The Pass-On Defense to Antitrust Violations: Not All Gone

By Jules S. Zeman

Given the recent state Supreme Court decision in *Clayworth v. Pfizer Inc.*, California state courts are now much more attractive to antitrust plaintiffs. In fact, coupled with existing legislation, California has become a preferential forum for antitrust claims. In *Clayworth*, the state Supreme Court unanimously rejected the "pass-on" defense to alleged antitrust violations under the Cartwright Act, California's antitrust law. 2010 DJ DAR 10765 (July 12, 2010).

The pass-on defense had allowed manufacturers and distributors to avoid damages for alleged illegal overcharges, if those costs were passed on to the ultimate consumers. In rejecting that defense, the court also allowed plaintiffs to seek an injunction under the Unfair Competition Law when plaintiffs have not suffered a monetary loss that they could otherwise recover as restitution.

In *Clayworth*, retail pharmacy plaintiffs that purchased prescription drugs from pharmaceutical manufacturers claimed that those manufacturers conspired to inflate prices by adopting various wholesale pricing mechanisms. Because the plaintiffs passed along the entire amount of the overcharge to their customers, the defendants asserted the pass-on defense arguing that the plaintiffs had not sustained damages.

The trial court ruled in favor of the manufacturers, holding that a pass-on defense was available under the Cartwright Act. The Court of Appeal affirmed, rejecting the argument that the state Legislature had approved application of the U.S. Supreme Court decision in *Hanover Shoe v. United Shoe Machinery Corp.* and its bar against pass-on defenses to the Cartwright Act. 392 U.S. 481 (1968). Instead, it relied on the Act's damages provision and concluded that a pass-on defense was available because the pharmacies had not actually sustained damages. It rejected the pharmacies' unfair competition claims by saying that they were not entitled to restitution and lacked standing to challenge the manufacturers' alleged unfair business practices.

The state Supreme Court overturned the appellate decision and rejected the pass-on defense. In part, the court relied on *Hanover Shoe*, which said, "where a buyer shows that the price paid by him for materials purchased for use in his business is illegally high and also shows the amount of the overcharge, he has made out a prima facie case of injury and damage within the meaning of Section 4 of the Clayton Act."

The court took note that *Hanover Shoe* held that to allow a pass-on defense would undermine the enforcement of the antitrust laws by discouraging plaintiffs to come forward.

The court rejected the manufacturer's argument that the Cartwright Act's use of "damages sustained" established a legislative intent to compensate only for damages that were not passed on. The court decided that the phrase "damages by him sustained" lacked consensus in contemporaneous definition and did not carry any specific meaning within the minimal legislative history. The court added that the definition offered by traditional contracts and torts cases for "damages sustained" was equally unsatisfactory. That definition did not help measure actual losses in an intermediary purchaser's allegations of price-fixing.

Without such guidance, the court looked to the Legislature's subsequent amendments to the Cartwright Act and the policy behind them. The court examined amendments following the enactment of the Hart-Scott-Rodino Antitrust Improvement Act by Congress in 1976 and the Supreme Court's decision in *Illinois Brick Co. v. Illinois*, 431 U.S. 720 (1977).

The court found that the Legislature incorporated the remedial framework of Hart-Scott-Rodino Act into the Cartwright Act, thereby enacting a statute that precisely tracked the Federal Act and authorized the California Attorney General to sue for Cartwright Act violations on behalf of consumers. The Legislature also adopted Hart-Scott-Rodino's damages provision, which required excluded damages, "where duplicative amounts had been awarded for the same injury." With this, the court determined that direct purchasers could recover overcharges that might in theory have been passed on to indirect purchasers. The court found that this consumer-protection amendment to the Cartwright Act was a tacit approval of *Hanover Shoe* and its goal of maximizing deterrence and disgorgement.

The court then looked at the Legislature's response to *Illinois Brick*, which it deemed to negate this particular judicial interpretation of the Cartwright Act. The "*Illinois Brick* Repealer" bill had passed both houses unanimously and repudiated *Illinois Brick* on indirect purchaser lawsuits in the Cartwright Act. Following this change, any injured person could bring suit in state court "regardless of whether such person dealt directly or indirectly with the defendant."

Next the court examined the underlying intent of the Cartwright Act, which was to promote free competition by punishing violators. Here, deterrence outweighed the concern that a private party could receive a windfall such as treble damages even when there was no monetary loss. Although *Clayworth* did not involve consumer plaintiffs, the court applied legislative intent to deny the antitrust violator the full measure of profits from its violation. The court also noted *Hanover Shoe's* concern

for judicial efficiency. Specifically *Hanover* sought to avoid a pass-on defense that might include excessive auditing to show the consequences of a limited overcharge and attendant ills such as lost sales. The court adopted the *Hanover Shoe* rule by reasoning that allowing a universal pass-on defense would contradict the legislative history of the Act and its policies favoring the protection of competition and prevention of antitrust violations.

The court qualified its holding however, by continuing to allow specific instances of a pass-on defense. Without addressing their scope or application, the court carved out potential exceptions for "cost-plus" contracts, an exception also recognized in *Hanover Shoe*, and situations involving duplicative recovery. Based on the court's analysis of damages and the treatment of the "pass-on" defense, the court held that the actions of the plaintiffs in passing on the defendant's overcharges would not defeat the plaintiffs' ability to bring Unfair Competition claims. While the Unfair Competition Law, as amended in 2004, requires plaintiffs to have "lost money or property" as a result of the violation, the court held that plaintiffs could satisfy this requirement based on money lost from overcharges. The court rejected the defendants' arguments, stating that they "conflate[d] the issue of standing with the issue of the remedies to which a party may be entitled. 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. The doctrine of mitigation, where it applies, is a limitation on liability for damages, not a basis for extinguishing standing."

The court also rejected the notion that plaintiffs who were not entitled to restitution are not entitled to any remedy. Instead, the court found that the right to seek injunctive relief under the Unfair Competition Act is wholly separable from the right to restitution.

The *Clayworth* decision was a significant victory for antitrust plaintiffs in California. In its decision, the court exalted the importance of deterrence as the Legislature's primary goal. Despite the potential for windfalls, the court has empowered plaintiffs to bring suit — even when they have suffered no damages — in order to accomplish the goals of the Cartwright Act. Now that California is in line with *Hanover* on the pass-on defense, antitrust plaintiffs will be more attracted to California state courts. Indeed, given the legislative repeal of *Illinois Brick*, California is a preferential forum for antitrust claims.

Still, *Clayworth* cannot be seen as the death knell for the pass-on defense for all price-fixing claims. The facts of many cases will be distinct from *Clayworth*. Surely, indirect purchasers can still take advantage of the pass-on defense articulated by the court. And, although outcomes are still uncertain, litigation will occur in cases that may demonstrate duplicative recovery.

Many uncertainties remain. For instance, the court did not explain how to avoid duplicative recoveries in the event that multiple levels of purchasers have sued. Questions remain how to apply the pass-on defense where no indirect purchaser case has been filed but the statute of limitations has not run. If, for instance, the direct purchaser has achieved full judgment, can the pass-on defense be applied in the subsequent indirect purchasers' lawsuits? Given these and other issues, one can't conclude that the death knell has rung for the pass-on defense in California.

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How Lindsay Lohan Could Have Avoided Jail

By Lou Shapiro

Much attention has been given to Lindsay Lohan's nail polish or how much time she will actually serve out of the 90-day sentence. Surprisingly, a solution for a last ditch effort to have avoided the 90-day incarceration seems to have gone unaddressed.

I had the benefit of being one of the misdemeanor calendar deputy public defenders in Judge Marsha Revel's courtroom from 2008 through 2009. This of course is the courtroom that has handled probation for Lohan's drunken-driving cases.

To provide background, Department 2 of the Los Angeles County Superior Court in Beverly Hills is a high volume misdemeanor courtroom. A typical day can involve 10 arraignments, a suppression motion, a Pitchess motion, a spill-over preliminary hearing, and several bench warrant pick-up cases with mental illness issues tacked-on.

While treading through the morass of cases, Judge Revel makes it a priority to take note of clients who are facing substance abuse problems. She takes pride in assisting them in their quest to reach sobriety, if they express an interest in doing so. She will even go so far as to pick up the diamond-studded phone while on the bench and personally make arrangements with an appropriate treatment center. Judge Revel rarely sentences a client to custody time, if there is an alternative rehabilitative plan of action available and presented to her.

That brings us to the Lohan matter. Here is a young woman who during the last few months slipped repeatedly in the eyes of the court. She missed a court appearance, sustained a positive alcohol ankle bracelet detection, and failed to follow a court order, which was to attend an alcohol treatment program once a week (albeit it was ultimately completed).

Whether the 90-day custody sentence is warranted for Lohan's shortcomings is for another discussion. The point in play is that Lohan had ample opportunity to try to avoid this outcome. Had Lohan taken the initiative to self-enroll in a residential treatment program (in contrast to a mere sober living home) prior to the surrender date, she might have been able to persuade the court to suspend the 90-day sentence pending successful completion of a four to six month residential treatment program.

Precedence for this can be found in Vehicle Code Section 23598, "Live-in Alternative to Incarceration Rehabilitation Programs," which provides: "In lieu of the alcohol or drug education program prescribed by Section 23538, 23542, 23548, 23552, 23556, 23562, or 23568, a court may impose, as a condition of probation, that the person complete, subsequent to the underlying conviction, a program specified in Section 8001 of the Penal Code, if the person consents and has been accepted into that program. Acceptance into that program shall be verified by a certification, under penalty of perjury, by the director of the program."

Penal Code Section 8001 provides, "For purposes of this title, a live-in alternative to incarceration rehabilitation program with special focus on substance abusers means any long-term (two-year minimum) private, nonprofit program that has operated and complied with the following conditions for at least five years prior to the effective date of this section:

(a) Participants live full time at the program site and receive room and board, and all necessary support at no cost to the participant. (b) All necessary support shall include reasonable medical, dental, psychological, and legal services, counseling, entertainment, clothing, academic, life-skills, and interpersonal education, vocational training, rehabilitation, transportation, and recreation activities. (c) Neither the directors nor the

Associated Press

Lindsay Lohan looks on as her attorney Shawn Chapman Holley speaks in court Tuesday in Beverly Hills, where she was taken into custody to serve a jail sentence for probation violation.

officers of the program shall be compensated in any manner other than the manner in which the participants of the program are compensated. (d) The program shall not be operated with any public funds."

Therefore, once Lohan completed the PC 8001 program, she could have asked that the 90-day sentence be vacated and/or have the time already spent in the residential treatment program count as a substitute for the 90-day jail sentence. Such volitional steps would have given the court an impression of positive change and self-improvement.

An alternative creative approach would be to have asked the court to impose the infamous "30-30 Rule." Instead of having to serve 120 days in the county jail, the client only has to do 30 days of county jail, but in addition to that, must complete a 30-month outpatient alcohol program. While this disposition is traditionally requested for a third offense DUI, the argument is viable that this can apply in other appropriate situations.

Under Vehicle Code Section 23548(b), "Conditions of Probation for Third Offense," if the court grants probation to any person punished under Section 23546 (third offense DUI), the court may order as a condition of probation that the person participate, *for at least 30 months* subsequent to the underlying conviction and in a manner satisfactory to the court, *in a driving-under-the-influence program* licensed pursuant to Section 11836 of the Health and Safety Code. *In lieu of the minimum term of imprisonment* specified in subdivision (a), the court shall impose as a condition of probation under this subdivision that the person be confined *in the county jail for at least 30 days* but not more than one year. The court shall not order the treatment prescribed by this subdivision unless the person makes a specific request and shows good cause for the order, whether or not the person has previously completed a treatment program pursuant to paragraph (4) of subdivision (b) of Section 23542 or paragraph (4) of subdivision (b) of Section 23562.

Under this approach, Lohan could have appealed the court to lower her jail sentence to 30 days in exchange for her commitment to complete a 30-month outpatient alcohol program.

One interesting and unrealized fact that supports the position that the 90-day jail sentence could have been avoided, or at least lessened, is that typically, clients are ordered to surrender at the jail facility. In this case, Lohan was ordered to surrender in the courtroom. It's as if Judge Revel was throwing Lohan a life jacket, by giving her a last ditch opportunity to avoid going to jail, but she didn't want the jacket.

While no one can say for sure that Lindsay Lohan could have avoided jail time, she certainly was given chances to try.

This opinions expressed in this article belong solely to the author.

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