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New California Supreme Court Decision Provides More Confusion Than Clarity For Companies Facing Indirect Purchaser Claims

On July 12, 2010, the California Supreme Court issued its opinion in *Clayworth* v. *Pfizer* (No. S166435) addressing two of California's competition statutes: the Cartwright Act (California's antitrust statute), and the Unfair Competition Law (UCL). Retail pharmacies (Pharmacies) alleged that pharmaceutical manufacturers (Manufacturers) violated both statutes by agreeing to fix the prices of their brand-name drugs in the United States at levels significantly higher than the same drugs were sold abroad, resulting in overcharges to the Pharmacies. The trial court granted summary judgment, because the Pharmacies had passed on to consumers the entirety of any overcharges they had paid. The trial court held that as a result, the Pharmacies could not show any "damages sustained," as required to establish a Cartwright Act damages claim, and similarly could not show any "lost money or property," as required to establish standing for a UCL claim. The court of appeal affirmed. In a decision with important ramifications for companies doing business in California, the Supreme Court reversed.

The Cartwright Act

The California Supreme Court held that the Manufacturers could not assert a "pass-on defense" (i.e., the defense that the Pharmacies could not recover damages because they passed on all of the overcharges to consumers). In holding that "a pass-on defense generally may not be asserted" under the Cartwright Act, the Supreme Court essentially adopted the federal *Hanover Shoe* rule for California antitrust actions. (Slip Op. 36.) This holding resolved an open question under California law since 1978, when the California legislature departed from the federal scheme, which bars both offensive pass-on (allowing indirect purchasers to sue for damages) as well as defensive pass-on. Specifically, the legislature in 1978 amended the Cartwright Act (in a direct response to the US Supreme Court's 1977 *Illinois Brick* decision) to allow indirect purchasers to bring damage claims under the Cartwright Act. The open question addressed by *Clayworth* was whether California law would be construed consistently to also allow defensive pass-on.

While the general rule announced in *Clayworth* seems to answer that question in the negative, the second paragraph of the opinion's conclusion creates an exception that ultimately may

Contacts

Ronald C. Redcay
+1 213.243.4002

James F. Speyer
+1 213.243.4141

Christopher S. Tarbell
+1 213.243.4254

Kelly A. Welchans
+1 213.243.4006

prove to swallow the general rule. After first recognizing an exception also recognized under federal law for cases involving "cost-plus" contracts, the opinion states that when "multiple levels of purchasers have sued, or where a risk remains that they may sue…[and] if damages must be allocated among the various levels of injured purchasers, the bar on consideration of pass-on evidence must necessarily be lifted." (Slip Op. 37.) The language of this second exception seems to create an open-ended exception that could render the general rule just announced irrelevant in most antitrust cases.

Generally, whenever there is significant evidence of an antitrust violation (for example, a governmental criminal investigation or indictments involving price-fixing or civil investigations involving monopolization), both direct purchasers and end-user (consumer) indirect purchasers bring antitrust damages suits. In *Clayworth*, there was no such evidence and no government investigations. That likely explains why there were no antitrust suits by direct purchasers or end use consumers, and therefore, no need in *Clayworth* to allocate damages among different levels of purchasers. But, in the usual situation "where multiple levels of purchasers have sued, or where a risk remains that they may sue," the *Clayworth* decision may not preclude the pass-on defense. (Slip Op. 37.) The applicability of this broad exception will turn upon the meaning of the Court's language possibly limiting the exception to instances in which "damages must be allocated among the various levels of injured purchasers" and where defendants need a pass-on defense "to avoid duplication in the recovery of damages." (Slip Op. 37.)

Here are just a few of the obvious questions the Court's language raises as to the scope of the exception: First, is the filing of a direct purchaser class action in federal court sufficient to trigger this exception in the indirect purchaser's case in California court? Certainly in such a case, "multiple levels of purchasers have sued" and defendants need the pass-on defense "to avoid duplication in the recovery of damages." However, the federal case does not contemplate that "damages must be allocated among the various levels of injured purchasers" because the direct purchasers are entitled under federal law to recover the entire overcharge they paid, without any allocation to downstream purchasers. In sum, both the plaintiff and the defendants in the indirect purchaser case could point to *Clayworth* language to support their conflicting position on whether a pass-on defense would be available in such a case.

Second, the Court's language regarding the "risk" of litigation involving multiple levels of purchasers raises many questions. The Court found that this "risk" was not present in *Clayworth*, because no other lawsuits had been filed and the statute of limitations had expired. (Slip Op. at 37.) Presumably, the risk of future lawsuits contemplated by the Court was eliminated by the running of the limitations period. But could other courts point to other circumstances (for example, that others will not sue because of commercial dependence on the alleged antitrust violator) to conclude that there is no risk of suits by those at another level of purchase?

Moreover, what is the effect of a settlement with purchasers at a different level (direct purchasers or end-use consumers) on a Cartwright Act claim brought by middlemen indirect purchasers? Those middlemen plaintiffs will contend that the exception does not apply because after the settlement there is no further risk of suit, nor need for allocation. But the defendants will contend that the settlement (and the lawsuit that was settled) are sufficient to allow them to assert a pass-on defense against the middleman plaintiff.

These questions merely illustrate some of the ways the *Clayworth* decision does not definitively decide the viability of the pass-on defense in the usual California antitrust case. Whether *Clayworth* results in a new group of middlemen antitrust litigants will depend on how California courts interpret this exception to *Clayworth*'s overarching Cartwright Act holding.

Unfair Competition Law

While *Clayworth* devoted most of its attention (37 of 42 pages) to the pass-on defense under the Cartwright Act, the Court's UCL discussion is also significant. The Court appeared to decide three open UCL issues that are likely to have a substantial impact on the arguments both plaintiffs and defendants will make in future UCL litigation.

First, the Court stated that the Pharmacies had standing to sue under the UCL even though they made only indirect purchases from the Manufacturers, citing *Shersher* v. *Superior Court*,

154 Cal. App. 4th 1491 (2007). (Slip Op. 39.) *Shersher*, in fact, did not involve standing, but rather the issue of whether a plaintiff who did not have money taken directly from it by the defendant could recover restitution. In that regard, *Shersher* seemed inconsistent with the seminal UCL restitution opinion, *Korea Supply Co.* v. *Lockheed Martin Corp.*, 29 Cal.4th 1134, 1151 (2003), where the Court stated that the UCL is "limited to restoring money or property to *direct victims* of an unfair practice." *Clayworth*, however, in endorsing *Shersher,* casts doubt on defendants' ability to continue to rely on the "direct victim" language of *Korea Supply*.

Second, the Supreme Court held that the Pharmacies satisfied the UCL's "lost money or property" requirement for standing whether or not they were entitled to restitution. (Slip Op. 39-40.) The Court recognized that the voter-approved Proposition 64 "substantially revised the UCL" and predicated standing upon proof that the plaintiff actually "lost money or property" as a result of the unfair practice. Cal. Bus. & Prof. Code § 17204. Several lower courts had held that the "lost money or property" condition for standing required plaintiff to show an entitlement to restitution. The *Clayworth* opinion concluded that such reasoning wrongfully "conflates the issue of standing with the issue of…remedies." (Slip Op. 39.) "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." (Slip Op. 39.) In other words, a Plaintiff may satisfy the UCL "lost money" requirement simply by showing a monetary loss caused by the unfair practice, as the Pharmacies suffered here when they overpaid for the Manufacturers' drugs.

The Court's statement could be a signal as to how it will rule in another UCL case, *Kwikset Corp.* v. *Superior Court* (S171845), now awaiting argument and decision. *Kwikset* directly raises the issue whether a plaintiff who is not entitled to restitution could satisfy the "lost money" requirement for standing. The recent statements in *Clayworth* suggest that it might rule in *Kwikset* that a plaintiff not entitled to restitution can satisfy the standing requirement. Such a ruling would disapprove the rationale of the court of appeal in *Kwikset*, and the other lower court opinions requiring entitlement to restitution as a condition of UCL standing. However, as discussed below, the *Clayworth* Court's third statement on UCL standing may mean that the Court nonetheless may decide that the *Kwikset* plaintiff does not have standing.

In this third statement, the Court in *Clayworth* ruled that the "harm" suffered by the Pharmacies was the "overcharges" they paid. (Slip Op. 39.) The Court twice made clear that the Pharmacies' "lost money" that gave them standing was not the total amount they paid for the drugs, but rather only the overcharge they paid. (Slip Op. 39 ("They lost money: the overcharges they paid" and "Pharmacies paid more than they otherwise would have because of [the alleged UCL violation].")) Moreover, it cited *Hall* v. *Time, Inc.*, 158 Cal. App. 4th 847 (2008), a case that held a plaintiff that paid Time US$29.51 for a book did not lose money—and therefore lacked UCL standing—because the book was worth US$29.51. If the Court adheres to this requirement, it also should find that the *Kwikset* plaintiff lacks standing because he too received a product worth what he paid, and should reject the *Kwikset* plaintiff's argument that for purposes of UCL standing a plaintiff "loses money" whenever he or she parts with money, even if no overcharge occurred.

We hope that you have found this advisory useful. If you have additional questions, please contact your Arnold & Porter attorney or:

Ronald C. Redcay
+1 213.243.4002
Ronald.Redcay@aporter.com

James F. Speyer
+1 213.243.4141
James.Speyer@aporter.com

Christopher S. Tarbell
+1 213.243.4254
Christopher.Tarbell@aporter.com

Kelly A. Welchans
+1 213.243.4006
Kelly.Welchans@aporter.com
