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Privileged and Confidential? EU Court of Justice Rules Against Extending Legal Privilege to In-House Lawyers

By Kristina Nordlander and Stephen Spinks

In-house lawyers do not have a right to legal professional privilege in investigations carried out by the European Commission, according to a judgment handed down by the Court of Justice of the European Union on 14 September 2010.

The judgment confirms the status quo in EU law that legal advice from an in-house lawyer or a request to an in-house lawyer for such advice is not protected from seizure in EU competition law investigations. The judgment comes as no surprise, confirming as it does, earlier rulings and the advisory opinion of the Court's Advocate General. Nevertheless, it is a disappointment for businesses as it curtails the ability of in-house lawyers to provide confidential competition law advice to their employer.

Practical Consequences

The EU authorities will now be emboldened to continue to remove and examine documents prepared by or sent internally to in-house lawyers. In international cartel investigations, in particular, in-house lawyers should be aware that such documents may not be protected by legal privilege in the EU.

The Court did not clarify or comment on whether legal privilege extends to non-EU external lawyers as well as EU qualified external lawyers (this was not at issue in the case). However, an earlier advisory opinion of the Advocate General in the case suggested that non-EU lawyers are not entitled to legal privilege.

California Supreme Court Rules that Pass-On Defense Is Not Available in Price-Fixing Cases under California's Cartwright Act

By Beatrice B. Nguyen and Chahira Solh

In *Clayworth v. Pfizer, Inc.*,[1] the California Supreme Court recently held that there is no general "pass-on" defense under the Cartwright Act,[2] California's state antitrust statute. In its unanimous decision on an issue of first impression, the Court rejected the general application of the "pass-on" defense in favor of the statute's broad deterrent purpose, but preserved the California courts' power to consider pass-on evidence to allocate damages where plaintiffs at multiple levels of the distribution chain bring suit. Consequently, the decision has far-reaching effects for defendants in defending against antitrust claims brought under California law and the potential to complicate future Cartwright Act cases for the courts and parties.

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Unlike federal law, which limits antitrust damage claims to "direct purchasers," the Cartwright Act allows "indirect purchasers" to sue on antitrust claims. The issue presented in *Clayworth* was whether defendants could defeat a Cartwright Act claim by showing that a direct or intermediary purchaser plaintiff had passed on the entirety of an alleged price overcharge to an indirect purchaser and therefore suffered no damages. Federal antitrust law does not provide for the pass-on defense under the U.S. Supreme Court's holding in *Hanover Shoe, Inc. v. United Shoe Machinery Corp.*,[3] and *Clayworth* partially adopts the *Hanover Shoe* rule for California state law. As the Court explained, "Every indication available from the Legislature demonstrates that, given a choice, it would prefer an enforcement regime in which *Hanover Shoe* is the law."[4]

Background and Previous Applications of California Antitrust Law

The action was brought by a group of retail pharmacies ("plaintiffs" or "Pharmacies") against a number of defendants generally involved in the manufacturing, marketing, and/or distribution of brand name (or patented) pharmaceutical products throughout the United States ("defendants" or "Manufacturers") and alleged claims of price-fixing under the Cartwright Act and for violations of California's Unfair Competition Law[5] ("UCL"). Based on the Pharmacies' admission that they passed on the entirety of the alleged overcharge to their own customers, the Manufacturers sought summary judgment on the ground that the Pharmacies suffered no damages. The trial court held

[1] 49 Cal. 4th 758 (2010).

[2] Cal. Bus. & Prof. Code §§ 16700 *et seq*.

[3] 392 U.S. 481 (1968).

[4] *Clayworth*, 49 Cal. 4th at 775.

[5] Cal. Bus. & Prof. Code §§ 17200 *et seq*.

that, as the Cartwright Act permitted indirect purchaser plaintiffs to rely upon pass-on evidence to bring a claim, the defendants were permitted to rely upon pass-on evidence as part of their defense as well. The court thus recognized the availability of the pass-on defense and granted summary judgment in favor of the defendants.

The Court of Appeal affirmed this decision, rejecting an argument by the plaintiffs that the California Legislature had approved application of the federal rule of *Hanover Shoe*. The Court of Appeal found that the Pharmacies were not entitled to damages from the Manufacturers, because the Pharmacies were not damaged by the allegedly higher prices they paid. The defendants argued that the Pharmacies charged correspondingly higher drug prices to their customers, thereby "passing on" any increase in their cost to pharmacy customers and never suffering any damages from the allegedly higher prices.

The Court of Appeal reasoned that a pass-on defense is available under the language, history, and purpose of the Cartwright Act, including the statutory language requiring that plaintiffs show "damages sustained"[6] and the fact that, unlike under federal law, California law allows claims by indirect purchasers. The Court of Appeal further held that the UCL claim failed because the Pharmacies had not "lost money or property" so as to have standing under Cal. Bus. & Prof. Code § 17204 and could not be entitled to restitutionary relief.

The California Supreme Court Decision

In an opinion issued on July 12, 2010, the California Supreme Court reversed the Court of Appeal's decision, holding that under the Cartwright Act, as under the federal rule in *Hanover Shoe*, the pass-on defense is generally not permitted.[7] Because the text of the Cartwright Act itself did not provide guidance regarding the availability of the defense, the Court looked to the legislative history of the act.

The Court read the California Legislature's amendments to the Cartwright Act, made in response to federal antitrust laws, as demonstrating an intent by the California Legislature to incorporate the federal rule against allowing the pass-on defense. The Court based this holding on two things: (i) the California Legislature's amendment of the Cartwright Act in response to the Hart-Scott-Rodino Act,[8] and (ii) the California Legislature's amendment of the Cartwright Act in response to *Illinois Brick v. Illinois*,[9] which indicated that "the Legislature fully embraced the *Illinois Brick* dissent, including – critically for our purposes – its view that Hanover Shoe . . . was a sound rule of law."[10]

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The Court's principal concern was policy-oriented: the potential under-deterrence of anticompetitive conduct if the pass-on defense were allowed. In a case such as *Clayworth* where only plaintiffs from one level of the distribution chain had brought suit, and there was no risk of

[6] Cal. Bus. & Prof. Code § 16750

[7] *Clayworth*, 49 Cal. 4th at 763 ("We conclude that under the Cartwright Act, as under federal law, generally no pass-on defense is permitted.").

[8] *Id.* at 775- 81.

[9] 431 U.S. 720 (1977).

[10] *Clayworth*, 49 Cal. 4th at 781-82.

duplicative recovery, the Court concluded that recognizing the pass-on defense "would hamper enforcement by reducing incentives to sue and police antitrust violations."[11] The Court reasoned that California antitrust laws should be interpreted to deter anticompetitive behavior – even if such deterrence results in a "windfall" to plaintiffs.[12] The overarching policy goals of strongly deterring antitrust violations, ensuring enforcement of the State's antitrust laws, and providing for the full disgorgement of any improperly gained proceeds weighed heavily against a finding that the pass-on defense should be available to California antitrust defendants.[13]

Although the facts of *Clayworth* did not present such a situation, the Court speculated that direct or intermediary purchasers that passed on an overcharge may still have suffered an injury, for example by losing overall sales as a result of raising prices because of the overcharge, even if they paid none of the overcharge themselves. The defense should not be allowed to defeat direct or intermediary plaintiffs' claims in such cases.[14]

The Court recognized two limited circumstances in which the defense may be available. First, the Court noted that *Hanover Shoe* recognized an exception for "cost-plus" contracts, and given the California Legislature's endorsement of the federal rule in *Hanover Shoe*, the Court stated that the exception for cost-plus contracts would also apply under California law.[15] Second, the Court noted that in cases where direct and indirect purchaser plaintiffs from multiple levels of the distribution chain are entitled to damages, defendants would be permitted to raise the pass-on defense to prevent double recovery.[16] Neither of these two exceptions applied to the facts in *Clayworth*, however, and the Court did not address the scope of these exceptions.

With respect to the UCL claims, the Court found that the plaintiffs had "standing" to sue under the UCL because the voters of Proposition 64 "plainly preserved standing for those who had had business dealings with a defendant and had lost money or property as a result of the defendant's unfair business practices."[17] The Court also found that the plaintiffs had not waived and can continue to seek injunctive relief under the UCL.[18]

The decision is likely to make California state antitrust law and California state courts more attractive to antitrust plaintiffs, including indirect purchasers.

[11] *Id.* at 784.

[12] *Id.* at 783.

[13] *Id.*

[14] *Id.* at 785-86.

[15] *Id.* at 787.

[16] *Id.* ("In instances where multiple levels of purchasers have sued, or where a risk remains they may sue, trial courts and parties have at their disposal and may employ joinder, interpleader, consolidation, and like procedural devices to bring all claimants before the court. In such cases, if damages must be allocated among the various levels of injured purchasers, the bar on consideration of pass-on evidence must be lifted; defendants may assert a pass-on defense as needed to avoid duplication in the recovery of damages.").

[17] *Id.* at 788.

[18] *Id.* at 789-90.

Implications

There will be much critical analysis of *Clayworth* in the coming months and years. Corporate counsel should be aware that antitrust plaintiffs will almost certainly be emboldened by the Court's language regarding the importance of deterrence and particularly the Court's allowance for possible plaintiff "windfalls." The decision is likely to make California state antitrust law and California state courts more attractive to antitrust plaintiffs, including indirect purchasers. However, while defendants, with a few exceptions, will not be able to rely on the pass-on defense to defeat claims brought by plaintiffs at only one level of the distribution chain, the Court recognized that pass-on evidence could be considered in apportioning damages, which could result in reduced damages awards and avoid duplicative recovery.

In addition, it remains to be seen whether the Court's decision marks the end of the pass-on defense in California courts, or if the decision will give it new life because of the exceptions identified in the opinion, which may be raised in many cases. Since the Court did not address the scope of these exceptions or explain how California courts are to manage coordinating and managing the claims of plaintiffs at multiple levels of the distribution chain, the decision promises to present significant case management challenges in the future.

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Beatrice B. Nguyen is a partner of Crowell & Moring LLP.

Chahira Solh is an associate of Crowell & Moring LLP.

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You may also contact us by emailing our editor, Anita Banicevic at abanicevic@dwpv.com.