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California Supreme Court Disallows Pass-On Defense in State Antitrust Actions

By **Stuart C. Plunkett**

This week the California Supreme Court issued its most significant antitrust opinion in years, with important implications for damages claims for conspiratorial overcharges under the Cartwright Act by intermediaries in the supply chain, as well as for standing in California Unfair Competition Law cases.

Clayworth v. Pfizer, Inc., ___ Cal. Rptr. 3d ___, No. S166435, slip op. (July 12, 2010), overturned the dismissal on summary judgment of Cartwright Act and UCL claims brought by several retail pharmacies against manufacturers of brand-name prescription drugs. Plaintiffs alleged that the manufacturers had unlawfully conspired to maintain prices for their drugs in California at levels above those charged for the same or comparable products in Canada, and sought damages under the Cartwright Act and damages and an injunction under Section 17200 of the UCL.

The manufacturers denied the allegations and asserted as an affirmative defense that the pharmacies' claims were barred on the ground that the pharmacies had passed on any alleged overcharge to their consumers and therefore did not suffer a compensable injury. The trial court granted summary judgment to the manufacturers in light of evidence that the pharmacies' pricing practices would have resulted in 100% of any overcharge being passed on to their customers. The Court of Appeals affirmed.

CARTWRIGHT ACT

The Court squarely rejected the pass-on defense asserted by defendants, concluding that it was unsupported by the statute and inconsistent with the legislature's goals of deterring antitrust violations and ensuring disgorgement of ill-gotten gains. Thus, the Court held that alleged antitrust conspirators may not assert as a defense that plaintiffs seeking to recover overcharge damages "passed on" some or all of the overcharge to indirect purchasers farther downstream in the chain of distribution. In doing so, the Court reversed the California trial and appellate courts and adopted the federal rule announced in *Hanover Shoe v. United Shoe Machine*, 392 U.S. 481 (1968), notwithstanding that California's legislature had previously repealed the federal-law companion to *Hanover Shoe*—*Illinois Brick's* rule against indirect purchaser standing in overcharge cases—thereby allowing indirect purchasers to invoke California law to recover for overcharges passed down to them.

Clayworth recognized only two exceptions to this rule: (a) a plaintiff may not be able to recover overcharges when its resale of the product was governed by a pre-existing cost-plus contract, assuring that it would not suffer any lost profits; and (b) "as needed" to avoid duplicative recovery when the claims of plaintiffs at multiple levels of the supply chain have been brought before the same court using available procedural devices such as joinder, interpleader, and consolidation.

The immediate consequence of this ruling will be new incentives for intermediaries in the supply chain to sue for damages under California law even if they did not suffer significant harm, because they now can recover damages based on 100%

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of the overcharge they paid regardless of the impact on their profits. The potential for duplicative recovery created by such suits will lead defendants to experiment with strategies for bringing all claimants—and even potential claimants who have not yet sued—before a single court so that their aggregate exposure can be limited to the total amount of the overcharge (trebled), and each plaintiff’s potential recovery can be limited to the portion of the overcharge it actually bore.

In addition, the Court’s reasoning may well influence class certification and standing issues in other contexts: the Court endorsed the reasoning of several old U.S. Supreme Court cases suggesting that a purchaser suffers “injury” whenever it purchases an overcharged good, regardless of whether it passes on that overcharge and thus may suffer no ultimate financial loss.

CALIFORNIA UNFAIR COMPETITION LAW

The Court went on to address the trial and appellate court findings that plaintiffs did not have standing to sue under California’s Unfair Competition Law, Cal. Bus. & Prof. Code § 17200 (“UCL”), as a result of having passed on 100% of any overcharge. Again reversing the lower courts, the Supreme Court held that plaintiffs have standing to pursue UCL claims despite the fact that they may not be entitled to any restitution. Although the passage of Proposition 64 had limited standing to those persons “who ha[ve] suffered injury in fact and ha[ve] lost money or property” as a result of unfair competition, the Court found that plaintiffs met this standard. “They lost money: the overcharges they paid.” The fact that the retailers mitigated their damages by passing on the overcharges did not alter this result: “That a party may ultimately be unable to prove a right to damages (or, here, restitution) does not demonstrate that it lacks standing to argue for its entitlement to them.”

Separately, the Court also held that the plaintiffs could seek injunctive relief under section 17203 of the UCL without the need to show any entitlement to restitution. As the Court explained, the “right to seek injunctive relief under section 17203 is not dependent on the right to seek restitution; the two are wholly independent remedies.”

On the one hand, the Court’s ruling appears to weaken the need to show “loss of money or property” such that it might be satisfied by losses suffered in the marketplace rather than in transactions between plaintiff and defendant; and to expand the potential for UCL injunctive claims untethered to any claim for monetary relief, especially for competitor suits under the UCL, the viability of which had been cast in some doubt by cases applying Proposition 64 which required a plaintiff to demonstrate its entitlement to restitutionary relief. On the other hand, *Clayworth* is readily susceptible to a narrower interpretation, given that plaintiffs in that case had purchased (indirectly) from the defendants and allegedly paid an overcharge on such purchases, and thus (as the court held) potentially could seek restitution. The harder issue—whether a plaintiff who cannot show a viable restitution claim can nevertheless satisfy UCL standing or seek injunctive relief—was not decided.

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