

The US Debate on the Indirect Purchaser's Claim to Damages in Competition Law Cases: Lessons for South Africa

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Abstract

A debate that has dominated American competition law jurisprudence relates to whether indirect purchasers should be prevented from claiming damages in private enforcement cases or whether both direct and indirect purchasers should be given the opportunity to claim civil damages. While there may be practical considerations impacting the extent to which those who have been indirectly harmed by cartels can reasonably expect to claim damages, an overly restrictive approach that would only consider direct purchasers may mean that some who might have a valid claim are effectively denied access to justice. None of the courts in the bread price-fixing cases or other subsequent competition law damages cases in the South African courts dealt with the essential question, which is whether or not all participants in the supply chain, regardless of their role as end consumers (indirect purchasers) or purchasers of inputs (direct purchasers), should be allowed to sue an upstream cartel for damages? In this article I analyse the seminal cases which prompted this debate in the United States and, I argue that in South Africa, the implications of not allowing an indirect purchaser to claim damages has a negative impact on the end consumers' case. I advocate for allowing both indirect and direct purchasers to claim damages, and for the defendant to raise a passing-on of the overcharge defence in response.

Keywords: cartels; damages; competition law; indirect purchasers; passing-on defence; overcharge; private enforcement; civil damages

Introduction

In an open market, firms compete to win their customers' business by offering more products or services at lower prices. Firms that engage in anti-competitive practices such as collusion effectively transfer money out of the pockets of unsuspecting consumers into their own coffers in the form of higher profits. If found guilty by the competition authorities, they are liable to pay a fine. However, the victims of such anti-competitive practices do not benefit from this fine and, in order for the victim to acquire any compensation for the harm done, they must approach the civil courts. This path to compensatory damages in competition cases is not well defined in South African jurisprudence. Further, damages claimants face many procedural and evidentiary challenges related to resources and access to evidence and must navigate the court system.¹

When a violation of the Competition Act has occurred, any number of market participants in the supply chain may suffer harm as a result, whether in the upstream or downstream markets. These claimants could be end consumers, purchasers of intermediate inputs, or both.

The South African Competition Act allows a very general category of persons who have suffered loss or damage due to anti-competitive conduct to bring civil actions for damages.² There is no specific doctrine of standing for damages claimants. It should also be noted that 'the more remote a claimant's loss is from the infringement, the less likely it may be to obtain damages.'³ The claimant thus has to prove that there is a direct, significant link between the anti-competitive conduct and the loss suffered.⁴

None of the courts in the Bread class action cases or other subsequent competition law damages cases in the South African courts dealt with the essential question, which is: whether or not all participants in the supply chain, regardless of their role as end-consumers (indirect purchasers) or purchasers of inputs (direct purchasers), should be given standing to sue an upstream cartel for damages? Would the Defendant be allowed to argue that the direct purchaser passed on the overcharge to its downstream customer (the indirect purchaser)? The net of liability could stretch right down to the end consumer. Although South African courts have thus far overlooked these questions in all competition law damages cases, it is important to consider when analysing damages claims in a competition law context. The implications of not allowing an indirect purchaser to claim damages negatively impact the end-consumers case. Allowing both

1 See Kasturi Moodaliyar, 'South Africa' in AA Foer and JW Cuneo (eds), *The International Handbook of Private Enforcement of Competition Law* (Edward Elgar 2010) 553.

2 Section 65 of the Competition Act 89 of 1998 (as amended).

3 David Harrison and Rachel Cuff, 'Private Damages Actions in Competition Law' (September 2007) *The In-House Lawyer* 52 at 55.

4 See *S v Mokgethi* 1990 1 SA 32 (A).

indirect and direct purchasers to claim damages, in turn, affects the amount payable by the defendant firm.

Take, for example, a manufacturing cartel consisting of firms that own flour mills, which sells flour at a ten per cent overcharge to bakeries (direct purchasers). The bakeries add an additional ten per cent to the price of bread and pass on the overcharge⁵ to supermarkets. The supermarkets add on ten per cent to their costs and pass on the overcharge to the consumer. The supermarkets and end consumers did not purchase the bread directly from the manufacturers and are thus indirect purchasers.

The indirect purchasers were indirectly harmed by the price-fixing of the flour mills. Should they be allowed to claim damages from the cartel members? What is the relevance to them of the direct purchasers' increases? Should both indirect and direct purchasers be able to claim damages and perhaps join their claims? In their defence, should cartel members be allowed to argue that direct purchasers passed on the overcharge to the indirect purchasers and therefore did not suffer the harm of the cartel overcharge? These are questions that South African courts need to deal with when assessing a damages claim.

A seminal case in the United States was decided by the US Supreme Court in *Hanover Shoe, Inc v United Machinery Corp*,⁶ where the direct purchaser claimed damages from a monopolist. The Court held that the defendant (the cartel) could not avoid liability for damages by arguing that the direct purchaser had passed on the overcharge to subsequent indirect purchasers.⁷ Nine years later, in 1977, the *Illinois Brick Co v Illinois*⁸ case came before the Supreme Court, brought by indirect purchasers who claimed they suffered harm from an upstream cartel. The Court held that only direct purchasers could sue and excluded the indirect purchaser plaintiffs from recovering damages in federal cases. This meant that only the direct purchaser could recover damages from the cartel, even though it passed on the overcharge, and that the indirect purchasers who may have suffered the full impact of the price increase would not have any recourse. This stimulated a debate in the United States, with many questioning the

5 This is the difference between the market price of the goods and the price actually paid. See *City of Atlanta v Chattanooga Foundry and Pipe Co* 101 F 900, 901 (CCED Tenn) affd 203 US 390 (1906), which was a claim for damages that arose as a result of the anticompetitive agreement in *Addyston Pipe and Steel Co v United States* 175 US 211 (1899).

6 392 US 481 (1968) (*Hanover Shoe* SC).

7 Before the *Hanover Shoe* decision, the competition law violator was allowed to use the passing-on defence in cases in which the direct purchaser was suing or in the case of an indirect purchaser suing, if the product was sold as is (ie without being altered). If the product was used as an input to produce another product, then the passing-on defence could not be used. See *Twin Ports Oil Co v Pure Oil Co* 119 F 2d 747 (8th Cir 1941), cert denied, 314 US 644 (1941).

8 431 US 720 (1977) (*Illinois Brick*).

reasoning of these decisions and their fairness and impact.⁹ The central debate arising from these cases is whether only direct purchasers or both direct and indirect purchasers should be allowed to recover damages from the cartel.

After providing an overview of the *Hanover Shoe* and *Illinois Brick* cases, I then assess the US debate regarding whether there should be a right of recovery for indirect purchasers. At the time, it was only the courts in the United States which focused on the direct and indirect purchaser debate. Other jurisdictions would only later pick up on these issues in their directives on private damages in competition law.¹⁰ This article serves to analyse the arguments provided by the courts and commentators in the leading jurisdiction, where the main ideas on these issues were initially developed, in order to anticipate how the courts in South Africa might engage with this issue. This is the reason why the US cases are of relevance and take centre stage in this article.

One should note that the calculation of damages in competition law cases would depend on the anti-competitive harm caused and where the claimant would fit in the value chain. For example, in the US; based on the *Hanover Shoe* case, it is only the direct purchaser who will be able to recover the overcharge, which is the difference between the amount the claimant paid for the goods or services and the amount he would have paid ‘but for’ the anti-competitive conduct.¹¹

Various economic models can be employed for estimating damages. Despite their shortcomings, these models have their own beneficial characteristics to help provide the best estimate to quantify damages. The tractability of any model is dependent on the amount of data available. The quantification of the harm caused by the cartel infringement can be a very difficult and costly exercise for the claimant, which could act as a barrier to claiming damages.¹²

9 See Oxera, ‘Passing the Buck: The Passing-on Defence in Cartel Damages Cases’ (*Oxera*, 2007) <<http://www.oxera.com/Oxera/media/Oxera/downloads/Agenda/Cartel-damages-claims.pdf?ext=.pdf>> accessed 6 April 2010.

10 See for example, European Union ‘Directive of the European Parliament and of the Council on certain rules governing actions for damages under national law for infringements of the competition law provisions of the member States and of the European Union’ PE-CONS 80/14 (2014) <<http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32014L0104>>

11 *Eastman Kodak Co v. Southern Photo Materials* 237 U.S. 359 (1927) 376- 379. See Herbert Hovenkamp, ‘Quantification of Harm in Private Antitrust Actions in the United States’ (9 February 2011) University of Iowa Legal Studies Research Paper. See also European Commission Staff Working Document, ‘Practical Guide: Quantifying Harm in Actions for Damages based on Breaches of Article 101 or 102 of the Treaty on the Functioning of the European Union’ SWD (2013) 2015 at 7.

12 Oxera, ‘Quantifying Antitrust Damages: Towards Non-binding Guidance for Courts’ (2009) <http://ec.europa.eu/competition/antitrust/actionsdamages/quantification_study.pdf> See also Emily Clark, Mat Hughes and David Wirth, ‘Study on the Conditions of Claims for Damages in Case of Infringement of EC Competition Rules: Analysis of Economic Models for the Calculation of Damages’ (Ashurst, 31 August 2004)

When quantifying damages, it is most important to consider carefully what kind of data exists, what assumptions can be made and what inferences can be drawn, rather than merely choosing one method over the other on subjective grounds. The key guidance for the courts is to ensure the robustness of any estimate obtained by testing how well the method employed holds up under different assumptions. An exploration of the methodologies used to calculate the overcharges is not within the scope of this article. Rather, I am concerned here with the indirect/direct purchaser claim to damages and the passing-on of the overcharges defence.¹³

Also of relevance to the indirect/direct purchaser debate are the more recent US decisions of *Campos v Ticketmaster*¹⁴ and *Apple Inc v Pepper* which shows how changing technology platforms and market structures could sometimes blur the distinction of an indirect purchaser and allow for another party who may not necessarily be seen as direct purchaser (as was in Apple’s argument) to also earn the right of standing to claim damages.¹⁵ The difference of opinion in these cases relates to who should be identified as the indirect purchaser in online or digital platforms. I analysed this debate and concluded that, however, it is decided, the Illinois Brick rule remains intact and that indirect purchasers cannot sue for damages in the US. I then offer the South African courts to consider possible approaches when adjudicating direct and indirect purchaser damages claims. Finally, I present my conclusion that the indirect purchaser should be allowed to claim damages and the Defendant be allowed to raise passing on as defence if a direct purchaser is claiming damages against it.

The American Approach: An Analysis of Legal Standing

The *Hanover Shoe* case was a case of an abuse of dominance, whereas the claim for damages in the *Illinois Brick* case resulted from a cartel. The outcomes of these two cases affected the defence the Defendant could raise and the legal standing of the indirect purchaser. This is examined below.

<http://ec.europa.eu/competition/antitrust/actionsdamages/comparative_report_clean_en.pdf>

- 13 For a discussion on the calculation of overcharge in South African cases, see *Comair Limited v South African Airways (Pty) Ltd* (2008/23443; 2011/34079) [2017] ZAGPJHC 10 (15 February 2017); *Nationwide Airlines (Pty) Ltd (In Liquidation) v South Africa Airways (Pty) Ltd* 2016 (6) SA 19 (GJ); see also L Mncube, ‘The South African Wheat Flour Cartel: Overcharges at the Mill’ (2014) 13(4) J Industry, Competition and Trade 487–509; Junior Khumalo, Jeffrey Mashiane and Simon Roberts, ‘Harm and Overcharge in the South African Precast Concrete Products Cartel’ (2014) 10(3) J Comp L & Econ 621–646; and Albertus van Niekerk, ‘Calculating Cartel Follow-on Damages: General Considerations and Application to South African Construction Sector’ (2015); Econex Report 3 <<http://econex.co.za/publication/research-report-3/>>
- 14 *Campos v Ticketmaster Corp.*, 140 F.3d 1166 (8th Cir. 1998).
- 15 *Apple Inc. v Pepper* 587 US S.Ct. (2019).

Hanover Shoe, Inc. v United Shoe Machinery Corp

Preceding the *Hanover Shoe* case, the defendant, the United Shoe Machinery Corporation, a company that enjoyed dominance in a market that provided manufacturing equipment with strict restrictions, was found guilty of monopolisation¹⁶ through long-term leasing contracts.¹⁷ Wyzanski J recognised that United Shoe grew its market share by offering superior products and services but expressed strong disapproval of its lease-only policy for its machinery.¹⁸ He saw that United Shoe's strength and control in the market coupled with its policies to lease and not sell its machinery 'furthered the dominance of one firm'.¹⁹ He posed 'unnatural barriers',²⁰ thus restricting competition and violating section 2 of the Sherman Act.²¹

Private plaintiffs who suffer harm due to antitrust violations can also bring actions. Section 4 of the Clayton Antitrust Act provides a remedy in the form of treble damages for the successful private plaintiff.²² The purpose of section 4 is to compensate victims and deter future anti-competitive behaviour.

Stemming from this case, the District Court initially heard the claim for damages brought by the plaintiff, Hanover Shoe, a manufacturer of shoes. The plaintiff complained that, in terms of section 4 of the Clayton Act, it suffered harm from the illegally high prices imposed by United Shoe, which monopolised the shoe machinery market by forcing its customers, like Hanover Shoe, to lease, as opposed to buying, its best machines.²³

In its defence, United Shoe argued that it was not liable for damages because Hanover Shoe did not suffer any losses, as it had passed on the overcharge to its customers (the purchasers of shoes). United Shoe also put forth the claim that if Hanover Shoe 'had bought machines at lower prices, [it] would have charged less and made no more profit

16 In defining the elements of an illegal monopolisation, the Court in *United States v Grinnell Corporation*, 384 US 563, 570–571 (1966) set out a two-part test: '(1) the possession of monopoly power in the relevant market and (2) the willful acquisition or maintenance of that power as distinguished from growth or development as a consequence of a superior product, business acumen, or historic accident.'

17 *United Shoe Machinery Corp v United States*, 110 F Supp 295 (D Mass 1953).

18 *ibid* n 236 at 344–345.

19 *ibid*

20 *ibid* at 345.

21 *ibid* at 323–325, 340–346. Section 2 of the Sherman Act declares it unlawful for any person to 'monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations ...'

22 Section 4 15 USC (1982). Any person who shall be injured in his business or property by reason of anything forbidden in the antitrust laws may sue therefore in any district court of the United States in the district in which the defendant resides or is found or has an agent, without respect to the amount in controversy, and shall recover threefold the damages by him sustained, and the cost of suit, including a reasonable attorney's fee.

23 *Hanover Shoe, Inc v United Shoe Machinery Corp* 185 F Supp 826, 830 (MD Pa 1960) (*Hanover Shoe DC*).

than it made by leasing.²⁴ United tried to support its defence by arguing that if the demand were inelastic, Hanover would have been able to pass on the overcharge and not endure any loss of sales.²⁵ Thus in the context of section 4 of the Clayton Act, Hanover was not ‘injured in his business or property’.

The District Court²⁶ heard the first *Hanover Shoe* case and rejected United Shoe’s argument that the overcharge had been passed on. The Court recognised that Hanover Shoe was entitled to recover damages under section 4 of the Clayton Act, as its ‘injury occurred when it was over charged for the machinery’.²⁷ Quoting from the *S Pac Co v Darnell-Taenzer Lumber Co* case, the Court stated that ‘[t]he general tendency of the law, in regard to damages at least, is not to go beyond the first step’ and exonerate a defendant because of ‘remote consequences’.²⁸ The District Court found in favour of Hanover Shoe, and United Shoe appealed the decision to the Supreme Court.

The Supreme Court considered two aspects. The Court first took note that allowing a passing-on defence would result in a complexity of litigation that would be difficult to manage. It expressed concern that ‘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.’²⁹ Also, ‘wading through’ the various levels of the supply chain and determining the cost increases requires substantial evidence, and often the parties have to engage in complex economic theories.³⁰

The second aspect the Court focused on was the adverse effect the passing-on defence would have on deterrence. It felt that if the passing-on defence were allowed, it would disincentivise potential direct purchasers from seeking recovery because their likelihood of success would be limited.³¹ Indirect purchasers may either be too weak or remote, too dispersed, or, because they have only a small claim against the defendant, may not regard claiming damages or joining a class action to do so as worthwhile.³² Violators of competition law would thus escape any significant penalties and ‘retain the fruits of their illegality’, as indirect purchasers ‘would only have a tiny stake in the lawsuit and hence little incentive to sue.’³³ Allowing the passing-on defence would therefore not act as a deterrent to future competition damages as envisioned by the Clayton Act.

24 *Hanover Shoe* SC (n 6) 392.

25 *ibid* 492.

26 *Hanover Shoe* DC (n 23) n 242.

27 *ibid* n 8 490–491.

28 *ibid* n 242 829–830; *S Pac Co v Darnell-Taenzer Lumber Co* 245 US 531, 533 (1918).

29 *Hanover Shoe* SC (n 6) 493.

30 *ibid*.

31 *Hanover Shoe* SC (n 6) 494.

32 *ibid*.

33 *ibid*.

Thus, the Supreme Court denying the defendants the passing-on defence in *Hanover Shoe* prevented long, drawn-out hearings.³⁴ If allowed to claim, the indirect purchaser would have a task that the Court described as that which ‘would normally prove insurmountable’.³⁵ Direct purchasers were given the opportunity to claim full damages, and defendants could not argue that the overcharge had been passed on, as this would substantially reduce the deterrent effect of the private enforcement of damages.³⁶

Illinois Brick

The State of Illinois and about 700 local government entities in Chicago commissioned general contractors for construction on several projects. These general contractors bought supplies from masonry contractors. The masonry contractors bought concrete bricks from the Illinois Brick Company. It was discovered that the Illinois Brick Co was in a cartel that conspired to fix the prices of concrete bricks. The State of Illinois and the government departments brought a claim for damages against Illinois Brick Co. The government applicants argued that, even though the masonry contractors were direct purchasers of the bricks from Illinois Brick Co, it was themselves, as indirect purchasers, who suffered from the price-fixing conspiracy because the overcharge was passed on to the government applicants and they had to bear the additional costs.³⁷

The defendants contended that the *Hanover Shoe* case took precedent in this instance in that it not only prevented the defendant from exercising the passing-on defence but also barred indirect purchasers such as the State of Illinois from recovering damages.³⁸ They argued that this position should apply to this case as well.

On appeal, the Supreme Court, the majority ruled that the State of Illinois could not bring a claim for damages against Illinois Brick Co because it did not purchase the bricks directly from the company and instead purchased the product via contractors. White J³⁹ saw two options: ‘either we must overrule *Hanover Shoe* ... or we must preclude [the indirect purchasers] from seeking to recover on their pass-on theory.’⁴⁰ The Supreme Court denied that the passing-on defence could be used as an offensive strategy: ‘Whatever rule is to be adopted regarding pass-on in antitrust damages actions, it must apply equally to plaintiffs and defendants.’⁴¹ This means that if the passing-on defence could not be used defensively by a defendant in a case of damages where the direct purchaser is the claimant (as in *Hanover Shoe*), it surely could not be available for an indirect purchaser to use offensively to show their right to a claim. If indirect

34 *ibid.*

35 *ibid* 493.

36 *ibid.*

37 *Illinois Brick* (n 8) 726.

38 *ibid* n 258 at 727.

39 White J also wrote the majority judgment in the *Hanover Shoe* SC decision.

40 *Illinois Brick* (n 8) 736.

41 *ibid* 728.

purchasers could sue, it would pose ‘a serious risk of multiple liabilities for defendants.’⁴²

The Supreme Court reiterated the *Hanover Shoe* sentiment regarding the problem of multiple liabilities. The Court envisioned the possibility that there would be multiple claims for damages in various courts by indirect purchasers who were positioned at different levels of the supply chain, all seeking treble damages for the overcharge they paid.⁴³ This could result in inconsistent judgments handed down in the various courts. The Supreme Court in *Illinois Brick* faced the dilemma of either overruling the *Hanover Shoe* case or refusing to permit indirect purchasers to recover damages that were passed on to them.⁴⁴ The Court also affirmed the *Hanover Shoe* view that prohibitive costs would reduce the incentives for indirect purchasers to sue for damages.⁴⁵ The Court believed that in keeping with the Clayton Act, it would serve the interest of justice to allow the direct purchaser to claim damages rather than attempt to apportion damages to multiple claimants at different levels of the supply chain, which would have a greater deterrent effect.

Richman and Murray found that the *Illinois Brick* rule added to the complexity of these damages cases because the indirect purchasers who were prevented from suing in the federal court instituted parallel actions against the defendants in state courts, ‘creating a confusing mosaic of antitrust litigation.’⁴⁶

Concluding Remarks on the Background to the Seminal Cases

Although the Supreme Court decisions in *Hanover Shoe* and *Illinois Brick* are restricted to damages claims under US federal law, these decisions brought about much discussion and debate regarding indirect purchasers’ right to claim damages and the Court’s rejection of the passing-on defence.⁴⁷ The Supreme Court also questioned whether the goals of compensation and deterrence could be adequately achieved.

Before the *Illinois Brick* case, there was much confusion and disagreement in the lower courts as to whether indirect purchasers could sue for treble damages because *Hanover Shoe* only dealt with the position of the direct purchaser.⁴⁸ The Supreme Court simplified the enquiry by allowing only direct purchasers to claim damages. It would be

42 *ibid* 730.

43 *ibid* 731–733.

44 *ibid* 736.

45 *ibid* 734–735.

46 Barak D Richman and Christopher R Murray, ‘Rebuilding *Illinois Brick*: A Functionalist Approach to the Indirect Purchaser Rule’ (2007–2008) 81 S Cal L Rev 69, 99.

47 See George J Benston, ‘Indirect Purchaser’s Standing to Claim Damages in Price Fixing Antitrust Actions: A Benefit/Cost Analysis of Proposals to Change the *Illinois Brick* Rule’ (1986) 55 Antitrust LJ 213; Frank Verboven and Theon Van Dijk, ‘Cartel Damages Claims and the Passing-on Defense’ (2009) 57 J Ind Econ 457–491; Hovenkamp (n 11).

48 See pre-*Illinois Brick* cases: *Philadelphia Housing Authority v American Radiator* 50 FRD 13 (ED Pa 1970) and *Re Western Liquid Asphalt* 487 F 2d 191 (9th Cir 1973), cert denied 415 US 919 (1974).

easier to show that the cartel overcharged the direct purchaser.⁴⁹ Cases involving intermediate markets, especially when the form of the product has significantly changed and moved through various levels of the supply chain, would be much more difficult to prove.⁵⁰ The Court denied the passing-on defence and multiple liabilities, thereby avoiding costly and lengthy trials. This stance also protected the damages award of direct purchasers who had recovered the entire overcharge, which cannot be apportioned to indirect purchasers.⁵¹

It is to be expected that the same Court would uphold its prior decision in *Hanover Shoe* and extend the argument to the *Illinois Brick* case. If they had allowed for the offensive use of passing-on and thus allowed indirect purchasers to claim damages, this would have contradicted their earlier decision and rendered it obsolete, or it could have led to the double liability of defendants. The consequence of this is that end consumers finally pay the overcharge, especially in the case of intermediate products, and are further disadvantaged because they are barred from claiming damages. If direct purchasers chose not to sue, the cartel would escape with little punishment.⁵² If indirect purchasers were allowed to sue for damages, this could also expose the cartel to multiple damages cases.⁵³

Is the Passing-on Defence Necessary to Show a Proper Assessment of Damages?

In a world where indirect purchasers are allowed to claim damages, how necessary would it be to allow for the passing-on defence? Should the defendant cartel be allowed to use the passing-on defence and thereby limit its liability for compensation to the direct purchaser plaintiff? Suppose the defendant uses the passing-on defence. In that case, the burden shifts to the defendant (the cartel) to show how the overcharge has been passed on from the direct purchaser to the indirect purchaser. It would be an easier exercise to determine the overcharge in the case of cost-plus contracts.⁵⁴ But the link between the upstream prices and the downstream prices may not be that obvious.

Is it acceptable to deny the defendant from using the passing-on defence to avoid complicated multiparty litigation and expense? However, Harris and Sullivan argue that

49 See John H Johnson and Gregory K Leonard, 'Frictions and Sticking Points: Applying the Textbook Model to the Analysis of Cost Pass-through in Indirect Purchaser Class Actions' (2008) *Antitrust Insights* 1.

50 See Maarten Pieter Schinkel, Jan Tuinstra, and Jakob Rugeberg, 'Illinois Walls: How Barring Indirect Purchaser Suits Facilitates Collusion' (2008) 39 *RAND J Econ* 683.

51 Benston (n 47).

52 Martin Hellwig, 'Private Damage Claims and the Passing-on Defence in Horizontal Price-fixing Cases: An Economist's Perspective' (*Max Planck Institute for Research on Collective Goods*, 2006) <https://www.coll.mpg.de/pdf_dat/2006_22online.pdf> accessed 17 May 2010.

53 Schinkel, Tuinstra, and Rugeberg (n 50) 683–684.

54 *Kansas v Utilicorp United Inc.* 497 US 199, 110 S CT.

‘[t]he Court, without considering chain complexity, erroneously inferred from chain length alone that it is difficult to determine whether passing-on has occurred.’⁵⁵ The authors believe that, if the various supply levels could be identified, the overcharge determination would be manageable.⁵⁶ They contend that empirical techniques would be adequate in calculating the overcharge. However, the process would be tedious: ‘It is, perhaps, a worthy goal to protect courts from tedium, but surely not at the cost of depriving parties injured by a blatant wrong from appropriate redress.’⁵⁷ If the passed-on overcharge can be easily traced, should the defence be available to the defendants?

Another point to consider is if the defendant can successfully argue that the direct purchaser plaintiff had passed on the overcharge, the focus then shifts to the indirect purchaser to bring the action.⁵⁸ How should a direct plaintiff who has passed on the overcharge be compensated for the harm that resulted from that passing on? Would a direct purchaser be incentivised to sue for damages knowing that the defendant is likely to raise the passing-on defence? Currently, the direct purchaser does not have to concern itself with passing on, and the recovery is higher and certain and need not be shared with downstream litigants.⁵⁹ When deciding to pursue a claim for damages, the direct purchaser should consider the impact of the court allowing the passing-on defence and weigh factors such as costs, evidence, and strength of the case to determine their chances of success. The role of the passing-on defence should not outweigh these factors.

Characterising the Indirect Purchaser

The *Illinois Brick* case introduced the difficulty of defining an indirect purchaser with legal standing. It is easy to identify the direct purchaser due to its direct point of sale with the cartel. But indirect purchasers could extend quite far down the supply-chain rabbit hole. For example, consider a market in which a steel cartel sells steel sheets to the direct purchaser. An indirect purchaser would include every customer who bought a product from the direct purchaser and every customer who now has an end product that includes the steel sold by the cartel. Steel sheets could be used as input in nuts and bolts, the construction industry, car manufacturing, and so on, and the form of the end product could be completely different to that which the cartel sold. There could be numerous levels in the supply chain where the product could be used in its raw form, or value could be added to the product. The cartelised product could look quite similar to the finished product or be completely unrecognisable.

55 Robert G Harris and Lawrence A Sullivan, ‘Passing-on the Monopoly Overcharge: A Comprehensive Policy Analysis’ (1979) 128 U Pa L Rev 338–339, referring to *Illinois Brick* (n 8) 741–744.

56 *ibid* n 292 at 339.

57 *ibid*.

58 Fabio Polverino, ‘A Class Action Model for Antitrust Damages Litigation in the European Union’ (2007) 30 World Competition 492.

59 V Sarris, ‘The Efficiency of Private Antitrust Enforcement: The ‘Illinois Brick’ Decision’ (Doctoral thesis, Yale University 1979) 129.

Types of modifications may also relate to the various costs added on to the cartelised product. If the input product accounts for ‘only a small percentage of the price of the product, then the increment in price of the final consumer product attributable to an overcharge may be too small to measure.’⁶⁰ Should standing extend to any firm or person who bought the product at any level of the supply chain? Should we include purchasers who switched to an inferior input product because they could not afford to pay the cartelised prices? Or should legal standing be given to competitors of the cartel who were squeezed out of the market and want to claim for lost profits? How far should we go to show harm caused by the cartel? Courts would not allow injuries that are too remote to permit the recovery of damages.⁶¹ These complexities make it more difficult to justify why indirect purchasers should be allowed to claim damages and to calculate the overcharge. This section highlights the two main difficulties with characterisation and the two main problems revealed by commentators. This debate concerns whether to include or exclude the indirect purchaser from suing for damages.

First, both indirect and direct purchasers are injured by anti-competitive conduct. Under *Illinois Brick*, only direct purchasers’ benefit (even if they passed on the entire overcharge) at the expense of the indirect purchasers. Hovenkamp emphasises that the ‘indirect purchaser rule potentially awards the direct purchaser more than three times the damages “by him sustained”, while indirect purchasers receive nothing.’⁶²

Second, there may be circumstances in which direct purchasers do not wish to pursue damages claims. Direct purchasers may fear claiming damages if there is a threat of limit or delay of supply from the cartel, particularly where demand is inelastic.⁶³ If the direct purchaser can add on a fixed percentage markup and profit from it and pass on the overcharge, it would rather do so than run the risk of claiming damages and potentially threatening supply.⁶⁴ If the indirect purchaser is barred from suing the cartel, a possible claim for damages will no longer serve as an incentive to stop the violation. Harris and Sullivan argue that this would lessen the deterrent effect of private damages cases.⁶⁵

Arguing against the position taken by Harris and Sullivan, Landes and Posner support the *Illinois Brick* decision and argue that the direct purchaser would have every

60 John E Lopatka and William H Page, ‘Indirect Purchaser Suits and the Consumer Interest’ (2003) 48 Antitrust Bulletin 546.

61 *Loeb v Eastman Kodak Co* 183 F 704 (3rd Cir 1910) set out the direct injury test and asks whether the plaintiff’s injury was ‘indirect, remote, and consequential’ at 709.

62 Herbert Hovenkamp, ‘The Indirect-purchaser Rule and Cost-plus Sales’ (1990) 103 Harvard L Rev 1721 at 1718. Quoting s 4 of the Clayton Act, Hovenkamp argues that the *Illinois Brick* rule is inconsistent with the allocation of compensation this Act tried to encourage.

63 See Harris and Sullivan (n 57) 249–254.

64 Sarris (n 59) 133.

65 Harris and Sullivan (n 57) 249–254.

incentive to sue for the damages windfall. They provide three reasons this decision enhances the deterrent effect:

First, the direct purchaser is a more efficient enforcer of the antitrust laws than the indirect purchaser and should therefore be given maximum incentive to bring antitrust suits. Second, the problem of apportioning damages among direct and indirect purchasers would be so costly that it would decrease the incentives of *any* purchaser to sue. Third, even if direct and indirect purchasers were equally efficient antitrust enforcers, and even if allocation problems could be solved without seriously depleting the recovery pool, deterrence would be weakened if the right to sue were divided among more parties, so that each claim was relatively small.⁶⁶

There is a flaw in Landes and Posner's reasoning in that they believe the only reason a direct purchaser would not have the incentive to sue is if perverse incentives were preventing them from doing so.⁶⁷ Direct purchasers may plainly not have any incentive to sue in numerous cases

Third, another reason for a direct purchaser not to sue for damages is that they could be aiding the cartel. Through their study, Schinkel, Tuinstra, and Ruggerberg showed that the *Illinois Brick* rule is capable of facilitating collusion between suppliers.⁶⁸ If a firm in the upstream cartel can strike a deal with their downstream customers (direct purchasers) through perverse incentives, this can prevent the direct purchaser from pursuing an action for damages against the cartel.⁶⁹ The cartel essentially buys the direct purchaser's silence. But, even if one had to accept the possibility outlined in this study, one cannot ignore the fact that the *Illinois Brick* rule includes the exception that indirect purchasers can sue if it can be proven that the direct purchaser co-conspired with the cartel.⁷⁰

One of the reasons indirect purchasers were refused to stand was because the *Illinois Brick* Court wanted to avoid multiparty litigation. There is no denying that multiparty litigation lawsuits are costly. In the United States, the defendant could be liable for treble damages in each of these lawsuits. Court resources are limited, and some believe that 'it makes even less sense to permit inconsistent judgments as to who bore the overcharge.'⁷¹ This could happen in a case, for example, where an indirect purchaser is

66 William M Landes and Richard A Posner, 'The Economics of Passing-on: A Reply to Harris and Sullivan' (1980) 128 U Pa L Rev 608–609.

67 *ibid* n 305 at 613–614.

68 Schinkel, Tuinstra, and Ruggerberg (n 50) 684.

69 *ibid*.

70 *Illinois Brick* (n 8) 736.

71 Section of Antitrust Law ABA Report of the Indirect Purchaser Task Force, 63 Antitrust T LJ (1995) 995.

successful in one court, and the direct purchaser is unsuccessful in its claim in another court.⁷²

The *Illinois Brick* Court foresaw the problem of duplicative damages recovery if the indirect purchaser was allowed to sue for the overcharge that was passed on to it, and the direct purchaser could also lay a claim to the overcharge against the defendant.⁷³ The defendant would thus be liable for more than envisioned by the Clayton Act. Hovenkamp repudiates this claim by saying that the indirect purchaser will only claim what the direct purchaser has passed on to him.⁷⁴ Although this still means that the carteliser would be obliged to compensate part of the harm more than once.

The *Illinois Brick* case became part of a vigorous debate for many decades to come. I outlined the conflicting views of Harris and Sullivan, and Landes and Posner regarding who it would be most appropriate to compensate. Although the *Illinois Brick* case remains intact at the federal level, many state courts have taken the alternative view and allowed indirect purchasers to sue. This dichotomous approach by the federal and state courts does not provide any clarity on the way forward. *Hanover Shoe* offers a lifeline to the defendant firms by way of the passing-on defence, and the *Illinois Brick* rule fails to compensate end consumers. Compensation should not be forfeited in favour of deterrence. In fact, the ideal solution would be one where both are achievable.

Is it simply unfortunate that *Illinois Brick* was decided after *Hanover Shoe*? In a separate dissent, Blackmun J lamented ‘an unhappy chronology’ that bound *Illinois Brick* to *Hanover Shoe*, musing that ‘[i]f [*Hanover Shoe*] had not preceded this case ... I am positive that the Court today would [grant standing].’⁷⁵ Other commentators also feel that because of the chronology of these two cases, the majority in *Illinois Brick* felt obliged to give equal treatment to plaintiffs and defendants and to uphold the *Hanover Shoe* decision.⁷⁶

The indirect purchaser rule which has been applied for decades to traditional market structures, is, in itself, rigid. Online digital platform markets are changing the landscape, and it is not always clear who the indirect purchaser is or what the cartelised or monopolised product is. The courts in the United States were split when it came to who the indirect purchasers are in online marketplaces.

In the *Campos v Ticketmaster* case, concertgoers sued Ticketmaster for the monopolistic prices that concert venues were charging for their admission tickets. Ticketmaster was

72 Sarris (n 59) 123; see also Kevin J O’Connor, ‘Is the *Illinois Brick* Wall Crumbling?’ (2000–2001) 15 Antitrust 34.

73 *Illinois Brick* (n 8) 730–731.

74 Hovenkamp (n 11) 1730.

75 Lopatka and Page (n 60) 765.

76 See Roger D Blair and Jeffrey L Harrison, ‘Re-examining the Role of *Illinois Brick* in Modern Antitrust Standing’ (1999) 68 Geo Wash L Rev 42; O’Connor (n 72) n 314 at 34.

dominating the ticket distribution sales by entering into exclusive contracts with concert venues.

According to the 8th Circuit Court majority decision, the agreements between Ticketmaster and the venues were ‘antecedent transactions’ which the venues themselves (and not the concert-goers who paid the Ticketmaster with the service fee built into the price of admission) were the purchaser who was directly affected by the supra-competitive prices. The court found that the concert-goers who bought tickets from an intermediary like Ticketmaster were indirect purchasers, although they bought the tickets directly from Ticketmaster. In keeping with the Illinois brick doctrine, the concert-goers who were the indirect purchaser, in this case, were not allowed to sue Ticketmaster for damages due to its monopolistic pricing.

The Ticketmaster case is in sharp contrast to the 9th Circuit Court’s decision in the 2017 Apple case. Apple sold apps through its Apple app store, made by third-party developers, and charged the developers a thirty per cent commission. Apple charged developers a USD99 annual membership fee, the app developer could set any price, and Apple charged a thirty per cent commission on the app. Four iPhone owners contended that Apple charged too much for the apps and sued Apple for abusing its monopoly position by charging higher than competitive prices in the aftermarket for the Apple apps. Apple argued that the iPhone owners did not have standing as they were not direct purchasers of the app, keeping in line with the reasoning of the Illinois Brick case.⁷⁷ Apple argued that the thirty per cent commission is charged to the app developers were passed on to consumers in the form of higher prices. The consumers were thus indirect purchasers and could not sue Apple under the *Illinois Brick* rule. The Court held that Apple was the distributor of apps, selling these apps directly to end-users through its app Store, and therefore the end-user would have standing (according to Illinois Brick) to sue Apple for its alleged monopolisation of the sale of iPhone apps as a direct purchaser. The 9th Circuit acknowledged its departure from the 8th Circuit Court in the Ticketmaster case.

On appeal, at the Supreme Court in what was now called the *Apple v Pepper Inc* case to determine whether it was the 8th or 9th Circuit Court which had the correct interpretation. The Supreme Court favoured the 9th Circuit Court’s decision that in the absence of any intermediary in the chain of distribution between Apple and the end-user, the end-user is viewed as a direct purchaser for the purposes of the Illinois Brick doctrine. The decision appears to question the boundaries of Illinois Brick in the US case of *Apple Inc v Pepper*.

The US Supreme Court held that under the *Illinois Brick* case, the iPhone owners were direct purchasers and did have the standing to sue Apple for alleged monopolisation. The Court drew on section 4 of the Clayton Act, which states that ‘any person who shall

77 *ibid.*

be injured in his business or property by reason of anything forbidden in the antitrust laws may sue.’⁷⁸ The Court held:

‘That broad text readily covers consumers who purchase goods or services at higher-than-competitive prices from an allegedly monopolistic retailer.’

The Court felt that unlike the indirect purchasers in the *Illinois Brick* case, the consumers of the Apple apps, being the iPhone owners, are not at the bottom of the vertical supply chain attempting to sue a manufacturer at the top of the chain.

Put plainly, Justice Brett Kavanaugh, writing for the majority, stated that [‘t]he plaintiffs purchased apps directly from Apple and therefore are direct purchasers under *Illinois Brick*.’⁷⁹

Apple argued that *Illinois Brick* allows consumers to sue the party that set the retail price, and in their case, they do not set the retail price. That is done by the app developers.⁸⁰ The Supreme Court stated that section 4 of the Clayton Act broadly provides for injured parties to sue for antitrust damages and that *Illinois Brick* creates a bright line where direct consumers (and not indirect purchasers) could sue for antitrust violators from whom they purchased goods or services.⁸¹ ‘When there is no intermediary between the purchaser and the antitrust violator, the purchaser may sue.’⁸² The Court did not favour Apple’s extension of a ‘who sets the price rule’ from the indirect purchaser rule of *Illinois Brick*.⁸³ The Court did not address the merits of the antitrust claim and referred the matter to the lower courts.

In the dissent penned by Justice Gorsuch, J., the dissenting judges were of the view that the App developers who were charged the thirty per cent by Apple had passed on the overcharge (if any) to the iPhone owners and that this would lead to a complex inquiry into how Apple charges its commission. The dissenting judges also agreed with Apple that the apportionment of damages in such a case becomes difficult and brings the possibility of double damages.

This ruling did not expand the scope of antitrust standing; however, it is possible that the victim-centred approach in the *Apple v Pepper* case may encourage more plaintiffs, using the growing number of online platforms, especially the large corporations like Apple, to push the boundaries of *Illinois Brick* to eventually seeing it overturned. There is no doubt that this case will create more private antitrust litigation. In assessing whether a plaintiff is a direct or an indirect purchaser under Federal Antitrust law, courts

78 15 U. S. C. §15(a).

79 *ibid* 588.

80 *ibid* 594.

81 *ibid*.

82 *ibid*.

83 *ibid* 595.

no longer will rely on who sets the price or how a retailer structures its financial arrangements with upstream suppliers. If it is an intermediary between a seller and a buyer, the buyer is an indirect purchaser barred from seeking antitrust damages. If there is no intermediary, the buyer is a direct purchaser and must sue for damages.

The *Ticketmaster* and the *Apple* cases show that with the advent of online digital platforms, the marketplace is no longer a simple series of transactions as we have seen in *Illinois Brick* and *Hanover Shoe* where it was not in question which consumer was the indirect purchaser. These new digital platforms are becoming more complex, and it may not always be easily determinative as to who the direct and indirect purchaser is. But what remains is the principle that under *Illinois Brick*, the indirect purchaser is barred from suing the initial cartel or monopolist at the top of the distribution chain.

Possible Solutions and Recommendations for South Africa

South African courts are yet to decide on whether to allow the defendant to raise a passing-on defence or to engage in the debate as to whether the indirect purchaser should be allowed to claim or prevented from claiming damages. In anticipation of the courts engaging with these issues, I pose four possible scenarios for the courts to consider:

- (1) allow the indirect purchaser to sue, and do not allow the passing-on defence;
- (2) do not allow the indirect purchaser to sue and allow the passing-on defence;
- (3) do not allow the indirect purchaser to sue, and do not allow the passing-on defence;
and
- (4) allow the indirect purchaser to sue and enable the defendant to raise the passing-on defence.

I am reluctant to offer scenarios 1 and 2 as a possibility, as this would place an unfair advantage on the indirect purchaser in scenario 1 and on the defendant in scenario 2. Scenario 2 allows the possibility of the defendant getting away with not providing compensation to any party for the infringement. Scenario 3 is what is offered by the US cases of *Hanover Shoe* and *Illinois Brick*. It comes with its caveats: the direct purchaser who passed on the overcharge may be unjustly enriched, and the actual victims will not have access to those compensatory funds. Scenario 4 is the best route for the South African courts to take as it would allow the defendant to institute the passing-on defence, but without removing the possibility of the indirect purchaser claiming damages. All victims of anti-competitive conduct should have the opportunity to put forward their cases.

Sarris proposes a solution that depends on the statute of limitations and limiting overcompensation to damages claimants.⁸⁴ She assumes a scenario in which there is one direct purchaser and one indirect purchaser. Starting with the premise of the *Illinois Brick* case, the direct purchaser would be entitled to sue for damages in the value of the overcharge. An assessment of passing on is not required. The direct purchaser would have a four-year statute of limitations period in which to sue, and that exclusive right will end after the four years have been prescribed or ‘one year after the indirect purchaser has filed a notice of intention to sue the price fixer ... whichever comes first.’⁸⁵ Thereafter the indirect purchaser would have an exclusive right to sue for triple damages without having to prove that the overcharge was passed on to him. If there is more than one level of indirect purchasers, they may all have a chance of recovery and would have to file a notice of intention to sue. But ‘[o]nly one party at a time will have the right to recover.’⁸⁶ Sarris believes that this solution would address problems raised by the *Illinois Brick* Court, such as proving passing on and avoiding multiple liabilities. In South Africa, the statute of limitations is three years. This solution may be workable; however, due process may be hampered if the respondent must wait years for each party to file an intention to sue, which may take years if there are parties at multiple levels of the supply chain.

When both direct and indirect purchasers sue, does this result in optimal deterrence? Are duplicating recoveries desirable?⁸⁷ Lopatka and Page have not found indirect class actions to be of much benefit when it comes to deterrence. According to their research, the primary reason is that in cases in which the product in question is an input used as an ingredient in other products, the class actions are not certified in most cases. If the cases were certified, the damages were either not awarded directly to the consumers who suffered harm but rather distributed to worthy causes, or the rewards were too low.⁸⁸ That in itself should not be reason enough to prevent indirect purchaser claims. The indirect purchaser class should be given the opportunity to weigh their risks. Distributing the damages to worthy causes should be seen as a positive step towards uplifting consumer welfare.

Many commentators see indirect purchasers as hindering the route to deterrence.⁸⁹ Although necessary in cartel cases, the goal of deterrence need not be the focal point in South African civil claims for damages. The competition authorities are the first port of call when it comes to enforcement. The Competition Tribunal fines firms that are found guilty of cartel behaviour. That should be an adequate deterrent. The civil claims would

84 Sarris (n 59) 135–137.

85 *ibid* 136.

86 *ibid* 137.

87 Lopatka and Page (n 60) n 298 at 533.

88 *ibid* 569.

89 *ibid* 569–570.

add to that deterrence. Yet, the primary focus of civil claims for damages would be providing appropriate compensation.

The ideal solution would be to provide compensation while promoting deterrence and doing so with the lowest administrative costs. Richman and Murray have produced a solution for the United States that they claim captures all three of these criteria.⁹⁰ They propose that all claims by victims, including indirect purchasers of the cartel, be combined into one consolidated application. Damages could then be allocated to the plaintiffs in one suit. They believe that this would provide an incentive and reward to the parties bringing the action. They also foresee the problem where one party opts out of the consolidation with the plan to bring its own stand-alone suit.⁹¹ They propose a mandatory consolidation action to curb this problem.

This article is not about bringing reform to the US position, but rather about the lessons we can learn from the United States to avoid the problems created by the *Hanover Shoe–Illinois Brick* situation in South Africa. With the advent of damages cases, we too will be seeing parties in multilayered supply chains who wish to institute damages claims. The challenges faced by the US courts will not be any different to those arising in South African courts.

Conclusion

Unlike in South Africa, in the United States, private damages play a pivotal enforcement role in competition cases. Therefore, achieving deterrence and enforcement while sacrificing compensation was a key point for the *Illinois Brick* Court to consider. The optimal solution would have been to promote both the goals of enforcement and compensation to all victims.⁹²

Some commentators agree that the *Illinois Brick* rule has contributed to greater deterrence of anti-competitive behaviour by giving exclusive rights to direct purchasers to sue for damages, consequently lowering complexities and costs.⁹³ Others argue that the rule failed to promote competition enforcement and that the *Illinois Brick* rule sacrificed compensation for deterrence.⁹⁴ Sarris writes, ‘There is a trade-off between efficient enforcement and the just compensation of victims of antitrust violations because the act of compensation consumes society’s resources, and thus adds to the administrative costs of enforcement.’⁹⁵

90 Richman and Murray (n 46) 101.

91 *ibid* 102.

92 Sarris (n 59) 117.

93 See Landes and Posner (n 66) 1274–1279; Edward A Snyder, ‘Efficient Assignment of Rights to Sue for Antitrust Damages’ (1985) 28 *J L & Econ* 469 at 667; Benston (n 47) 235–236.

94 Richman and Murray (n 46) 91.

95 Sarris (n 59) 120.

This debate as to whether indirect purchasers should be allowed to claim damages and allow the Defendant to use the passing-on defence remains untested in South African competition law cases. If the opportunity is created for more litigants to claim damages, this could impact not just the ability to be compensated but also affect deterrence. Technology is changing rapidly, and digital platforms could add a new dimension to the conventional market structures, as we have seen in the *Apple Inc v Pepper* case. These platforms may also result in a blurred distinction between the indirect and direct purchaser. Ultimately, access to justice for the damages claimant should be achieved or, at least, achievable with the promotion of both public and private enforcement. More importantly, accessing justice would mean creating the space for all prospective damages claimants to claim compensation.

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