

Comments / Commentaires

**AN ECONOMIC PERSPECTIVE ON THE RECENT  
INDIRECT PURCHASER RULINGS BY THE  
SUPREME COURT OF CANADA**

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*The Supreme Court of Canada recently issued its decisions in three pivotal Canadian competition law cases: Sun-Rype Products Ltd. v. Archer Daniels Midland Company, Pro-Sys Consultants Ltd. v. Microsoft Corporation, and Infineon Technologies AG v. Option consommateurs. The Court ruled that indirect purchasers have, at least to some extent, a right to sue under Canadian competition law. This paper discusses the implications of these rulings from the perspective of economists. Indeed, the determination of how much of the input price increase from a competition law violation is “passed through” to indirect purchasers is a topic within the realm of economic expertise. We note that, although pass-through is difficult to quantify, developments in data availability and analysis, including increasingly sophisticated statistical tools, have enabled economists to more easily and more accurately estimate pass-through rates along various stages of a chain of distribution (e.g., from the manufacturer to the retailer to the customer). Nevertheless, the mere existence of such methods does not by itself guarantee the applicability of a common method of proof in a given class action matter involving indirect purchasers. Perhaps even more so than for direct purchaser classes, there are many instances in which such calculations may be inaccurate because the class members are so dissimilar that a common method of establishing harm on a class-wide basis cannot and should not be used.*

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*La Cour suprême du Canada a récemment rendu ses décisions dans trois affaires essentielles au droit de la concurrence canadien : Sun-Rype Products Ltd. c. Archer Daniels Midland Company, Pro-Sys Consultants Ltd. c. Microsoft Corporation, et Infineon Technologies AG c. Option consommateurs. La Cour a conclu que les acheteurs indirects ont, du moins dans une certaine mesure, un droit d'exercer des poursuites en vertu du droit*

*de la concurrence canadien. Cet article porte sur les incidences de ces décisions du point de vue d'économistes. D'ailleurs, la détermination de la portion de l'augmentation du prix d'entrée découlant d'une violation du droit de la concurrence qui est « transférée » aux acheteurs indirects est un sujet qui se situe dans les limites de la compétence économique. Nous remarquons que bien qu'il soit difficile d'estimer le montant transféré, les évolutions de l'analyse des données, y compris les outils statistiques de plus en plus sophistiqués, ont permis aux économistes d'estimer plus facilement et plus précisément les taux de transfert aux diverses étapes de la chaîne de distribution (p. ex., du fabricant au client en passant par le revendeur). Pourtant, la simple existence de telles méthodes ne garantit pas, en elle-même, le caractère applicable d'une méthode de preuve commune dans le cadre d'un recours collectif donné connexe à des acheteurs indirects. Peut-être même plus qu'en ce qui concerne les acheteurs directs, il existe de nombreux cas dans lesquels ce genre de calculs peut être imprécis en raison de la grande diversité des membres au recours, de sorte qu'une méthode commune d'établissement du préjudice à l'échelle du recours ne peut, ni ne doit, être utilisée.*

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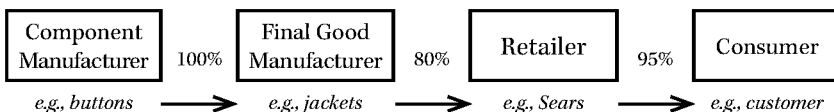
## Introduction

The question of whether indirect purchasers can seek to recover damages or restitutionary awards in price fixing cases is widely debated in several jurisdictions. In Canada, the Supreme Court recently issued its rulings in a trilogy of seminal cases dealing with this question.<sup>2</sup> The central issue before the Court was whether indirect purchasers can assert a cause of action under Section 36 of the Canadian *Competition Act*, which states that “any person who has suffered loss or damage” as a result of anticompetitive conduct can sue for the recovery of damages.<sup>3</sup> It is well established that direct purchasers – those that purchased the at-issue good(s) directly from the manufacturer who charged an artificially inflated price (*i.e.*, were “overcharged”) – have a cause of action under section 36 of the *Competition Act*. However, prior to the release of the Supreme Court’s recent rulings, it was less certain whether indirect purchasers – those that buy the at-issue good(s) from parties in the distribution chain other than the manufacturer (*e.g.*, from distributors and retailers), and to whom some or all of the alleged overcharge may have been “passed through” – could sue for damages under Canadian law. The state of Canadian law in this area was uncertain following the

British Columbia Court of Appeal's ruling that indirect purchasers do not have a cause of action for alleged competition law violations in *Sun-Rype Products Ltd. v. Archer Daniels Midland Company* and *Pro-Sys Consultants Ltd. v. Microsoft Corporation*, whereas the Quebec Court of Appeal rejected the British Columbia Court of Appeal's ruling and certified a class of both direct and indirect purchasers in *Infineon Technologies AG v. Option consommateurs*. The highly anticipated Supreme Court of Canada decisions allow indirect purchasers to assert a claim for loss or damage incurred as a result of price fixing under Canadian competition laws. This article analyzes the Supreme Court of Canada's rulings from the perspective of economists.

### Background

The pass-through rate measures the degree to which output prices change when input prices (costs) change. For example, a pass-through rate of 75% means that when costs increase by \$1.00, prices increase by \$0.75.<sup>4</sup> Pass-through rates can be estimated for each stage in the distribution chain. For example, suppose that there are three stages in the distribution chain in a given industry: (1) the component manufacturer to final good manufacturer; (2) the final good manufacturer to the retailer; and (3) the retailer to the final customer. Pass-through rates will likely vary both across and within levels of the distribution chain. Assuming away these important complexities for now, the pass-through rate of the cost increase from the component manufacturer to the final customer is estimated by multiplying the pass-through rates from each stage of the distribution chain (e.g., 80% from final good manufacturer to retailer \* 95% from retailer to final customer = 76% from component manufacturer to final customer).<sup>5</sup>



Indirect purchaser overcharges are estimated by taking the full overcharge to direct purchasers and multiplying this by the pass-through rates to the indirect purchasers. These overcharges then need to be adjusted to take into account the amount of the overcharge passed-through to the next level in order to arrive at a proper quantification of any indirect purchaser damages along the various steps in the supply

chain. The adjusted overcharges will therefore generally be much smaller than the original overcharge. Note that, contrary to prevalent thinking, it is *not* the case that a monopolist can more easily pass on an overcharge compared to sellers operating in a perfectly competitive market. In fact, all else equal, the more competitive the industry, the closer the pass-through rate will be to 100%. Under imperfect competition, a common circumstance, the pass-through rates can be less than 100%, equal to 100%, or greater than 100%, depending on the shape of the demand and supply curves.

In the United States, two pivotal federal cases – *Hanover Shoe Inc. v. United Shoe Machinery Corp.* (1968) and *Illinois Brick Co. v. Illinois* (1977) – set the stage for the quantification of damages in antitrust cases in that country. These decisions established that indirect purchasers may not recover damages in the United States Federal Court, while direct purchasers may in turn recover 100% of damages associated with overcharges resulting from antitrust violations. In response to these decisions, the majority of states have authorized indirect purchaser suits in state courts, either through “*Illinois Brick* repealer” statutes or through state consumer protection or unfair trade practices laws. This has resulted in many state-level indirect purchaser suits being brought in parallel with federal direct purchaser suits to recover damages for the same alleged antitrust violation(s). In 2007, the American Antitrust Modernization Commission recommended that Congress “overrule the Supreme Court’s decisions in *Illinois Brick* and *Hanover Shoe* to the extent necessary to allow both direct and indirect purchasers to recover for their injuries.”<sup>6</sup>

In the United States under the *Sherman Act*, antitrust damages claims are trebled as a means of deterring anticompetitive conduct. However, since direct purchasers are permitted to claim compensation equivalent to 100% of the alleged overcharge irrespective of any potential pass-through to downstream entities, awards to indirect purchasers can result in a multiple of damages awarded that is well beyond the trebling envisioned by the *Sherman Act*. The extent of any misallocation of compensation and the overall size of the excess penalty to defendants relative to actual damages suffered depends on the extent of the actual pass-through of the overcharge to indirect purchasers, an issue that has drawn considerable attention from economists.

In Canadian class proceedings involving allegations of anti-competitive conduct, plaintiffs are generally required to file expert evidence demonstrating proof of harm on a class-wide basis.<sup>7</sup> In cases involving indirect purchasers, expert evidence respecting proof of harm must necessarily be capable of accurately calculating the extent of pass-through for the various stages in the relevant chain of distribution. In its recent decision in the *Microsoft* case, the Supreme Court of Canada remarked that “[t]he most contentious question involving the use of expert evidence is how strong the evidence must be at the certification stage to satisfy the court that there is a method by which impact can be proved on a class-wide basis.”<sup>8</sup> Also in *Microsoft*, the Supreme Court noted that “the [expert] methodology must offer a realistic prospect of establishing loss on a class-wide basis so that, if the overcharge is eventually established at the trial of the common issues, there is a means by which to demonstrate that it is common to the class (*i.e.* that passing on has occurred)” and that “the methodology cannot be purely theoretical or hypothetical, but must be grounded in the facts of the particular case in question.”<sup>9</sup> These statements reinforce that expert opinions must be based on scientifically sound methods supported by reliable data. In the context of pass-through analyses, this is a standard that should be adhered to despite the inherent difficulties associated with such calculations.

In this article, we discuss three possible options the Supreme Court of Canada had available to consider when arriving at its recent trilogy of decisions. First, it could have avoided the inherent complexities of pass-through altogether, allowing only direct purchasers to sue for damages arising from competition law violations under Section 36 of the *Competition Act*. This would have reflected the current state of federal law in the United States, thereby also resulting in the same potential misallocation of damages. Second, the Court could have allowed direct and indirect purchasers to join together in making their damages claims, as it has. Third, it could have allowed indirect purchasers to assert claims for damages, but required that they bring separate actions from those of direct purchasers. The remainder of this paper discusses these three options, highlighting particular issues that are relevant from an economic perspective.

### **Option 1: Direct Purchaser Actions Only with No Pass-Through Defence**

First, we examine the option of allowing only direct purchasers to pursue an action for recovery of damages under Section 36 of the *Competition Act*, without regard to pass-through of any overcharges to downstream purchasers. Such a decision would have been consistent with the British Columbia Court of Appeal's decisions in *Sun-Rype* and *Microsoft* mentioned above.

The *Sun-Rype* case involved a price fixing allegation related to high fructose corn syrup, a sweetener used in food and beverage products. A class of both direct and indirect purchasers was certified at first instance, following allegations by the plaintiffs that at least a portion of the overcharge affecting direct purchasers was also passed on to end users (*i.e.*, indirect purchasers). In the *Microsoft* case, the certified class comprised only indirect purchasers who purchased computers with Microsoft operating systems and applications software for which they were allegedly overcharged.

The British Columbia Court of Appeal overturned both of these class certification decisions, holding that indirect purchasers do not have a cause of action under Canadian law. In arriving at its decision, the British Columbia Court of Appeal relied on the Supreme Court's decision in *Kingstreet Investments Ltd. v. New Brunswick (Department of Finance)*.<sup>10</sup> In *Kingstreet*, the Supreme Court of Canada ruled that the pass-through defence had been conclusively rejected in Canada. In its recent trilogy of decisions, the Supreme Court confirmed that passing-on cannot not be used as a defence (in accordance with *Kingstreet*). The Court also held – for the first time – that indirect purchaser plaintiffs are permitted to use pass-on offensively in order to establish a cause of action.

In *Hanover Shoe*, the Supreme Court of the United States similarly rejected the defence of passing-on, thereby awarding 100% of potential overcharges to direct purchasers. This decision was considered in *Illinois Brick*,<sup>11</sup> where the Supreme Court of the United States concluded that indirect purchasers could not assert a claim for damages, since direct purchasers are permitted to claim compensation equivalent to 100% of any alleged overcharge. To justify allocating 100% of damages

to direct purchasers, the Supreme Court of the United States argued that apportioning damages among the various levels of indirect purchasers was invariably an exceedingly complex, lengthy, and uncertain task, which would thereby render antitrust enforcement less effective.

Improvements in data availability and analysis, as well as increasingly sophisticated statistical tools, enable economists to more easily and more accurately estimate average pass-through rates along the various stages of the distribution chain in a given industry. Although this has enabled better calculations of actual damages to direct purchasers (net of pass-through to indirect downstream entities), there remain significant qualifications. For example, pass-through estimation can be especially complicated when a product has gone through multiple transformations along the chain of distribution. Overcharge calculations are also complex and may vary among direct purchasers. Indeed, while some form of regression analysis is generally possible, it is not appropriate in all cases.<sup>12</sup>

In many instances, such complex calculations may be inaccurate, particularly when class members are so dissimilar that a common method of establishing harm on a class-wide basis cannot and should not be used. Differences across potential class members can include general factors such as wide disparities in the size (and therefore bargaining power) of buyers, or geography (which may affect sources of alternative supply, costs of transportation, and other factors). However, important differences between potential class members will often depend on the specifics of a given case. If potential class members (or groups of class members) are so dissimilar from one another that many may not have been harmed at all (or even that some may have benefitted) from the alleged anti-competitive conduct, then it is likely not possible to establish a valid method by which impact can be proven on a class-wide basis. In such instances, most methods (including most regression analyses) would simply average disparate cases, thereby assuming, rather than testing, that there is a common effect of the alleged anti-competitive conduct on the proposed class members, and masking important differences. In cases involving indirect purchasers, even more so than cases with only direct purchasers, potential important differences across class members will be compounded as various levels along the chain of distribution are considered, rendering the accurate

determination of pass-through rates and damages using a common method more complex and (possibly) less likely.

As economists and as a matter of economic theory, we find it difficult to justify direct purchaser actions absent a consideration and assessment of pass-through. Allowing direct purchasers to claim the full amount (*i.e.*, 100%) of any alleged damages when they most likely passed on at least some of the overcharge downstream does not make economic sense. Specifically, economists should be interested in accurately identifying the economic impact of anticompetitive acts. If economists are able to determine that a given impact was not borne solely by direct purchasers, then a proper economic analysis would include a determination of how such an impact was transmitted to others in the chain of distribution.

### **Option 2: Combined Direct and Indirect Purchaser Actions**

Second, we consider the option of both direct and indirect purchasers joining together in making their damages claims, which the recent Supreme Court of Canada rulings provide for. Most proposed and certified competition class actions in Canada have involved both direct and indirect purchasers.<sup>13</sup> The ruling in the above-mentioned *Infineon Technologies* case in Quebec is just one such example. As explained above, in actions involving indirect purchaser plaintiffs (including those involving both direct and indirect purchaser plaintiffs), there is added complexity in the proper quantification of damages resulting from the determination of pass-through rates. In such indirect purchaser cases, there are many instances in which estimated overcharges, once adjusted for pass-through rates, may be inaccurate because class members are so dissimilar that a common method of establishing harm on a class-wide basis cannot and should not be used.

From the perspective of economists, there is an irreconcilable conflict between direct purchasers and indirect purchasers. Direct purchasers have an incentive to argue that they did not pass on any of the alleged overcharge to their downstream purchasers, while indirect purchasers have the incentive to argue that a high pass-through rate by direct purchasers made them bear the burden of the overcharge. From an economic standpoint, developing sufficient evidence

to demonstrate indirect purchaser damages is non-trivial and must be based on scientifically valid economic methods to ensure that the extent of recovery by all purchasers (direct and indirect) is commensurate with the harm or loss actually suffered. From a legal standpoint, it is also a requirement for a successful claim for damages under Section 36 of the *Competition Act*.

There is an important issue in allowing indirect purchasers to sue for recovery of damages under Section 36 that centers around the words “any person” included in that section: who constitutes “any person”? How far down the chain of distribution might a purchaser still be considered indirect? The task of calculating pass-through to claimants farther down the supply chain requires estimating multiple pass-through rates based on data that is often sparse and where intra-level variations in pass-through may be significant. Thus, the difficulty in allocating harm along the supply chain is compounded as courts attempt to determine how the overcharges were passed through the distribution chain and who was ultimately affected by the impugned conduct. This is especially true in cases involving components of an end product, where it may be difficult to assess whether the particular product for which indirect purchasers are claiming damages contains the at-issue component. If there is regular substitution for other products that were not affected by the alleged misconduct, then prospective indirect purchaser class members may not have bought the overcharged product.<sup>14</sup>

In its recent decisions, the Supreme Court of Canada recognized that remoteness and complexities associated with proving harm at various levels of the distribution chain will impose a high threshold for indirect purchasers, which they will have to clear in order to successfully assert a claim for damages at trial. In *Microsoft*, the Supreme Court ruled that “[i]n bringing their action, the indirect purchasers willingly assume the burden of establishing that they have suffered loss, [which] may well require expert testimony and complex economic evidence”<sup>15</sup> and that “[t]he multitude of variables involved in indirect purchaser actions may well present a significant challenge at the merits stage.”<sup>16</sup> However, the Court ruled that this should not bar indirect purchasers from asserting such claims.<sup>17</sup>

As economists, we believe that permitting direct and indirect purchasers to make a joint claim for damages has both advantages and drawbacks. In addition to potentially limiting the risk of overcompensation to plaintiffs, it has the benefit of allowing for an economic analysis that can factor in the entirety of the evidence, including all available and relevant data. However, the conflict between the different levels of purchasers along the distribution chain, explained above, is an important problem. Indeed, sorting out conflicts and important differences between and among purchasers would require detailed and complex analyses. Joint actions by direct and indirect purchasers will result in awards that are commensurate with underlying damages only if scientifically sound methods are applied. In particular, economic experts will need to review downstream pass-through to isolate the portion of damages to direct purchasers that results from the overcharge and is not passed on to indirect purchasers farther down the supply chain. Similarly, a careful analysis of the extent to which the overcharge reached a given indirect purchaser and, if the indirect purchaser is not the end user, the extent to which that overcharge was passed-through to entities farther downstream, will be required to arrive at an economically valid estimate of damages for all of the indirect purchaser claimants.

### **Option 3: Separate Direct and Indirect Purchaser Actions**

Third, we consider the option of separate cases for direct purchasers and indirect purchasers, as is currently the practice in the United States. This option presents the risk of multiple recovery unless the downstream pass-through defence is made available to defendants in direct purchaser actions. Similarly, each claimant – whether a direct or indirect purchaser – should only be entitled to compensation for the portion of the overcharge that it absorbed and that was not passed-on farther down the supply chain. As with actions involving both direct and indirect purchasers, indirect purchasers in the same or different levels of the distribution chain in an “indirect purchaser only” action would still have to ascertain pass-through among them to determine where the overcharge appropriately lies.

Drawbacks to filing separate cases for direct and indirect purchasers, in addition to an increase in the risk of multiple recovery, include extra

burdens on the judicial system and the parties. However, unlike American law, Canadian law does not expressly stipulate that violations of the *Competition Act* result in treble damages, implying that overly excessive damages payments may be less problematic in Canada. Nonetheless, even with joint direct and indirect purchaser actions being permitted in Canada, multiple actions still could arise as large corporations may choose to opt out of the joint class and pursue their own separate claims for damages. Moreover, multiple overlapping claims may and often do arise across multiple Canadian jurisdictions.

The foremost advantage of separate actions is that they would not appear to give rise to conflicts as between direct and indirect purchasers, each arguing for different rates of pass-through, as described above. Although the conflict would nevertheless exist in theory, neither direct nor indirect purchasers would be precluded from arguing that they alone absorbed the majority of the alleged overcharge. This could allow for a simpler and more focused economic analysis of the harm that occurred to the group of purchasers bringing the given action (either direct or indirect), although such an analysis could run the risk of omitting important factors as the economist(s) may not have access to the entirety of the evidence along the full chain of distribution.

### **Conclusion**

This article provides discussion and analysis, from the perspective of economists, on relevant issues surrounding the recent Supreme Court of Canada's decisions to allow indirect purchaser claims under Canadian competition law. Specifically, we discussed three options available to the Supreme Court of Canada in making its rulings related to indirect purchaser claims: (1) rejecting indirect purchaser claims; (2) allowing joint actions from direct and indirect purchasers; or (3) allowing separate claims from both direct and indirect purchasers. In summary, we generally agree with the Court's decision insofar as it advocates that pass-through should be considered in assessing the harm suffered at various levels of a given chain of distribution. Indeed, as a matter of economics, pass-through ought to be an integral part of the proper determination of alleged harm in cases involving direct purchasers, indirect purchasers, or both. We believe that the Supreme Court of Canada's rulings appropriately seek to avoid overcompensation and windfall damages payments to direct purchasers that may have

passed on some or all of the alleged overcharge farther downstream. However, the Court's rulings do not provide clear guidance on how to deal with the inherent conflict between direct and indirect purchasers with regards to pass-through, an issue that is particularly important in joint actions that the Court has now allowed. We therefore anxiously await future courts' decisions on how these Supreme Court rulings will be applied in practice, and the directions on methodology and data requirements that will ensue.

### Endnotes

<sup>1</sup> Marissa Ginn, Ph.D., is a Vice President at Analysis Group, and Marc Van Audenrode, Ph.D., is a Managing Principal at Analysis Group. The authors thank Paul Greenberg and George Kosicki for helpful comments. The usual disclaimer applies, namely that these views are solely those of the authors and do not necessarily reflect the views of Analysis Group.

<sup>2</sup> *Sun-Rype Products Ltd. v. Archer Daniels Midland Company*, 2013 SCC 58, [2013] SCJ No 58 [*Sun-Rype*]; *Pro-Sys Consultants Ltd. v. Microsoft Corporation*, 2013 SCC 57, [2013] SCJ No 57 [*Microsoft*]; *Infineon Technologies AG v. Option consommateurs*, 2013 SCC 59, [2013] SCJ No 59 [*Infineon Technologies*].

<sup>3</sup> *Competition Act*, RSC 1985, c C-34, s 36.

<sup>4</sup> The term "pass-through rate" is synonymous with "pass-on rate".

<sup>5</sup> Note that in some circumstances, pass-through may also be estimated directly using data from the top and bottom of the distribution chain.

<sup>6</sup> US, Antitrust Modernization Commission, *Report and Recommendations* (April 2007), online: Antitrust Modernization Commission <[http://govinfo.library.unt.edu/amc/report\\_recommendation/amc\\_final\\_report.pdf](http://govinfo.library.unt.edu/amc/report_recommendation/amc_final_report.pdf)>. The Antitrust Modernization Commission recommended that direct plaintiffs should still be allowed to make a claim, regardless of whether the overcharge was passed on, that damages should not exceed the trebled overcharges incurred by direct plaintiffs, that damages should be apportioned among direct and indirect purchaser plaintiffs in accordance with the evidence as to the portion of harm they incurred, and that all direct and indirect purchaser actions should be consolidated into one federal court.

<sup>7</sup> The requirements for the authorization of a class in Quebec are less rigorous than those in other parts of Canada, as that stage of the proceedings is merely meant to screen out frivolous claims. Indeed, the class authorization process in Quebec does not expect nor require expert evidence advancing a methodology capable of demonstrating aggregate damages to the direct and/or indirect purchasers. See e.g. *Infineon Technologies*, *supra* note 2 at paras 128, 137, 150.

<sup>8</sup> *Microsoft*, *supra* note 2 at para 116.

<sup>9</sup> *Ibid* at para 118.

<sup>10</sup> 2007 SCC 2, [2007] 1 SCR 38 [*Kingstreet*]; The Court of Appeal for British Columbia held in *Sun-Rype Products Ltd. v. Archer Daniels Midland Company*,

2011 BCCA 187, 331 DLR (4th) 631: “American state court decisions appear to be largely policy driven; they do not come to grips with **the absence of a legal basis for an indirect purchaser’s cause of action once it is accepted there is no passing on defence as, since *Kingstreet*, I consider it must be accepted here.**” (emphasis added)

<sup>11</sup> *Illinois Brick Co v Illinois* (1977), 431 US 720, 97 S Ct 2061.

<sup>12</sup> For a thorough discussion on this topic, see Pierre Crémieux, Ian Simmons & Edward A Snyder “Proof of Common Impact in Antitrust Litigation: The Value of Regression Analysis” (2010) 17:4 *Geo Mason L Rev* 939.

<sup>13</sup> Neil Campbell, David Kent & Lisa Parliament, “The Canadian approach to ‘passing on’ and indirect purchaser claims”, (June 2011), online: McMillan <<http://www.mcmillan.ca>>.

<sup>14</sup> Substitutability was an important issue in the *Sun-Rype* case, where the Supreme Court of Canada ultimately ruled that the class could not be certified for indirect purchasers because indirect purchasers were unable to identify whether the item(s) they purchased did in fact contain the at-issue product.

<sup>15</sup> *Microsoft*, *supra* note 2 at para 45.

<sup>16</sup> *Ibid* at para 110.

<sup>17</sup> *Ibid* at para 45.