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California Supreme Court Rejects Pass-On Defense in Price Fixing Case

Jeffrey May (Wolters Kluwer) · Thursday, July 15th, 2010

In a case of first impression, the California Supreme Court recently decided that alleged victims of a price fixing scheme can pursue treble damages claims under the California Cartwright Act, even though the victims passed on some or all of the purported overcharges to indirect purchasers downstream in the chain of distribution. Thus, the state's high court "conclude[d] that under the Cartwright Act, as under federal law, generally no pass-on defense is permitted."

The underlying suit was brought by retail pharmacies located in California against drug companies for unlawfully conspiring to fix the prices of their brand-name pharmaceuticals. The pharmacies contended that, as a result of the conspiracy, they were forced to pay an overcharge–the differential between the conspiracy-inflated prices and the prices they would have paid in a competitive market. They sought treble damages, restitution, and injunctive relief under California law.

A state trial court ruled that a pass-on defense was available under the Cartwright Act and that the pharmacies were not entitled to damages because the complaining pharmacies had passed on all of the alleged overcharges to consumers. A state appellate court affirmed (2008-2 Trade Cases ¶76,286), holding that a pass-on defense was available under the plain meaning of the Cartwright Act's damages provision. Based on the legislative history of the amendments to the Cartwright Act and developments in federal antitrust law, the California Supreme Court reversed the judgment of the appellate court.

The state supreme court rejected the drug companies' concerns that the law should not countenance a rule that permits a windfall to undamaged plaintiffs, such as the pharmacies. "This objection misconceives both the nature of the *Hanover Shoe* rule in general and its potential application here," the court said. The court noted that the pharmacies might have been able to prove lost profits and a decline in the value of their businesses as going concerns.

The state supreme court adopted the holding of *Hanover Shoe v. United Shoe Mach.* (1968) 392 U.S. 481, 1968 Trade Cases ¶72,490. In that decision, the U.S. Supreme Court held that antitrust violators ordinarily could not assert as a defense that illegal overcharges had been passed on by a plaintiff direct purchaser to indirect purchasers. Therefore, under federal antitrust law and now under the California Cartwright Act, an antitrust defendant is generally unable to defeat liability by asserting a pass-on defense.

Under federal law, both the offensive and defensive uses of a pass-on theory are prohibited. The

Hanover Shoe decision was followed nine years later by the U.S. Supreme Court's decision in *Illinois Brick Co. v. Illinois* (1977) 431 U.S. 720, 1977-1 Trade Cases ¶61,460. In *Illinois Brick*, the Court held that indirect purchasers could not use a pass-on theory offensively to sue for overcharges. Thus, duplicative recovery of damages under federal law from the same alleged price fixing conspiracy could be avoided.

On the other hand, California antitrust law does not follow the *Illinois Brick* rule barring indirect purchaser standing. Shortly after the U.S. Supreme Court's *Illinois Brick* decision, California passed an *Illinois Brick* repealer statute to allow indirect purchaser suits.

Duplicative Damages

As a result, California allows indirect purchasers to use a pass-on theory to sue for overcharges, and the issue of duplicative damages may arise. The problem was not present in the underlying action, however, because no wholesaler, consumer, or *parens patriae* suits had been filed that might pose a risk of duplicative recovery. Furthermore, the statute of limitations for the period at issue had long since expired. The California Supreme Court explained that in order to avoid duplication in the recovery of damages under the California Cartwright Act in future cases, the bar on consideration of pass-on evidence might need to be lifted.

The July 12, 2010, decision in *Clayworth v. Pfizer, Inc.*, S166435, appears at http://www.courtinfo.ca.gov/opinions/documents/S166435.PDF.