

November 28, 2003

## Court refuses to certify indirect purchaser class because of difficulties in proving liability:

Chadha v. Bayer Inc.

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### I. Introduction

In its recent decision in *Chadha v. Bayer Inc.*, the Ontario Court of Appeal upheld the Divisional Court's refusal to certify a class of indirect purchasers of pigments used to colour bricks. The Supreme Court of Canada denied leave to appeal on July 17, 2003.

The appeal court declined to adopt a rule barring claims by indirect purchasers. Rather, its decision was motivated mainly by the lack of evidence offered by the plaintiffs to show that it could prove on a class-wide basis that higher prices caused by an alleged conspiracy to fix the price of the pigments were passed on to all members of the class. The decision leaves a narrow opening for consumer class actions for price fixing, but plaintiffs will face a high evidentiary threshold in attempting to certify future consumer class actions.

### II. Antitrust class actions in Canada

The federal Competition Act<sup>1</sup> is the primary source of Canada's competition (antitrust) law. Section 45 deals with conspiracies. In general terms, it creates a criminal offence of conspiring to lessen competition "unduly".<sup>2</sup>

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<sup>1</sup> R.S.C. 1985, c. C-34

<sup>2</sup> Section 45 provides in part as follows:

**45. (1) Every one who conspires, combines, agrees or arranges with another person**

- (a) to limit unduly the facilities for transporting, producing, manufacturing, supplying, storing or dealing in any product,
- (b) to prevent, limit or lessen, unduly, the manufacture or production of a product or to enhance unreasonably the price thereof,
- (c) to prevent or lessen, unduly, competition in the production, manufacture, purchase, barter, sale, storage, rental, transportation or supply of a product, or in the price of insurance on persons or property, or
- (d) to otherwise restrain or injure competition unduly,

is guilty of an indictable offence and liable to imprisonment for a term not exceeding five years or to a fine not exceeding ten million dollars or to both.

Section 45 has been described prescribing a "partial rule of reason", somewhere along the continuum between per se and rule of reason: *R. v. Nova Scotia Pharmaceutical Society*, [1992] 2 S.C.R. 606 at 650 (¶89-91).

Section 36 of the Competition Act provides a right to sue for and recover damages caused by practices that are criminal under the act, including conspiracies contrary to s. 45.<sup>3</sup>

Class actions are regulated provincially in Canada. In Ontario, the Class Proceedings Act, 1992 ("CPA")<sup>4</sup> provides for certification of class actions. Other provinces have similar legislation.<sup>5</sup> Class proceedings, particularly those in Ontario, are frequently structured as national classes, making class proceedings available throughout Canada. Class actions can, and often do, include claims under s. 36 of the Competition Act.

Ontario's class action legislation is similar to (and indeed, modeled on) rule 23 of the U.S. Federal Rules of Civil Procedure. However, where rule 23 requires that the common issues predominate over individual issues, the CPA sets a lower threshold, requiring that a class proceeding be "the preferable procedure for the resolution of the common issues".<sup>6</sup> However,

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<sup>3</sup> Section 36 provides in part as follows:

- 36.** (1) Any person who has suffered loss or damage as a result of
- (a) conduct that is contrary to any provision of Part VI, or
  - (b) the failure of any person to comply with an order of the Tribunal or another court under this Act,
- may, in any court of competent jurisdiction, sue for and recover from the person who engaged in the conduct or failed to comply with the order an amount equal to the loss or damage proved to have been suffered by him, together with any additional amount that the court may allow not exceeding the full cost to him of any investigation in connection with the matter and of proceedings under this section.

Part IV contains the criminal provisions of the act. Note that s. 36 does not allow for recovery of punitive or aggravated damages, much less the treble damages available in the U.S.

<sup>4</sup> S.O. 1992, c. 6

<sup>5</sup> British Columbia has legislation similar to Ontario's: Class Proceedings Act, R.S.B.C. 1996, c. 50; and Quebec's Code of Civil Procedure permits class actions: Code of Civil Procedure, Book IX. Alberta has recently passed (but not yet proclaimed in force) legislation similar to Ontario's and British Columbia's: Class Proceedings Act, R.S.A., c. C-16.5.

<sup>6</sup> s. 5:

#### **Certification**

5. (1) The court shall certify a class proceeding on a motion under section 2, 3 or 4 if,
- (a) the pleadings or the notice of application discloses a cause of action;
  - (b) there is an identifiable class of two or more persons that would be represented by the representative plaintiff or defendant;
  - (c) the claims or defences of the class members raise common issues;
  - (d) a class proceeding would be the preferable procedure for the resolution of the common issues; and
  - (e) there is a representative plaintiff or defendant who,
    - (i) would fairly and adequately represent the interests of the class,
    - (ii) has produced a plan for the proceeding that sets out a workable method of advancing the proceeding on behalf of the class and of notifying class members of the proceeding, and
    - (iii) does not have, on the common issues for the class, an interest in conflict with the interests of other class members. 1992, c. 6, s. 5 (1).

the importance of the common issues in relation to the claim as a whole is a factor in determining whether a class proceeding would be preferable to individual proceedings.<sup>7</sup>

### III. Court of Appeal decision

#### 1. Facts

The plaintiffs in *Chadha v. Bayer Inc.* alleged that manufacturers of iron oxide pigments for bricks, paving stones and other building materials conspired to fix prices for the pigments over a 17 year period from 1985 to 1991. They proposed a class consisting of “all homeowners or other end users in Canada who have suffered loss or damage as a result of” the alleged conspiracy.

On a motion for certification, Sharpe J. certified three common issues: first, whether the defendants had fixed prices; second, whether they were liable to class members for the conspiracy; and third, what was the appropriate measure of damages.<sup>8</sup>

The defendants appealed to the Divisional Court, which allowed the appeal.<sup>9</sup> The plaintiffs appealed to the Court of Appeal. The Court of Appeal dismissed the appeal. The plaintiffs sought leave to appeal to the Supreme Court, but were turned down, on July 17, 2003.<sup>10</sup>

#### 2. *Insufficient evidence to certify liability as a common issue*

At issue before the Court of Appeal was the second common issue, that is, liability. The problem was that loss to the plaintiffs was a necessary element in establishing liability. Sharpe J. had held that loss could be proven by an overall assessment of damages on the basis of the net gain realized by the defendants together with a measurable price impact on the ultimate consumer of the building products containing the pigments. Feldman J.A., writing for the Court of Appeal, held that the plaintiffs’ evidence did not show how they would prove at trial that all end purchasers of buildings containing the pigments overpaid for the buildings as a result. The plaintiffs’ expert assumed full pass on of any price increase; but this was the very issue that had to be provable on a class-wide basis before it could be certified as a common issue.

Feldman J.A. embarked on a detailed examination of the recent *Linerboard* case.<sup>11</sup> In that case, the Third Circuit Federal Court of Appeals upheld the certification of a class of purchasers of products containing linerboard, the supply of which was allegedly fixed by manufacturers in order to cause prices to rise. The case appeared to present pass on problems because what the plaintiffs purchased was not linerboard but corrugated sheets (also called “containerboard”) and corrugated boxes, both of which contain linerboard.<sup>12</sup> The defendants in that case argued that the impact of the conspiracy on the plaintiffs would be an individual issue, not common, making liability an individual issue.

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<sup>7</sup> *Hollick v. The City of Toronto*, [2001] 3 S.C.R. 158

<sup>8</sup> (1999), 45 O.R. (3d) 29 (Gen. Div.)

<sup>9</sup> (2001), 54 O.R. (3d) 520 (Div. Ct.)

<sup>10</sup> [2003] S.C.C.A. No. 106. This is equivalent to a denial of certiorari by the U.S.S.C.

<sup>11</sup> *In re: Linerboard Antitrust Litigation*, 305 F.3d 145 (3<sup>rd</sup> Cir. 2002)

<sup>12</sup> Linerboard is the “outside” part of corrugated cardboard. Containerboard consists of a sandwich of facing sheets of linerboard glued to a fluted sheet in the middle.

The Third Circuit held that impact was a common issue, for two reasons. First, this was a case where the doctrine of presumed impact could be applied. The economic laws of supply and demand say that if supply is cut, prices will rise; and prices for linerboard did rise in tandem with cuts in its supply. Second, the plaintiffs relied on more than presumed impact: they led expert evidence to show that the restriction in supply of linerboard would impact all members of the proposed class. This evidence included econometric evidence based on an extensive empirical investigation into the relationship between prices for linerboard, containerboard, and corrugated boxes.

Feldman J.A. compared the evidence before the court in *Linerboard* with that presented in *Chadha*. In *Linerboard*, the plaintiff presented evidence based on economic theory and industry studies by experts which demonstrated that whether the plaintiffs suffered loss could be proved at trial on a class-wide basis. By contrast, the plaintiffs in *Chadha*

presented no evidence from industry representatives to explain how the manufacturers and distributors of bricks and the developers of new homes price their products, and in particular, whether there is a direct pass through of the price of every component into the sale price of all homes, the relevance of the value of the land component, and how other factors such as the real estate market and the individual bargaining of the purchaser and vendor affect the price.

### ***3. Pass on problematic, but no indirect purchaser rule in Ontario***

Feldman J.A. also addressed the indirect purchaser rule in *Illinois Brick*.<sup>13</sup> She noted the problems of proving pass on in a case with multiple parties in a chain of distribution. If at any point in the chain the price increase was absorbed and not passed on, the chain would be broken. She noted that the fact that the pigments form a minimal part of the building, and thus of the price, compounds the problem.

Feldman J.A. did not, however, adopt an absolute bar to claims by indirect purchasers. Rather, she left it as an open question in Ontario whether it would be possible to marshal an evidentiary record sufficient to satisfy the court that liability to indirect purchasers can be proved as a common issue in price fixing cases.

### ***4. Criminal provisions under Competition Act accomplish "behaviour modification" goal***

Feldman J.A. then concluded that a class proceeding was not the preferable procedure for resolution of the remaining common issues. The individual trials that would be needed to establish loss, and thus liability, for each of the estimated 1.1 million class members would make the action unmanageable.

Feldman J.A. agreed with the Divisional Court that of the three goals of class proceedings (judicial economy, access to justice, and behaviour modification), only the goal of behaviour modification would be served by the proposed class proceeding. But, she concluded, the circumstances requiring behaviour modification would have to be extremely compelling to overcome the fact that the proposed class proceeding would undermine, not promote, judicial economy, and would not significantly further access to justice (because of the minimal loss

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<sup>13</sup> 431 U.S. 720 (1977)

suffered by each class member). Here, she noted, criminal sanctions provided by the Competition Act achieve the goal of behaviour modification.<sup>14</sup>

#### IV. Impact of Chadha

Chadha is the first contested certification of proposed class proceeding involving claims under the private action provisions of the Competition Act for damages caused by a conspiracy.<sup>15</sup> It will affect future Competition Act class proceedings in two important ways: first, it clarifies what evidence plaintiffs must lead in order to certify a consumer class action; second, it provides some indication as to what kinds of classes might be certified in the future, and what kinds might not.

##### 1. Evidentiary threshold raised

As Illinois Brick and other U.S. cases recognize, indirect purchaser classes typically raise the “pass-on” problem: in order for the alleged conspirators to be liable to indirect purchasers, the indirect purchasers must establish that some or all of the price increase caused by the conspiracy was passed on through the chain of distribution by intermediate purchasers to the indirect purchasers in the proposed class. Since proof of loss is a necessary element of establishing liability, if liability is to be certified as a common issue, there must be some way of proving loss on a class-wide basis.

Chadha makes it clear that future class action plaintiffs must lead economic evidence showing how they intend to prove loss (and thus liability) on a class-wide basis. Feldman J.A. spoke approvingly of the use of both economic theory and empirical studies into the behaviour of prices in the industry in the Linerboard case. Feldman J.A. also said that statistical evidence might be admissible to establish loss on a class-wide basis.<sup>16</sup>

Plaintiffs proposing to certify a consumer class will now need to present extensive expert evidence dealing with the pass-on problem as part of their certification material. They will need to show that they can prove at trial on a class-wide basis that the alleged price increase was passed on to each member of the class.

Defendants will also want to lead economic evidence to show how pass on presents intractable problems of proof in any given case. In Chadha, the defendants led evidence, including expert

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<sup>14</sup> Interestingly, the Competition Bureau had earlier declined to launch a formal inquiry into the plaintiffs’ allegations.

<sup>15</sup> *Mouhteros v. DeVry Canada Inc.* (1998), 41 O.R. (3d) 63 (Ont. Gen. Div.) (certification refused) was earlier; it involved alleged misleading advertising contrary to Competition Act s. 52. A number of other certification motions involving Competition Act claims were decided around the same time as Chadha, including: *Price v. Panasonic Canada Inc.*, [2002] O.J. No. 2362 (S.C.J.) (resale price maintenance; certification refused on similar grounds as Chadha); *Carom v. Bre-X Minerals Ltd.* (2000), 51 O.R. (3d) 236 (C.A.) (fraud, misrepresentation and misleading advertising; certification granted); and *Williams v. Mutual Life Assurance Co. of Canada* (2000), 51 O.R. (3d) 54 (S.C.), aff’d [2003] O.J. No. 1160 (C.A.) (misrepresentation and misleading advertising; certification refused). A number of class actions following on guilty pleas in various international conspiracies are currently before the courts in Ontario, British Columbia and Quebec.

<sup>16</sup> CPA s. 23 expressly provides for the use of otherwise inadmissible statistical evidence in determining issues relating to the amount or the distribution of a monetary award, but not issues of liability. The Divisional Court held that statistical evidence could not be used to prove liability. Feldman J.A. declined to adopt this finding. Statistical evidence is treated with some suspicion by Canadian courts; in *Lafrenière v. Lawson*, [1991] 1 S.C.R. 541, the Supreme Court concluded that statistical evidence “may be helpful as indicative but is not determinative”.

economic evidence, discussing the structure of the market for iron oxide pigments, its use in construction materials, the nature of the demand for iron oxide pigments, and the distribution chain for iron oxide pigments. The defendants' economic expert concluded that it would have been difficult for participants in the distribution chain to pass on any price increase in its entirety, and highlighted the difficulties of proving pass on. The defendants also produced a chart showing the multi-level distribution chain for iron oxide pigments, which the court seems to have found quite compelling (the Divisional Court reproduced it as an appendix to its reasons).

## *2. Keep it simple*

The second implication of Chadha is for the kinds of cases that are likely to be certified in the future. A comparison of the facts of Chadha and Linerboard illustrates this.

In Linerboard, there was a very simple chain of distribution: the plaintiffs were, in fact, direct purchasers of linerboard and cardboard boxes from the alleged conspirators (the alleged conspirators were integrated companies, manufacturing both the corrugated cardboard and products made from the corrugated cardboard). Even if the alleged conspirators had not been integrated, Linerboard would likely have presented a relatively simple distribution chain. By contrast, in Chadha, the distribution chain between the defendants and the house owners went from the manufacturers to pigment distributors, then to producers of bricks, paving stones, and other products, then to building material distributors, then to subcontractors, then to general contractors, then to residential, commercial and industrial builders, then finally to the end user participating in the real estate market. At any point in this chain, competitive pressures could have prevented a price increase from being passed on, breaking the chain. Moreover, there were other factual complications. These included the fact that only concrete bricks contain iron oxide pigments (clay bricks do not), and not all concrete bricks contain the pigments – some concrete bricks are uncoloured. The plaintiffs appear not have lead sufficiently fine evidence as to the incidence of concrete bricks, paving stones, or other materials actually containing the iron oxide pigments.

In Linerboard, the relationship between the price for linerboard, containerboard, and cardboard boxes was clearly established. Linerboard is one of the principal ingredients in containerboard and cardboard boxes. The expert evidence suggested a strong correlation between prices for all of these products. Indeed, the price for linerboard was considered to be the industry's indicator price. By contrast, in Chadha, the evidence showed that not all houses or buildings contained iron oxide pigments, and in those that did, the pigments represented a small percentage of the cost of the bricks or paving stones, and a minuscule percentage of the ultimate cost of the home or building.

A comparison between Linerboard and Chadha thus suggests that courts will be more willing to certify cases where the distribution chain and other facts relevant to pass on are relatively simple, thus making it more likely that pass on can be proved.

## V. Conclusion

Chadha shows that Ontario courts are alive to the problems considered by the U.S. Supreme Court in *Illinois Brick*. However, instead of adopting a rule against indirect purchaser actions, Ontario has adopted a rule that requires that putative plaintiffs demonstrate how these problems will be overcome in a particular case before certification will be granted.

On a practical level, this result levels the playing field somewhat. Because of the immense risks associated with a loss, defendants in class actions have a history of settling even before certification. Because Chadha makes certification less likely, we may expect that defendants in Canada will be more willing to contest certification.