

CLIENT ALERT

California Supreme Court Rejects "Pass-on" Defense for Antitrust Damages

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On July 12, 2010, the California Supreme Court resolved an issue of first impression in *Clayworth v. Pfizer*, finding that the pass-on defense is not available under California law to defendants accused of price-fixing. In a unanimous decision, the Court held that for private antitrust litigation under California's Cartwright Act, it is no defense that the plaintiff passed on its damages to its customers. The case has far-reaching effects for defendants in defending against antitrust claims brought under California law.

In antitrust litigation, the pass-on defense involves an attempt by a defendant to show that a direct or intermediary purchaser plaintiff has passed on an alleged price overcharge to an indirect purchaser and therefore suffered either no damages or limited 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.*, and *Clayworth v. Pfizer* adopts for California state law the Hanover Shoe rule. 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."

The Court of Appeal had ruled below that the plaintiff retail pharmacies were not entitled to damages from the defendant drug manufacturers, because the pharmacies were not damaged by the allegedly higher drug prices they paid to drug wholesalers since they charged correspondingly higher drug prices to their customers. Since any higher costs to the pharmacies were "passed on" to pharmacy customers, the pharmacies never suffered any damages from the allegedly higher prices.

In interpreting the text of the Cartwright Act, the Court focused on legislative intent and relied on the California Legislature's subsequent amendments to the Cartwright Act. According to the Court, the Legislature's later amendments – following the federal Hart-Scott-Rodino Act and the federal decision in *Illinois Brick* – demonstrated its intention to follow the Hanover Shoe rule.

The Court's principal concern was policy-oriented: the potential under-deterrence of anticompetitive conduct. Even with no risk of duplicative recovery, the Court concluded that recognizing the pass-on defense "would hamper enforcement by reducing incentives to sue and police antitrust violations." The Court's opinion stresses several times that the California antitrust laws should be interpreted to deter anticompetitive behavior – even if such deterrence results in a "windfall" to plaintiffs.

There will be much critical analysis of *Clayworth v. Pfizer* in the coming months and years. But experience under the federal rules already allows two preliminary predictions from this decision.

The first should concern corporate defendants. 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.

The second is of benefit to corporate defendants. While defendants, with a few exceptions, will not be able to rely on the pass-on defense, the Court recognized that pass-on could be considered in apportioning damages, which could result in reduced damages awards and avoid duplicative recovery. For more information, please contact the professional(s) listed below, or your regular Crowell & Moring contact.

Beatrice B. Nguyen

Partner – San Francisco

Phone: +1 415.365.7815

Email: bbnguyen@crowell.com

Daniel A. Sasse

Partner – Orange County

Phone: +1 949.798.1347

Email: dsasse@crowell.com

Robert B. McNary

Counsel – Los Angeles

Phone: +1 213.443.5590

Email: rmcnary@crowell.com

Chahira Solh

Partner – Orange County

Phone: +1 949.798.1367

Email: csolh@crowell.com