

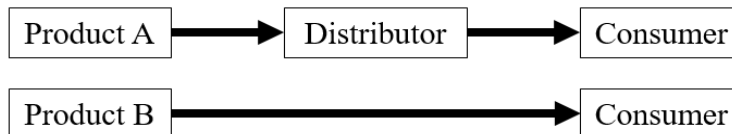
There Is No “Passing On” an Injury You Never Suffered: Revisiting the Bypassed Distributor Problem in Antitrust Law

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This article argues that the accepted resolution to the “bypassed distributor” problem in antitrust law, although adopted by numerous courts, is wrong. As a result of this error, courts have incorrectly permitted bypassed distributors to recover hundreds of millions of dollars despite never actually having suffered any injury. Moreover, these courts have violated Article III of the U.S. Constitution, by permitting plaintiffs with no injuries, and thus no standing, to recover damages. Courts should therefore revisit the bypassed distributor problem.

I. INTRODUCTION

A “bypassed distributor” in antitrust law is one that distributes an existing product (Product A) but would not be permitted to distribute another, competing product that is set to enter the market (Product B)—and would thus expect to lose profits when Product B enters:



Such a distributor is “bypassed” by Product B—it will not be in the chain of distribution for Product B—and thus will have no opportunity to profit from that product’s introduction. Moreover, such a distributor frequently will not enjoy any other benefit from Product B’s introduction, such as lower prices on Product A, as the manufacturer of Product A will not price-compete with Product B.¹

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¹ This occurs, for example, with branded pharmaceuticals when generic versions enter. See Henry G. Grabowski & John M. Vernon, *Brand Loyalty, Entry, and Price Competition in Pharmaceuticals after the 1984 Drug Act*, 35 J.L. & ECON 331, 337-341 (1992); Richard G.

If the manufacturer of Product A commits an antitrust violation that keeps Product B off the market, the bypassed distributor will not be injured. Indeed, the distributor will *benefit*, because so long as Product B is kept off the market, the distributor can continue to profitably distribute more of Product A than it would be able to distribute after Product B's introduction. Thus, while a delay in Product B's introduction may theoretically mean that Product A was priced supracompetitively, the distributor suffered no injury as a result of paying these supracompetitive prices.

This is the bypassed distributor problem: It is possible in some cases for the distributor of a supracompetitively-priced product to nevertheless suffer no injury. Put differently, the distributor of a theoretically supracompetitively-priced product may not *themselves* be paying any more than they otherwise would pay, and as a result may enjoy a pure benefit, and no loss, from an alleged antitrust violation. Can that bypassed distributor nonetheless bring an antitrust suit? You might expect the answer to be no, because an uninjured plaintiff typically cannot bring suit under Article III of the U.S. Constitution² or the Clayton Act³ (which establishes a private antitrust right of action). Yet almost every court to consider this issue has concluded

Frank & David S. Salkever, *Generic Entry and the Pricing of Pharmaceuticals*, 6 J.L. ECON & MGMT. STRATEGY 75, 75–90 (1997).

² See, e.g., *Lujan v. Defenders of Wildlife*, 504 U.S. 555, 560 (1992) (“[T]he irreducible constitutional minimum of standing” includes, as one of its requirements, that ‘the plaintiff must have suffered an ‘injury in fact’—an invasion of a legally protected interest which is (a) concrete and particularized, and (b) ‘actual or imminent, not ‘conjectural’ or ‘hypothetical.’”) (first quoting *Allen v. Wright*, 486 U.S. 737, 756 (1984), *Warth v. Seldin*, 422 U.S. 490, 508 (1975), *Sierra Club v. Morton*, 405 U.S. 727, 740-41, n.16 (1972); then quoting *Whitmore v. Arkansas*, 495 U.S. 149, 155 (1990), *Los Angeles v. Lyons*, 461 U.S. 94, 102 (1983)).

³ Clayton Antitrust Act of 1914 § 4, 15 U.S.C. § 15 (“[A]ny person who *shall be injured* in his business or property by reason of anything forbidden in the antitrust laws may sue . . .”) (emphasis added).

that the bypassed distributor has standing to bring an antitrust claim,⁴ and indeed is the “direct purchaser” under the *Illinois Brick* doctrine.⁵

As this short article explains, the reason for this error is that these courts have confused the bypassed distributor problem for the “pass-on” problem under *Hanover Shoe, Inc. v. United States Machinery Corp.*⁶—which holds that even where a purchaser has passed on its injury to another in the chain of distribution, it remains an appropriate plaintiff for antitrust purposes. The prevailing view is incorrect, because a bypassed distributor is never injured in the first place, and thus has no injury to “pass on” under the *Hanover Shoe* and *Illinois Brick* doctrines. Courts should therefore revisit the bypassed distributor problem.

II. THE MAJORITY VIEW FAILS TO UNDERSTAND THAT A BYPASSED DISTRIBUTOR MAY PAY A SUPRACOMPETITIVE PRICE WITHOUT BEING INJURED

The first stumbling block in addressing the bypassed distributor problem is understanding the potentially counterintuitive idea that a distributor can sometimes pay a supracompetitive price *without* suffering an injury. For example, in *In re*

⁴ See, e.g., *Braintree Labs., Inc. v. McKesson Corp.*, 2011 U.S. Dist. LEXIS 121499, at *5 (N.D. Cal. Oct. 20, 2011); *In re Relafen Antitrust Litig.*, 346 F. Supp. 2d 349, 368–70 (D. Mass. 2004); *King Drug Co. of Florence v. Cephalon, Inc.*, 309 F.R.D. 195, 210 (E.D. Pa. 2015) (vacated and remanded on other grounds by *In re Modafinil Antitrust Litig.*, 837 F.3d 238 (3d Cir. 2016)); *In re K-Dur Antitrust Litig.*, 2008 U.S. Dist. LEXIS 118396, at *34–36 (D.N.J. Apr. 14, 2008); *In re Hypodermic Product Direct Purchaser Antitrust Litig.*, 2006 U.S. Dist. LEXIS 89353, at *17–20 (D.N.J. Sept. 7, 2006); *Meijer, Inc. v. Warner Chilcott Holdings Co. III*, 246 F.R.D. 293, 304 (D.D.C. 2007); *In re Niaspan Antitrust Litig.*, 2015 U.S. Dist. LEXIS 92534, at *3–5 (E.D. Pa. Jul. 9, 2015); *In re Lidoderm Antitrust Litig.*, 2017 U.S. Dist. LEXIS 24097, at *74 (N.D. Cal. Feb. 21, 2017); *In re Prograf Antitrust Litig.*, 2014 U.S. Dist. LEXIS 180899, at *12 (D. Mass. Dec. 23, 2014); *In re Skelaxin (Metaxalone) Antitrust Litig.*, 2014 U.S. Dist. LEXIS 66707, at *14–27 (E.D. Tenn. May 15, 2014); *In re Loestrin 24 FE Antitrust Litig.*, 2019 U.S. Dist. LEXIS 118308, at *24 (D.R.I. July 2, 2019); *In re Glumetza Antitrust Litig.*, 336 F.R.D. 468, 480 (N.D. Cal. 2020); *but see Valley Drug Co. v. Geneva Pharmaceuticals, Inc.*, 350 F.3d 1181 (11th Cir. 2003) (accepting that bypassed distributors might not be injured, but ultimately addressing the separate issue of whether a distributor that is injured (and thus has standing) can serve as a class representative if it ultimately benefited from the conduct); *Natchitoches Parish Hosp. Serv. Dist. v. Tyco Int’l Ltd.*, 247 F.R.D. 253, 264–65 (D. Mass. 2008) (appearing to accept proposition that a bypassed plaintiff might not be an appropriate class representative, but concluding that the plaintiff at issue was not bypassed).

⁵ *Illinois Brick Co. v. Illinois*, 431 U.S. 720 (1977).

⁶ 392 U.S. 481 (1968).

Skelaxin (Metaxalone) Antitrust Litigation,⁷ frequently cited for the prevailing view on this issue, the court assumed that the sale of a product at a supracompetitive price necessarily results in injury to the purchaser:

Defendant ignores the fundamental import of *Hanover Shoe* and its progeny: “a direct purchaser may recover the full amount of the overcharge, even if he is otherwise benefitted, because the antitrust injury occurs and is complete when the defendant sells at ‘the illegally high price.’” . . . That is, the focus of the antitrust laws is limited to the anticompetitive sale. When Defendant sold the [drug at issue] to the wholesalers at an allegedly anticompetitive price, the injury was complete. The jury need not hear any more.⁸

However, this assumption is not well-founded, as the below hypothetical demonstrates.

Wesley’s Widgets. Wesley’s Widget Manufacturing Company (“Wesley’s Widgets”) enjoys a near monopoly over the market in which widgets compete. Wesley’s Widgets pays \$6 to manufacture each widget and sells that widget to distributors for \$8.

Dudley’s Distributing. Dudley’s Widget Distributing Co. (“Dudley’s Distributing”) has a longstanding, profitable business distributing widgets, which it purchases from Wesley’s Widgets for \$8, and distributes to retailers for \$11, who then sell them to consumers for \$15:

	Costs	Sales Price	Profit
Wesley’s Widgets	\$6	\$8	\$2
Dudley’s Distributing	\$8	\$11	\$3
Retailers	\$11	\$15	\$4
Consumers	\$15	N/A	N/A

George’s Gizmos. The big news in the industry, however, is that a less expensive option is soon to enter the market: gizmos manufactured by George’s Gizmo Manufacturing, Inc. (“George’s Gizmos”). Gizmos cost less than widgets due to lower manufacturing costs of \$3. Moreover, George’s has a modern approach to distribution; rather than selling to middlemen like Dudley’s Distributing,

⁷ 2014 U.S. Dist. LEXIS 66707 (E.D. Tenn. May 15, 2014).

⁸ *Id.* at *24 (quoting *Meijer, Inc. v. Warner Chilcott Holdings Co. III*, 246 F.R.D. 293, 304 (D.D.C. 2007); *In re Cardizem CD Antitrust Litig.*, 200 F.R.D. 297, 313 (E.D. Mich. 2001)).

George’s sells directly to the consumer. For \$5, a consumer can have a gizmo on their doorstep within two days, Saturday delivery available, no signature required.

	Costs	Sales Price	Profit
George’s Gizmos	\$3	\$5	\$2
Consumers	\$5	N/A	N/A

Impact on Wesley’s Widgets. Wesley’s anticipates maintaining or even increasing its prices after gizmos’ entry, so as to target the few consumers who either prefer widgets or have a need that can be met only by widgets and not by gizmos. Still, Wesley’s stands to lose most of its business and its profits. Indeed, Wesley’s may exit the widget/gizmo market entirely.

Impact on Dudley’s Distributing. The emergence of George’s Gizmos is also bad news for Dudley’s Distributing. Once gizmos enter the market, Dudley’s can expect to lose most of its widget distributing business—and its \$3-per-widget profit. And because Wesley’s is unlikely to respond to competition by cutting the price of widgets, Dudley’s does not stand to benefit even with respect to the small volume of widget sales that it might be able to maintain. Indeed, Dudley’s may even see its widget distributing business disappear altogether.

Dudley’s Files an Antitrust Claim. Assume that Wesley’s Widgets takes anticompetitive steps to delay or prevent the introduction of gizmos. Importantly, these steps are taken without the participation of Dudley’s Distributing. Further, assume these steps are successful and that George’s Gizmos is blocked from entering the marketplace with gizmos. Dudley’s Distributing then files an antitrust suit as the alleged direct purchaser of the allegedly overpriced widgets.

But Was Dudley’s Injured? Dudley’s may have paid a supracompetitive price in this hypothetical, because the price Wesley’s charged for widgets was higher than the price George’s would have charged for gizmos. But, if so, was Dudley’s injured by paying that supracompetitive price? It turns out the answer is no under either of the available metrics for measuring antitrust injury, because Dudley’s was neither overcharged nor lost any profits:

Overcharge Damages. To calculate overcharge damages, a court would compare the price Dudley’s paid for widgets in the “actual world,” i.e., the world *with* the alleged antitrust violation, against the price it would have paid for either widgets or gizmos in the “but for world” *without* the antitrust violation.⁹ However, there can be no overcharge on gizmos, because there is no price at which Dudley’s could have bought gizmos in the but for world. Nor can Dudley’s base an overcharge on its

⁹ See, e.g., *In re Namenda Direct Purchaser Antitrust Litig.*, 331 F. Supp. 152, 215 (S.D.N.Y. 2018); *Am. Sales Co., LLC v. Pfizer, Inc.*, 2017 U.S. Dist. LEXIS 137222, at *22–23 (E.D. Va. July 28, 2017); *PROVING ANTITRUST DAMAGES: LEGAL AND ECONOMIC ISSUES*, SECOND EDITION 233-34 (AM. BAR ASS’N 2010).

purchase of widgets because widget prices will not tend to fall after the entry of gizmos. Indeed, Dudley’s faces the risk that Wesley’s will stop distributing widgets through Dudley’s entirely. Dudley’s overcharge is thus zero:

Dudley’s Overcharge	Widget Costs	Gizmo Costs
Actual World	\$8	Not Available
But For World	\$8 or Not Available	Not Available
Overcharge	\$0	\$0

Lost Profits. Nor does Dudley’s fare better under a lost profits theory. Herbert Hovenkamp has argued that entities in Dudley’s position are injured not by an overcharge but rather by the profits they lose as a result of decreased sales volume.¹⁰ But this is no help to Dudley’s here; far from decreasing its sales volume, the alleged antitrust violation *increased* its sales volume, and accordingly resulted in additional profits, not lost profits:¹¹

Dudley’s Lost Profits	Widget Profits	Gizmo Profits
Actual World	\$3-per (larger volume)	\$0
But For World	\$3-per (smaller volume)	\$0
Lost Profits	Less than \$0	\$0

Dudley’s Distributing thus did not suffer an injury as a result of the delayed introduction of gizmos—even if it paid a theoretically supracompetitive price for widgets.

So why, then, does the majority view assume otherwise? The answer seems to be a misreading of a Tenth Circuit case applying the Supreme Court’s decision in *Hanover Shoe*.¹² As noted above, *Skelaxin* asserts that “the antitrust injury occurs and

¹⁰ Herbert Hovenkamp, *Apple v. Pepper: Rationalizing Antitrust’s Indirect Purchaser Rule*, 120 COLUM. L. REV. F. 14, 22 (2020) (“The real injury to direct purchasers and other intermediaries in the distribution chain is *not from the overcharge at all*; rather, it is from the loss of sales volume. As a result, the ‘overcharge’ is not even the theoretically correct measure of damages for an intermediary who passes on at least part of an overcharge.”); *see also, e.g.*, *Bigelow v. RKO Radio Pictures, Inc.*, 327 U.S. 251, 263–64 (1946) (lost profits proper measure of injury where exclusionary conduct prevented access to certain films, even though plaintiff had access to other films in actual world); Herbert Hovenkamp, et al., *IP and Antitrust: An Analysis of Antitrust Principles Applied to Intellectual Property Law* § 6.03 (3d ed., 2018 Supp.) (for “direct purchaser/reseller[s] . . . lost profits (or lost sales) rather than the overcharge would be a much more accurate proxy for . . . damages”).

¹¹ *See Illinois Brick*, 431 U.S. at 736 (no standing where “the purchaser is insulated from any decrease in its sales as a result of attempting to pass on the overcharge”).

¹² 392 U.S. 481 (1968).

is complete when the defendant sells at the illegally high price.”¹³ Though not cited directly in *Skelaxin*, this language is from the Tenth Circuit’s decision in *Sports Racing Services v. Sports Car Club of America*,¹⁴ which characterized *Hanover Shoe* but did not involve a bypassed purchaser. However, *Sports Racing* does not stand for the proposition that every sale at a supracompetitive price thereby injures the purchaser. The court there made clear in the same sentence that it was not the sale of a product *standing alone* that created an injury, but rather the *overcharge*. “[I]t would be unworkably difficult, considering the variety of factors that affect pricing policies, to try to determine the amount of the *overcharge* that the intermediate buyer passed on to the end user.”¹⁵

Hanover Shoe itself likewise requires not just a supracompetitive price, but also an injury as a result: “We think it sound to hold that when a buyer shows that the price paid by him for materials purchased for use in his business is illegally high *and also shows the amount of the overcharge*, he has made out a prima facie case of injury and damage within the meaning of § 4.”¹⁶ The bypassed distributor is thus an obvious exception to the Supreme Court’s reasoning in *Hanover Shoe* for allowing purchasers to bring suit despite having passed on their injuries. The Court there concluded that such purchasers were injured because “[a]t whatever price the buyer sells, the price he pays the seller remains illegally high, and his profits would be greater were his costs lower.”¹⁷ This isn’t true with a bypassed distributor; as shown above, its profits would have been *lower* if not for the alleged anticompetitive conduct, and its costs would have been *higher*.

Furthermore, a bypassed distributor does not raise the uncertainty about injury at issue in *Hanover Shoe*. While “[n]ormally the impact of a single change in the relevant conditions cannot be measured after the fact,”¹⁸ here we know what would happen if the competing product entered: The distributor would be bypassed. For

¹³ 2014 U.S. Dist. LEXIS 66707 at *24.

¹⁴ 131 F.3d 874, 883 (10th Cir. 1997).

¹⁵ *Id.* (emphasis added). Likewise, *Illinois Brick* held “direct purchasers to be injured to the full extent of the *overcharge paid by them*.” 431 U.S. at 746 (emphasis added). *Sports Racing* also noted that under *Hanover Shoe* there was no “reduction for any pass-on *recoupment* that buyer might realize.” *See id.* (emphasis added). Similarly, the Supreme Court in *Hawaii v. Standard Oil Co.* noted that under *Hanover Shoe* “courts will not go beyond the fact of th[e] injury to determine whether the victim of the overcharge has partially *recouped its loss* in some other way.” 405 U.S. 251, 262 n.14 (1972) (emphasis added). But it is impossible to “recoup” an injury that was never suffered.

¹⁶ *Hanover Shoe*, 392 U.S. at 489.

¹⁷ *Id.*

¹⁸ *Id.* at 492.

example, the Supreme Court in *Hanover Shoe* explained that a purchaser who paid a supracompetitive price for a product could be injured by a reduction in the volume of that product that it was able to purchase and distribute as a result of consumer demand falling in response to the higher price.¹⁹ But with a bypassed distributor, there is no concern that the distributor might have been able to distribute a greater volume if the competing product had been in the market.²⁰ On the contrary (particularly with pharmaceuticals, where this issue most often arises), the presence of the competing product will greatly decrease the volume of the product distributed by the bypassed distributor, precisely because it is bypassed.²¹

Thus, the majority view is based—at least in part—on failing to understand that it is possible for a bypassed distributor to pay a supracompetitive price, but not be injured.²²

III. THE MAJORITY VIEW RELIES ON A FICTIONAL INJURY THAT WOULD BRING *HANOVER SHOE* INTO DIRECT CONFLICT WITH ARTICLE III

Courts that have correctly recognized that a bypassed purchaser was not injured have nonetheless incorrectly allowed such a purchaser to recover. For example, in *Skelaxin* the court recognized that the plaintiff was seeking “compensation for an injury they likely did not suffer,” but it held that allowing the uninjured plaintiff to recover under *Hanover Shoe* and its progeny *Illinois Brick* would further what that court saw as the punitive goals of the antitrust laws:

Defendant argues vigorously that Supreme Court precedent does not stand for the proposition that direct purchasers should receive a windfall, that is, compensation for an injury they likely did not suffer. But, contrary to Defendant's argument, *Illinois Brick* suggests just that:

¹⁹ *Id.* at 492–93.

²⁰ *See supra* note 1.

²¹ *Id.*

²² *Apple Inc. v. Pepper*, is not to the contrary. 139 S. Ct. 1514, 1520 (2019) (“The broad text of §4—‘any person’ who has been ‘injured’ by an antitrust violator may sue—readily covers consumers who purchase goods or services at higher-than-competitive prices from an allegedly monopolistic retailer.”). While the consumers there were injured by paying supracompetitive prices, this does not suggest that any purchaser that pays such prices is automatically injured as a result. On the contrary, as shown above, bypassed distributors are not injured in some cases.

the antitrust laws are much more concerned with fully divesting antitrust violators of the benefit of their violation than with any potential windfall to plaintiffs.²³

This misunderstands the policy considerations in *Hanover Shoe*—which would not have been enough to override the constitutional need to show injury. *Hanover Shoe* involved a plaintiff that was initially injured but may have seen that injury redressed by someone other than the plaintiff as a result of passing on the overcharge in the chain of distribution.²⁴ It did not, as the majority view incorrectly concludes, involve a hypothetical or even fictional injury that the Court assumed to exist—and it certainly did not hold that a court could disregard Article III’s injury requirement solely for policy purposes. Indeed, much of the *Hanover Shoe* decision involved the Court explaining why a purchaser might still have a recoverable injury despite passing on that injury to another—it was clearly crucial to the Supreme Court there that there be *some* actual injury.²⁵ And the *Hanover Shoe* Court further noted that there could well be exceptions to its rule where it was clear that the purchaser had not been injured for various reasons—and that there could be cases where a plaintiff would be required to show a “loss of profits” before it was permitted to recover, if it was not otherwise injured.²⁶ In short, *Hanover Shoe* may allow a purchaser to recover for a passed on injury, but it still requires an injury.

IV. THE MAJORITY VIEW MISUNDERSTANDS THE “OTHERWISE BENEFITING” LANGUAGE IN *HANOVER SHOE*

Finally, the majority view tries to turn the bypassed distributor’s lack of injury on its head, by treating bypass as an “otherwise benefiting” defense that runs afoul of *Hanover Shoe*.²⁷ The idea, effectively, is that under *Hanover Shoe* an injured plaintiff can recover even if ultimately it “otherwise benefited” from the anticompetitive conduct. But what *Skelaxin* and other courts addressing this issue miss is that a plaintiff must have been *injured* before it can “otherwise benefit.” A benefit without an injury, as in the case of a bypassed distributor who solely benefits from delayed competitive entry, is not “otherwise benefiting.” It’s just benefiting.

²³ *Skelaxin*, 2014 U.S. Dist. LEXIS 66707, at *26.

²⁴ *See Hanover Shoe*, 392 U.S. at 489–94.

²⁵ *See id.*

²⁶ *See id.* at 494.

²⁷ *Skelaxin*, 2014 U.S. Dist. LEXIS 66707, at *21 (quoting *Relafen*, 346 F. Supp. 2d at 369).

Here, too, the origin of this “otherwise benefiting” language is the Tenth Circuit’s decision in *Sports Racing*—where the court rejected the argument that an injured purchaser could not recover on its monopolization claims because the conduct underlying those claims had also redounded to the purchaser’s benefit in other areas, thereby off-setting the injury—in other words, had “otherwise benefited” the purchaser—because this argument runs afoul of *Hanover Shoe*.²⁸ While fair enough that an “otherwise benefiting” defense may not be viable under *Hanover Shoe*, because the injured purchaser is still injured even if it otherwise benefits, that principle has no application to the bypassed distributor problem. A bypassed distributor does not, as in *Sports Racing*, suffer an injury but “otherwise benefit” when the date of its bypass is delayed, since its benefit does not outweigh some injury that it could be said to have suffered. Rather, such a distributor *just benefits*, with no “otherwise” about it, because it suffered no injury to offset. It is this lack of injury that precludes Article III standing for bypassed distributors.

V. CONCLUSION

A bypassed distributor that suffers no injury lacks standing under Article III of the U.S. Constitution and the Clayton Act. Nothing in *Hanover Shoe* or *Illinois Brick* allow such an uninjured purchaser to recover damages for an injury that it did not actually suffer. This is not a pass-on issue, as there is no “passing on” an injury you did not suffer. The majority view on bypassed distributors should therefore be revisited.

²⁸ *Relafen*, 346 F. Supp. 2d at 369 (citing *Sports Racing*, 131 F.3d at 885).