleman,” he must consider costs other than that of the antitrust violator’s product; labor costs, transportation costs, and promotional expenses, for example, all may affect the resale price. When establishing his price, he also must consider factors that affect the elasticity of demand and the demand function, which expresses the relationship between the quantity of a good demanded and the determinants of demand. Marshallian demand curves (see Figures 1-4 supra) relate quantity demanded to the price of the good while holding other factors, including income, prices of substitute and complementary goods, and consumer tastes, constant. See E. Shows & R. Burton, supra note 23, at 28-30. Because any seller, whether “consumer” or “middleman,” must take all exogenous determinants into account when setting his price, neither categorization should lessen substantially the task of locating the exact incidence of an illegal overcharge.

Continued use of the distinction can emasculate the enforcement efficacy of the treble damage suit. If, for example, intermediate purchasers are dominated by the violator (see, e.g., In re Western Liquid Asphalt Cases, 487 F.2d 191, 195 (9th Cir. 1973), cert. denied, 94 S. Ct. 1419 (1973) (evidence indicated that suppliers of asphalt controlled a high percentage of their direct customers, through stock acquisitions or indirectly through financial arrangements, including credit), or if they are reluctant to jeopardize their business relationships by suing a supplier, the distinction might preclude a suit by the only person willing to sue. For a discussion of reasons why businessmen might hesitate to institute private antitrust actions, see Panel Discussion, Private Actions—The Purposes Sought and the Results Achieved, 45 Antitrust L.J. 73, 87-96 (1973) (remarks of Mr. Bohon). For an interesting attack by two
In re Coordinated Pretrial Proceedings in Antibiotic Antitrust Actions illustrates the sterility of the consumer-middleman distinction. In this case, the court invoked the distinction to dismiss claims against drug manufacturers by a class of purchasers of animal feed containing allegedly price-fixed antibiotics. Yet the court's opinion discloses facts indicating that at least some part of the overcharge was borne by the animal feed purchasers. First, the antibiotic's cost apparently constituted only a small fraction of the total cost of the animal feed, probably inducing much of the overcharge to be shifted to the feed purchasers. Second, the feed was sold in a competitive retail market, which the court paradoxically believed "obscured any effect the alleged antibiotic drug conspiracy might have had on the price of finished feed." Quite to the contrary, competition in the retail market assures that some of the overcharge was passed on to farmers, the precise portion depending upon whether the retailers employed specialized resources to sell the feed. Only part of the burden would have been shifted forward if specialized resources were used, but if the resources could have left the feed retailing industry without suffering a reduced return, passing-on would have been complete. The consumer-middleman distinction, however, short circuited the court's analysis, precluding the court from a consideration of economic realities and thus denying clearly injured parties their appropriate relief.

economists, Kenneth Elzinga and William Breit, on the concept of private antitrust enforcement, see id. at 96-104.

Significantly, the consumer-middleman distinction would deny standing to ultimate consumers in at least one situation in which passing-on is almost assured, that is, when the cost of the violator's product is a small but vital part in the intermediate purchaser's final product. See notes 149-167 supra & accompanying text. Such a result seems wholly inconsistent with the private right of recovery provided by section 4 of the Clayton Act and with the Supreme Court's liberal application of that right.


186. A comparison of the cost of the antibiotic component in the feeds marketed by one of the defendants, Pfizer, Inc., with the cost of the non-antibiotic ingredients indicates that the cost of the antibiotic component was usually less than five percent of the total cost of the feed. Affidavit of John A. Hawbaker in Support of Motion for Pre-Trial Rulings in Certain Farm Cases, In re Coordinated Pretrial Proceedings in Antibiotic Antitrust Actions, 333 F. Supp. 295 (1971).

187. See notes 149-167 supra & accompanying text.

188. 333 F. Supp. at 312.

189. See notes 43-49 supra & accompanying text.
The Multiple-Intervening-Purchasers Fallacy

A final misconception is found in cases suggesting that inquiry into the merits of an offensive assertion of passing-on should be foreclosed if there were several purchasers intervening between the plaintiff and the defendant. Concededly, a plaintiff's burden of proof might be onerous if no easy assumptions about market elasticities, and hence passing-on, can be made; in such cases, elasticities of demand and supply at each intervening level must be ascertained. In recurrent circumstances, however, proof of passing-on may be quite simple even with a number of intervening purchasers. For example, if demand for the final product is inelastic, demand at each previous intervening level also is likely to be inelastic. Similarly, if the price-fixed good is a vital but relatively inexpensive part of the final product purchased by the ultimate consumer, then demand at each level should be inelastic with respect to the illegal overcharge. Moreover, even the need for more intricate economic proof, although it may impose a heavy burden upon a distant purchaser, should not compel an arbitrary bar to suit when that bar is not grounded in economic theory. Indeed, raising such a bar seems to conflict directly with deterrence objectives long articulated by the Supreme Court.

PROCEDURAL CONSIDERATIONS

Although the existence of Hanover as an established precedent should minimize objections to placing tight restrictions upon use of the passing-on defense, several objections might be raised to a more liberal use of offensive use of passing-on evidence. It may be argued, for example, that strike suits will be encouraged or that the expense of private treble damage actions will be increased. More seductive might be the assertion that, when contrasted with restricted availability of the passing-on defense, free use of the same theory

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191. Three such assumptions are discussed at notes 132-167 supra & accompanying text.

192. See notes 57-58 supra & accompanying text.

193. See notes 149-167 supra & accompanying text.
offensively by remote purchasers would legitimize multiple liability of defendants exceeding the threefold damages already sanctioned by statute. Closer study of these arguments, however, will reveal their lack of merit.

The Privity Rule and the Illusory Threat of Multiple Liability

Adapting Judge Cardozo's famous dictum in *Ultramares Corp. v. Touche, Niven & Co.*, it may be said that the reconstruction of the citadel of privity is proceeding apace in antitrust law. Unless within the cost-plus exception of *Hanover*, remote purchasers generally have been denied offensive use of the passing-on concept. Citing the need to protect the defendant from multiple liability, some courts thus have reasoned that because *Hanover* readily renders a defendant liable to his direct buyers, remote purchasers must be denied the right to assert passing-on theory offensively.


Some courts have relied upon the Supreme Court's citation in *Hanover* of Southern Pac. Co. v. Darnell-Taenzer Lumber Co., 245 U.S. 531 (1918), an Interstate Commerce Commission case decided before the "assault upon the citadel" had begun, to divine the Court's intention to establish a rule of privity. See Balmac, Inc. v. American Metal Prods. Corp., supra at 93,062; Denver v. American Oil Co., supra at 630-31. The Court, however, discussed *Darnell-Taenzer* in a footnote that merely traced the history of the passing-on defense in the Supreme Court, also noting lower court decisions in which the defense had been sustained or denied. 392 U.S. at 490 n.8. The Court's textual discussion of policy considerations bearing upon the passing-on question, moreover, minimizes any likelihood that the abbreviated mention of *Darnell-Taenzer* evinced an intent to adopt a privity rule. As one court has noted, if a simple rule of privity was to be stated, the Court certainly would have mentioned the many lower court decisions that had repudiated privity as a prerequisite for standing to bring a treble damage action. See Boshes v. General Motors Corp., 59 F.R.D. 589, 595 (N.D. Ill. 1973). Indeed, it is even more unlikely that the Court would have established a privity requirement without explicitly disapproving or distinguishing its own earlier decisions indicating that section 4 of the Clayton Act is to be given a broad reading. See, e.g., Radovich v. National Football League, 352 U.S. 445, 454 (1957); Mandeville Island Farms, Inc. v. American Crystal Sugar Co., 384 U.S. 219 (1968). In *Mandeville* the Court prescribed an expansive scope for section 4: "The statute does not confine its protection to consumers, or to purchasers, or to competitors, or to sellers. . . . The Act is comprehensive in its terms and coverage, protecting all who are made victims of the forbidden practices by whomever they may be perpetrated." Id. at 236.
Other courts, addressing the issue of multiple liability directly, have rejected a privity requirement. In Boshes v. General Motors Corp.\footnote{197. 59 F.R.D. 589 (N.D. Ill. 1973).} and In re Western Liquid Asphalt Cases,\footnote{198. 487 F.2d 191 (9th Cir. 1973), cert. denied, 94 S. Ct. 1419 (1974).} it was found that the danger of multiple liability could be minimized, if not eliminated entirely, by using certain procedural devices such as intra-district and interdistrict transfer and consolidation of cases, statutory interpleader, the doctrines of res judicata and collateral estoppel, and compulsory joinder of parties.\footnote{199. See 487 F.2d at 198-201; 59 F.R.D. at 598-97.}

Moreover, both courts noted that the relatively short statute-of-limitations period for treble damage antitrust suits also protects defendants to some extent. Additional protection is afforded by the Federal Rules of Civil Procedure concerning intervention and interpleader, and by the possibility of placing all or part of the damages awarded to a direct buyer in an interest-bearing escrow account for a definite period of time to satisfy later judgments in favor of remote purchasers.\footnote{199. See 487 F.2d at 198-201; 59 F.R.D. at 596-97.}

Even if the risk of multiple liability cannot be eliminated totally, it is by no means clear that offensive use of the passing-on concept should be restricted by a privity rule. Arguably, because treble damage actions were intended to be punitive as well as compensatory, requiring a defendant to chance multiple liability is more consistent with congressional purpose than is denying standing to injured par-
ties. Moreover, the limited economic significance of treble damage actions should dispel some concern regarding excessive liability: Professor Walter Erickson has concluded on the basis of one study that antitrust violators often profit by their wrongdoing despite having incurred treble damage liability, partly because of the four-year statute of limitations and partly because of the failure of the awards to reflect adequately the time value of money. The fear of multiple liability should not lead courts to sweep aside the fundamental deterrent purpose of civil antitrust actions, which depends upon making the violation of antitrust statutes unprofitable. In the words of one court, "[C]utting off the rights of such a substantial number of potentially injured persons merely because such a 'possibility' exists is far too drastic a measure to take." 

Settlements, Strike Suits, and Class Actions

Eliminating arbitrary barriers to treble damage actions by remote purchasers, such as the privity rule and the consumer-middleman distinction, will revitalize civil deterrence in antitrust law. Moreover, by permitting remote plaintiffs to force an evidentiary hearing on the passing-on question, those claimants may receive their just share of a settlement. Undoubtedly, the apportionment of a settle-

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210. See id. at 104-09. As an example, Professor Erickson assumed that a price-fixing conspiracy, in effect for two years, netted excess after-tax profits for the violators of $10,000 in 1955 and $20,000 in 1956. If a government criminal action were commenced in 1962 and if a civil action then were brought immediately after a 1965 conviction, resulting in a treble damage recovery of $90,000 in 1968, the defendants would have had use of the illegal profits for more than 12 years. Assuming that the defendants could earn 12 percent return on this capital, which was the average rate of return on capital in manufacturing between 1947 and 1967, see id. at 117, the ill-gotten interest-free loan would have appreciated to $121,600 by 1968. Hence, a net profit of $31,600 could be realized even if full treble damage liability were imposed. See id. at 104-07. This problem may be exacerbated if private litigants are unable to recover for damages sustained during the entire life of the conspiracy. See id. at 107-09. Of course, this example does not include other costs that the defendants might incur, such as litigation expenses and criminal penalties. Nevertheless, the fear of multiple liability appears illusory.


212. For an example of participation in a tentative antitrust settlement by ultimate consumers, see Wall Street Journal, Mar. 11, 1975, at 14, col. 3, describing allotment of $2.3 million for consumers of potato, corn, and tortilla chips in California, Arizona, and Nevada from 1967 through 1970. Notice was given by an advertisement in major California newspapers, containing a form to be submitted to the clerk of the court by April 1975. The "rebate"
ment award among many classes of plaintiffs often will approximate closely the proportionate incidence of an illegal overcharge. To the extent that settlements reflect the size and strength of remote purchasers' claims, a compensatory purpose clearly is served. Considering the possible reluctance of direct purchasers to sue their suppliers, participation of remote purchasers also should enhance the deterrent effect of settlements.

The frequency with which antitrust suits are settled rather than tried, however, has raised the suggestion that these settlements may reflect defendants' fear of enormous treble damage liability, rather than the merits of the plaintiffs' claims. The possibility of

was limited to $15 per consumer household. Proof of purchase was not required, but a false statement was subject to penalties for perjury. Others sharing the six-million-dollar settlement were retail grocers, receiving nearly $2.3 million; eating and drinking establishments, $699,000; liquor stores, $583,000; and public entities, $170,000.

213. See West Virginia v. Chas. Pfizer & Co., 314 F. Supp. 710, 727-30, 744-47 (S.D.N.Y. 1970), aff'd, 440 F.2d 1079 (2d Cir.), cert. denied, 404 U.S. 871 (1971) (evidence tending to show that the allocation of the settlement fund was correlated with the damage borne by each of the various classes of plaintiffs). A relatively small portion of the fund went to wholesalers and retailers, who probably had been able to pass on much of the overcharge, since the demand for prescription drugs is inelastic, doctors being relatively insensitive to the price of the drugs they prescribe. The court concluded that passing-on probably had occurred, although it may have given too much weight to the cost-plus mark-up system employed by wholesalers and retailers. See 314 F. Supp. at 710; cf. notes 168-175 supra & accompanying text.

214. See notes 115-22 supra & accompanying text.

215. It has been suggested that the presence of attorneys representing a number of different classes "may reduce the problem of the class attorney who 'sells out' the class by agreeing with the defendant on a settlement that involves a small award of damages and a large award of attorneys' fees." Landes & Posner, The Private Enforcement of Law, 4 J. Legal Stud., 1, 35 n.75 (1975).

216. Class actions in general appear to be tried infrequently, although exact statistics are not available. Cf. Dam, Class Actions: Efficiency, Compensation, Deterrence, and Conflict of Interest, 4 J. Legal Stud. 47, 59-60 (1975). Better information on the relative frequency of settlement of antitrust treble damage class actions as compared to other types of class actions may be provided in a study of class actions in five federal judicial districts now being conducted with the support of the American Bar Foundation. See American Bar Foundation, 1974 Annual Report 11-12 (1975).

217. It also is contended that some plaintiffs may file meretricious actions in the hope that the cost of litigation will cause defendants to settle on favorable terms. See, e.g., Dam, supra note 216, at 59 & n.24; Breit & Elzinga, Antitrust Enforcement and Economic Efficiency: The Uneasy Case for Treble Damages, 17 J.L. & Econ. 329, 340-41 (1974). The phenomenon of frequent settlement seems to occur in all class actions, whether or not treble damages are sought. See note 216 supra. Thus there is little reason to expect a higher proportion of meretricious lawsuits among antitrust class actions than among any other group of class actions. In fact, many useful private antitrust suits follow in the wake of government indictment and a plea of nolo contendere. See Posner, supra note 95, at 372. To call these actions "strike suits" is to convert the term into nothing more than a pejorative epithet.
"strike suits" is not, however, unique to antitrust law;\textsuperscript{218} the problem should be remedied procedurally, not by barring a type of lawsuit because of vague contentions that such suits may lack merit. Undoubtedly, large classes of remote purchasers sometimes may present insurmountable problems of manageability, but again the remedy is procedural, the refusal to certify a class action, instead of the development of an unsound substantive doctrine that will leave more manageable classes without redress.\textsuperscript{219}

**Conclusion**

Since the Supreme Court in *Hanover* addressed the passing-on question, antitrust courts have struggled with the concept but achieved highly undesirable results. By limiting severely the availability of a passing-on defense, the Court sought to promote the overriding deterrence purpose of civil antitrust actions; antitrust violators, the Court believed, should not be able to force injured parties into a difficult factual inquiry that might disuade claimants from instituting treble damage suits. Other courts, however, have misread this precedent to the extent that a serious threat now is posed to the continued strength of civil antitrust enforcement. Heavy reliance upon arbitrary rules to preclude suit by remote purchasers of goods tainted by anticompetitive action, or to permit a passing-on defense based upon inadequate proof, indeed can cripple *Hanover's* beneficent purpose.

Standard principles of economic incidence theory, however, provide tools to analyze passing-on issues properly, often without the protracted factual inquiry that influenced the Court in *Hanover* to withhold from most defendants the passing-on theory. Many fact patterns, not uncommon in markets often affected by antitrust violations, can be labeled as ones in which passing-on undoubtedly

\textsuperscript{218} Strike suits are profitable to plaintiffs' attorneys only if defendants are willing to run the risk that settling one strike suit may encourage other potential plaintiffs to bring similar suits. Cf. Posner, *An Economic Approach to Legal Procedure and Judicial Administration*, 2 J. Legal Stud. 399, 433 (1973) (arguing that a truly groundless claim is unlikely because "the defendant knows that if he calls the plaintiff's bluff the plaintiff will not throw away good money litigating the case, and the plaintiff should know that the defendant knows this.").

Becker and Stigler, who have argued for increased reliance upon private law enforcement with damages sufficient to deter would-be law breakers, also have proposed that full compensation of costs be paid to defendants by unsuccessful plaintiffs. Becker & Stigler, *Law Enforcement, Malfeasance, and Compensation of Enforcers*, 3 J. Legal Stud. 1, 15 (1974).

\textsuperscript{219} See note 211 supra & accompanying text.
will, or will not, occur, and it is unsound to keep this evidence from courts trying to compensate innocent victims while punishing and discouraging wrongdoing. Even when more intricate economic evidence is required, injured claimants should not be denied the opportunity to carry their burden with such proof. To presume conclusively that an illegal overcharge has been borne by direct or by remote purchasers is unnecessary and unwarranted when direct evidence is readily accessible.