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ANTITRUST

Expert Analysis

Pass-On Defense Disallowed in California

By
Elai Katz

The California Supreme Court ruled that defendants may not escape antitrust liability by showing that plaintiffs were able to pass on anticompetitive overcharges to their own customers. The Federal Trade Commission (FTC) agreed to settle charges of competition and consumer protection violations brought against the leading maker of computer chips by imposing limitations on the company's dealings with customers and rivals, requiring the maintenance of an open interface and prohibiting "predatory design" and deceptive statements.

Other recent antitrust developments of note included several European rulings on airline mergers and a decision by the U.S. Court of Appeals for the Third Circuit refusing to condemn auto-racing association rules and exclusive contracts requiring the use of one brand of tires.

'Pass-On' Defense

Antitrust lawsuits based on allegations of illegally inflated prices can raise complex difficulties in determining how the overcharges were spread along the distribution chain, a problem that has spawned assorted, sometimes inconsistent rules in different jurisdictions. The California Supreme Court faced some of these issues in a dispute between pharmacies and drug makers that underscores the interplay of federal and state antitrust jurisprudence.

Pharmacies brought suit under the Cartwright Act, California's antitrust law, alleging that drug manufacturers agreed to set artificially high prices for pharmaceuticals sold in the United States compared to the same drugs sold abroad. The defendant drug makers argued that the pharmacies' claims were barred because they passed on any alleged overcharge to health insurers, drug benefit plans or consumers. The trial court and intermediate appellate court agreed and ruled that the pharmacies lacked standing to bring antitrust claims against the drug makers.

The California Supreme Court reversed and stated that, subject to some exceptions, a pass-on defense may not be asserted under the Cartwright Act and the presumptive measure of damages is the overcharge paid by the plaintiff. The Court noted that it was following federal law, where since the U.S. Supreme Court decided *Hanover Shoe v. United Shoe Machinery*, 392 U.S. 481, in 1968, defendants have been precluded from defeating federal antitrust suits by asserting that direct purchaser plaintiffs (often retailers or distributors) were able to pass on the allegedly unlawful overcharges to their own customers (often the ultimate consumer).

> The California Supreme Court stated that, subject to some exceptions, a pass-on defense may not be asserted under the Cartwright Act.

As a corollary to the elimination of the pass-on defense, the U.S. Supreme Court ruled nine years later that plaintiffs that did not purchase directly from defendants—but rather paid the alleged overcharge passed along by distributors or other direct purchasers—could not bring federal antitrust claims to recover overcharges. *Illinois Brick Co. v. Illinois*, 431 U.S. 720 (1977). This federal rule has not been followed in many states, including California, which subsequently amended its antitrust laws to expressly authorize claims by indirect purchasers ("*Illinois Brick* repealers").

The California high Court rejected the manufacturers' argument that the pass-on defense should be allowed under state law, where indirect purchasers have standing, and warned that in cases such as this, where there was no risk of duplicative recovery because pass-on purchasers have not come forward, antitrust violators would retain their unlawful profits if the pass-on defense were permitted. The Court observed that duplicative recovery concerns could be addressed with procedural devices, such as mandatory joinder. The Court also indicated that consideration of pass-on evidence would be permitted when the court must allocate damages between different categories of plaintiffs.

Clayworth v. Pfizer, Inc., 2010-2 CCH Trade Cases ¶77,088

Comment: The exception to the rule laid down in the case reported immediately above, where the pass-on defense may be asserted to avoid duplication and enable allocation of damages between indirect and direct purchasers, may be invoked in many Cartwright Act claims because indirect purchasers, lacking standing under the Sherman Act, often seek redress under state antitrust law.

Unfair Competition

The FTC announced the settlement of administrative charges asserted against the leading computer chip manufacturer, Intel Corporation. The December 2009 complaint alleged unfair methods of competition and unfair or deceptive acts or practices in violation of §5 of the FTC Act and claimed that Intel's conduct was "designed to maintain Intel's monopoly in the markets for Central Processing Units (CPUs) and to create a monopoly for Intel in the markets for graphics processing units (GPUs)."

Intel's market share for the period exceeded 80 percent of the CPU market and 50 percent of the GPU market, according to the commission. Notably, the complaint did not charge Intel with monopolization or attempted monopolization under the Sherman Act, and as the FTC noted in its press release accompanying the agreement, a §5 violation "cannot be used to establish liability for plaintiffs to seek triple damages in private litigation against the same defendant."

The FTC lauded the relief obtained as going further than past settlements; the settlement agreement not only regulates contracts with Intel customers and rivals, but also polices Intel's use of its intellectual property and product design. The FTC asserted that the settlement will "open the door" to competition in the CPU, GPU, and chipset markets, and noted that although the settlement requires Intel to take certain actions, third parties are not required to accept them.

Under the settlement, Intel may not punish computer makers based on their usage of competitors' products, provide exclusionary pricing incentives, develop "predatory designs" that disadvantage rivals without improving performance, or provide misleading information designed to hinder rivals. Rival chipmakers will also have more leeway in pursuing joint ventures

ELAI KATZ *is a partner at Cahill Gordon & Reindel.* LAUREN RACKOW *and* LAWRENCE A. REICHER, *associates at the firm, assisted in the preparation of this article.*

or mergers without fear of suit by Intel due to modification of "change of control" clauses in their license agreements with Intel. Intel will also have to maintain an open interface for at least six years, enabling complementary products to connect with Intel chips and preventing improper bundling of Intel products.

Intel Corporation, FTC Docket No. 9341 (Aug. 4, 2010), available at www.ftc.gov

Supermarket Acquisition

The FTC required Tops Market LLC to divest seven Penn Traffic Company supermarkets after determining that Tops' recent acquisition of the bankrupt Penn Traffic was anticompetitive. Since a full investigation before the deal was completed could have caused the bankruptcy court to liquidate Penn Traffics' supermarket assets, the FTC reached an agreement with Tops that permitted the acquisition to close prior to a full investigation. The agreement allowed Tops to acquire all of Penn Traffics' assets in an expedited bankruptcy proceeding, while Tops agreed to keep all newly acquired Penn Traffic stores open and to sell stores that the FTC deemed as raising anticompetitive concerns.

Tops Markets LLC, File No. 101-0074 (Aug. 4, 2010), available at www.ftc.gov

Comment: The commission demonstrated pragmatic flexibility in the enforcement action reported immediately above, permitting a transaction to close prior to the conclusion of its investigation to preserve the viability of competitive assets.

Irish Airline Merger

The European Union General Court (formerly the Court of First Instance) dismissed Ryanair's appeal of the June 2007 decision by the European Commission (EC) prohibiting the two leading Irish airlines from merging. Ryanair's proposed acquisition of Aer Lingus would have created a dominant position in 35 routes between Ireland and destinations in the European Union and accounted for approximately 80 percent of all intra-European traffic to and from Dublin. The judgment also clarified that the burden rests on the merging companies to propose clear and adequate remedies aimed at removing the competition concerns identified by the commission, which Ryanair failed to do.

In a related appeal, the court rejected Aer Lingus' claim that Ryanair should have been required to divest its minority equity stake in the rival airline as the commission's authority under the Merger Regulation was limited to acquisitions conferring control of another firm.

Ryanair Holdings plc v. Commission, Case T-342/07, *Aer Lingus Group plc v. Commission*, Case T-411/07, available at www.curia.europa.eu, and "Commission welcomes General Court rulings in Ryanair case," MEMO/10/300, available at ec.europa.eu/competition (July 6, 2010)

Greek Airline Merger

The EC is investigating a proposed merger between three Greek companies that would acquire control over a newly merged company, including the businesses of Greek airlines, Olympic Air and Aegean Airlines. The commission initially found that the proposed transaction would lead to high market shares and potential monopolies on domestic routes in Greece and on a number of international routes. The EC was also concerned about a vertical relationship developing between the parties regarding ground handling at Greek airports.

"Commission opens in-depth investigation into proposed merger between Olympic Air and Aegean Airlines," IP/10/1017 (July 30, 2010), available at ec.europa.eu/competition

British-Spanish Airline Merger

The EC approved the proposed merger between British Airways and Iberia, concluding that the planned transaction would not significantly impact competition in air passenger and cargo transport, as well as related services. Regarding passenger routes, the commission determined that the merged entity will face sufficient competition on short-haul passenger routes from London to Madrid and Barcelona and on a number of short-haul passenger routes where one airline offers non-stop connection, while the other offers a one-stop connection.

> Under the settlement, Intel may not punish computer makers based on their usage of competitors' products, provide exclusionary pricing incentives, develop 'predatory designs' that disadvantage rivals without improving performance, or provide misleading information designed to hinder rivals.

"Commission approves merger between British Airways and Iberia," IP/10/938 (July 14, 2010) available at ec.europa.eu/competition

U.S.-Based Airline Merger

The EC approved a proposed merger between United Air Lines and Continental Airlines, concluding that the transaction would not negatively impact competition in the European Economic Area. Since United and Continental maintain hubs in different U.S. cities, the commission found the airlines' networks are complementary. The commission concluded that the proposed merger would lead to only incremental increases of the market shares of the parties and would not raise concern in any specific transatlantic routes. U.S. antitrust and transportation regulators must also approve the transaction.

"Commission approves merger between United Air Lines and Continental Airlines," IP/10/1010 (July 27, 2010), available at ec.europa.eu/competition

Exclusive Dealing

A manufacturer of tires for race cars claimed that a rival race tire maker entered into anticompetitive exclusive dealing arrangements with sanctioning bodies that set the rules for dirt-oval-track auto racing events in violation of the Sherman Act. The plaintiff alleged that the defendant made payments to sanctioning bodies to have one of its tires selected as the only tire that could be used for a series of races or racing seasons, thereby foreclosing the plaintiff from a substantial portion of the market.

The district court granted summary judgment to the defendant. The Third Circuit affirmed and stated that sports-related bodies are entitled to deference—but not immunity—in their adoption of equipment requirements and decisions to enter into exclusive supply arrangements for equipment.

The court also stated that competition to become the exclusive supplier is a powerful form of rivalry that should be encouraged. The court added that plaintiff had the opportunity to compete for an exclusive deal and had been successful in the past. In fact, the plaintiff took credit on its Web site for the early development and adoption in the 1970s of the single-tire practice it subsequently sought to challenge in this lawsuit. The court concluded that losing the battle to become the exclusive supplier is not the kind of injury that gives rise to an antitrust claim.

Race Tires America Inc. v. Hoosier Racing Tire Corp., 2010-2 CCH Trade Cases ¶77,111

Evidence

A truck dealer claimed that a truck manufacturer conspired with other dealers not to compete with each other in violation of §1 of the Sherman Act. Following trial, the jury returned a verdict in favor of the defendant manufacturer and the complaining dealer appealed, challenging the district court's pretrial evidentiary rulings.

The Third Circuit affirmed and stated that evidence regarding the plaintiff's involvement in other lawsuits, the conviction of its top salesman and claims that it misappropriated trade secrets were critical to the manufacturer's defense that the complaining dealer's sales losses were self-inflicted wounds due to mismanagement rather than the result of any anticompetitive arrangement.

Toledo Mack Sales & Service, Inc. v. Mack Trucks, Inc., 2010-1 CCH Trade Cases ¶77,084 (not designated for publication)