



Enhancing Compliance Programs Through Antitrust Screening  
Page 4



The New Bureau of Consumer Financial Protection – An Overview  
Page 10



California Supreme Court Rules Re: Pass-On Defense  
Page 15

# The Antitrust Counselor



Vol. 4.5 | September 2010

The Newsletter of the ABA Section of Antitrust Law's Corporate Counseling Committee

## Privileged and Confidential? EU Court of Justice Rules Against Extending Legal Privilege to In-House Lawyers

By Kristina Nordlander and Stephen Spinks

In-house lawyers do not have a right to legal professional privilege in investigations carried out by the European Commission, according to a judgment handed down by the Court of Justice of the European Union on 14 September 2010.

The judgment confirms the status quo in EU law that legal advice from an in-house lawyer or a request to an in-house lawyer for such advice is not protected from seizure in EU competition law investigations. The judgment comes as no surprise, confirming as it does, earlier rulings and the advisory opinion of the Court's Advocate General. Nevertheless, it is a disappointment for businesses as it curtails the ability of in-house lawyers to provide confidential competition law advice to their employer.

### Practical Consequences

The EU authorities will now be emboldened to continue to remove and examine documents prepared by or sent internally to in-house lawyers. In international cartel investigations, in particular, in-house lawyers should be aware that such documents may not be protected by legal privilege in the EU.

The Court did not clarify or comment on whether legal privilege extends to non-EU external lawyers as well as EU qualified external lawyers (this was not at issue in the case). However, an earlier advisory opinion of the Advocate General in the case suggested that non-EU lawyers are not entitled to legal privilege.

### Corporate Counseling Committee

Co-Chairs  
Steven Cernak  
Eric Stock

Vice-Chairs  
Anita Banicevic  
Dara Diomande  
Carter Simpson  
Jerry Swindell

Responsible Council Member  
Patrick Thompson

Newsletter Editor  
Anita Banicevic

In the event of a dispute with the EU authorities as to whether a document is actually protected by legal privilege, the document in question should be placed in a sealed envelope pending resolution of the matter – if necessary before the European courts.

## Background

The origins of the case lie in a surprise inspection carried out by the European Commission in 2003 into allegations that Akzo Nobel and its subsidiary participated in a cartel contrary to EU competition rules. The Commission searched the premises of Akzo Nobel's subsidiary Akros and seized hundreds of documents. A dispute arose between the EU investigators and the company's representatives about a number of documents which the company claimed were protected by legal privilege. These included correspondence to and from a qualified lawyer registered with the Dutch bar who worked as an employee in Akzo Nobel's legal department. These documents were at the centre of the case.

In its 1982 judgment in *AM & S Europe v. Commission*, the Court of Justice held that legal privilege only arises when the following two cumulative conditions are satisfied: (1) the advice is requested and given for the purpose of the client's rights of defence and (2) the advice must emanate from "independent lawyers, that is to say, lawyers who are not bound to the client by a relationship of employment". In its action, Akzo Nobel challenged the relevance of these criteria, in particular the notion that employed lawyers who are regulated members of the Dutch bar cannot be independent.

The case attracted great interest from associations representing lawyers. The European Company Lawyers Association, the American Corporate Counsel Association, the International Bar Association and the Conseil des Barreaux Européens intervened in favor of legal privilege being extended to in-house lawyers.

## Independence of Lawyers

The main reason underlying the Court's ruling that legal privilege did not apply is that it considered that in-house lawyers do not enjoy the same degree of independence as external lawyers who work either on an independent basis or in law firms. In contrast to an external lawyer, the Court stated that in-house lawyers cannot ignore the commercial strategies pursued by their employers.

## Changes in Legal Landscape

The Court rejected arguments from a number of parties that the "legal landscape" had changed – it found no evidence to support a "predominant trend" among the Member States' legal systems to treat legal advice of in-house and external lawyers in the same way. The Court suggested that it may view the issue differently should a majority of national laws on legal privilege change.

The Court did not therefore revise the notion of independence for lawyers. According to the Court, independence is determined not only positively by reference to the lawyer's ethical obligations but also negatively by reference to the absence of any employment relationship between the lawyer and his client.

The main reason underlying the Court's ruling that legal privilege did not apply is that it considered that in-house lawyers do not enjoy the same degree of independence as external lawyers who work either on an independent basis or in law firms.

## Equal Treatment

The Court of Justice also rejected arguments that the difference in treatment between similarly qualified and regulated in-house and external lawyers violated the principle of equal treatment. The Court stated that this principle only applied in comparable situations. It considered that in-house lawyers are in a “fundamentally different situation” due to their status of employment and, as such, their situation could not be compared to that of external lawyers. The fact that the in-house lawyer was a registered member of a bar association had no bearing on this finding.

## EU and National Regimes

The Court of Justice rejected the contention that the approach of the EU was in danger of eroding legal privilege extended by a number of national regimes to in-house lawyers. The Court stated that the principle of legal certainty did not require identical criteria to be applied to the different procedures under national and EU law.

The Court considered that any individual who seeks advice from a lawyer must accept the restrictions and conditions applicable to the exercise of that profession (for example, some in-house lawyers do not have the right to plead before courts). The Court stated that the rules on legal professional privilege form part of those restrictions and conditions. This means that those seeking advice from an in-house lawyer (or indeed an external lawyer), must take into account the professional limitations placed upon the lawyer in question when seeking that advice.

## Next Steps

The judgment of the Court of Justice marks the end of the road for the litigation before the EU courts in this case. Akzo Nobel may consider bringing action before the European Court of Human Rights (a separate body to the EU). However, any such action is complicated by the fact that the Convention is not yet part of the EU legal system and so any action would probably have to be against the EU Member States collectively. The advisory remarks of the Advocate General rejecting such arguments in the case may also temper a willingness to pursue this route.

Change, if it is to come in this area, may have to be the result of legislative developments in the treatment of in-house lawyers.

Change, if it is to come in this area, may have to be the result of legislative developments in the treatment of in-house lawyers.



Kristina Nordlander is a partner of Sidley Austin LLP.



Stephen Spinks is a partner of Sidley Austin LLP.

# Enhancing Compliance Programs Through Antitrust Screening

By Rosa M. Abrantes-Metz, Patrick Bajari, and Joseph E. Murphy \*

## Effective Compliance Efforts

One of the tough challenges facing company antitrust counsel is how to deal with the risk of collusive or cartel behavior which involves willful violations of the law. How can you, as legal counsel help your company's compliance officer to address this risk effectively? In the past, much antitrust compliance work has focused on training, perhaps accompanied by an antitrust compliance manual. But regardless of the amount of employee training and the existence of written materials, some practitioners may feel it is difficult to get a handle on what the actual risk is in this area.

Those who participate in price fixing, bid rigging and market allocation typically know they are engaged in wrongful conduct. The sorry history of major international cartels, and even of smaller local conspiracies, suggests that antitrust compliance training, while a necessary tool, simply is not sufficient. Similarly, manuals are there for those who choose to read and take them seriously, but this approach is also premised on good faith.

On the other hand, there are more intrusive tools that do not depend on people's good faith. These involve audits, monitoring and reviews of a business. If done well, including extensive reviews of records and interviews with a broad range of personnel, these techniques may reveal conduct that would otherwise remain undetected. But they also have drawbacks – they are intrusive and expensive. If they are not focused on the highest risk areas, their resource-intensive nature can generate management hostility.

The US Organizational Sentencing Guidelines calls for certain minimum standards for compliance programs. To meet these standards, companies need to “exercise due diligence to prevent and detect criminal conduct.” Among other points, these standards include:

“(5) The organization shall take reasonable steps—

(A) to ensure that the organization's compliance and ethics program is followed, including monitoring and auditing to detect criminal conduct . . . .”<sup>1</sup>

The US Organizational Sentencing Guidelines calls for certain minimum standards for compliance programs. To meet these standards, companies need to “exercise due diligence to prevent and detect criminal conduct.”

\* The authors thank David S. Evans for discussions on the topic. The views expressed in this article are those of the authors and should not be attributed to any affiliated organizations or their clients.

<sup>1</sup> U.S.S.G. section 8B2.1(b)(5)(A).

It would seem that, in addition to the logic of not simply relying on training and manuals to prevent willful violations, there is also regulatory direction that companies need to actively seek out possible violations in their operations.

Even though antitrust risk may be pervasive, it is still necessary to prioritize where the greatest antitrust risk resides. Consider for example a multinational company with over 120,000 employees, 5 major lines of business (each with numerous products and services) and operations in 70 countries. Where should antitrust audits begin? Which offices and which employees should have the most intensive examination? Which parts of the company merit closer scrutiny? The answer takes us to a technique called “screening” which is sometimes used by enforcement authorities worldwide to target limited investigative resources. Screening looks at certain quantifiable red flags<sup>2</sup> and applies statistical and computational analyses to determine priority areas for further focus.

### **What Are Screens and Why Are They Relevant for Compliance**

A screen is a statistical test that identifies markets where competition problems exist and determines, if a problem does exist, who is involved. Screens use commonly available data such as prices, costs, market shares or bids, and apply statistical tools to identify highly improbable or anomalous patterns in those data. Broadly speaking, screens employ two strategies.

The first strategy searches for improbable events. This type of screen is similar to looking for a cheat in a casino. For example, the probability that a gambler will place a winning bet in roulette is roughly .5 percent. During her shift, a roulette dealer may see a handful of players win 5, or even 7, times in a row. However, the probability of winning 20 times in a row is around 1 in one million. Simply observing such a winning streak does not prove that cheating has occurred, but it certainly suggests closer scrutiny is warranted.

Building on these types of observations, one can look for patterns in prices, costs or bids that are highly unlikely to occur except if collusion is present. An extreme but useful example of such patterns is a case of colluding firms which submitted bids that were equal to 7 significant digits while rotating the winning bidder. Such an outcome is akin to winning 20 bets in a row in roulette. It is highly improbable and signals that something is probably wrong.

The second type of screen uses the idea of a control group. For instance, in the 1980s, organized crime in New York City operated a concrete club that rigged bids on contracts over \$2 million. During the 1980s, the price of concrete was 70 percent higher in New York City than in other U.S. cities. While prices are generally higher in New York City, relatively few are 70 percent higher than

Screens use commonly available data such as prices, costs, market shares or bids, and apply statistical tools to identify highly improbable or anomalous patterns in those data.

---

<sup>2</sup> The U.S. Department of Justice has identified a set of pricing patterns to help identify collusive behavior. See U.S. Dep’t of Justice, Antitrust Division, *An Antitrust Primer: Price Fixing, Bid Rigging, and Market Allocation Schemes: What They Are and What to Look For*, at <http://www.usdoj.gov/atr/public/guidelines/primer-ncu.htm> (“DOJ Antitrust Primer”).

in other large cities. Prices that are anomalous compared to comparable markets suggest a competition problem. In this simple example, prices in other cities form natural control groups for New York.

Most collusion is not so blatant because colluders fear detection and typically take steps to disguise their actions. It may not be feasible to use the “naked eye” to identify these patterns. However, using modern statistical methods, it is possible to discover conspiracies by the anomalous patterns they generate in the data. These statistical tools can be incredibly powerful and may be difficult for even sophisticated conspirators to avoid. Obviously, statistical tools are not a panacea and must be combined with direct interviews and other forms of discovery. However, given that resources are limited and investigation is expensive, they can narrow down the set of possible conspirators to a manageable number.

Below, we shall provide some examples of screens that have been used in practice.<sup>3</sup>

### **Variance Screens**

The academic literature contains a large number of empirical studies of market manipulation including price fixing, market sharing agreements, financial and commodities markets manipulation and bid-rigging. These studies show that conspirators may generate prices or market shares that are “too stable” and do not respond to changing market conditions because the successful collusive agreement breaks the link between market conditions and prices. In a properly functioning market, prices are determined by supply and demand. When firms collude, these fundamentals are less relevant and the collusive agreement now determines prices.<sup>4</sup> This observation has been used by competition authorities such as the U.S. Federal Trade Commission to detect price fixing in retail gasoline markets. These techniques are also used by the European Commission among other agencies in the search for potential colluders by looking for markets where prices vary too little and do not respond to shocks to the wholesale price of gasoline.

### **Screens for bid-rigging**

Economists have found that collusive bids in bid-rigging conspiracies tend to be “too highly correlated” after taking market factors into account. For example, a cartel may have some members submit “phony bids” that are designed to make the collusive bid appear plausible, but which correlate highly with the winning bid.<sup>5</sup>

These statistical tools can be incredibly powerful and may be difficult for even sophisticated conspirators to avoid.

<sup>3</sup> Abrantes-Metz, R., P. Bajari, 2009. “Screens for Conspiracies and Their Multiple Applications,” *The Antitrust Magazine* 24 (1), Fall.

<sup>4</sup> Abrantes-Metz, R., L. Froeb, J. Geweke and C. Taylor, 2006. “A Variance Screen for Collusion,” *International Journal of Industrial Organization* 24, pp. 467-486.

<sup>5</sup> Bajari, P. and L. Ye, 2003. “Deciding Between Competition and Collusion,” *The Review of Economics and Statistics* 85 (4), pp. 971-989.

Using the naked eye, typically it is not possible to identify these patterns because the submitted bids depend on a variety of project and firm specific factors. However, statistical tools can control for these factors and uncover the anomalous behavior.

### **Benford's Law**

In many data sets, the distribution of digits has a naturally, regularly occurring pattern. The number of times that any particular numeral is the leading digit in a number often follows a fixed frequency. Benford's (1938) law is a mathematical formula that describes this regularly occurring distribution of digits.<sup>6</sup>

Studies have shown that the law applies to a surprisingly large number of data sets, including populations of cities, street addresses, electricity usage, word frequency, and the daily returns to the Dow Jones. Since Benford's law is a naturally occurring pattern in many data sets, violations of the law can be used to detect irregularities. Benford's law has been used to detect data tampering, manipulation of financial ratios and tax evasion and is starting to be applied to the detection of cartels.<sup>7</sup>

### **Other Internal Monitoring Applications of Screens**

Screens can also be used by managers to monitor for fraud in accounting and reimbursement statements, collusion on employee compensation surveys, revenues management or other forms of data manipulation or FCPA violations. Furthermore, screens could be used to detect price fixing in purchasing or procurement.

### **The Power of Screens**

While screens are very powerful, they have limitations. Screens will not prove that a business unit or employee is actually engaged in collusive conduct. The data will provide patterns and red flags which can help target the next level of review, but what appear initially to be red flags could turn out to have other perfectly legitimate explanations.

Screens will exhibit both false positives and false negatives, as is true of other forms of testing. A good antitrust screen will narrow the set of possible conspiracies to a manageable few, which might merit further review. A good screen should: (i) minimize the number of false positives and

Screens can also be used by managers to monitor for fraud in accounting and reimbursement statements, collusion on employee compensation surveys, revenues management or other forms of data manipulation or FCPA violations.

<sup>6</sup> Benford, F., 1938. "The law of anomalous numbers," *Proceedings of the American Philosophical Society* 78(4), pp. 551-572.

<sup>7</sup> Abrantes-Metz, R., Villas-Boas, S., and Judge, G., 2010. "Tracking the Libor Rate," *Applied Economics Letters*, forthcoming. See also Varian, H., 1972. "Benford's law," *The American Statistician* 26(3); Nigrini, M., 1996. "A taxpayer compliance application of Benford's law," *Journal of the American Taxation Association* 18(1), pp. 72-91; and others.

negatives; (ii) be easy to implement; (iii) have empirical support; and (iv) be costly to avoid by violators even when it is known that screens are being used.

Additionally, screening techniques can provide insights in actual investigations of potential wrongdoing. For example, when interviewed in an investigation, managers could be given the opportunity to explain statistical anomalies. However, the mere fact that the company has this level of investigative sophistication may be more likely to induce those being investigated to voluntarily admit their involvement in improper conduct. Indeed, without giving away the specific techniques being used, companies may make known to employees that they are using such sophisticated techniques as a deterrent to misconduct that employees might otherwise believe is invisible to the world.

While screening could be used in a variety of compliance areas, there is a particular urgency in antitrust. Under the Antitrust Division's Leniency Program and similar programs around the globe, there is a special premium associated with being the first in a conspiracy to detect cartel behavior. By using screening a company can substantially increase its chances of being first to detect and report a violation.

It is also important, in the event of a violation, to be able to convince enforcement authorities that the company is serious in its efforts to prevent and detect violations. Spokespersons for the Antitrust Division have made it clear, however, how they view programs limited to paper and training:

"[I]f a compliance program boils down essentially to 'we told them not to,' the Division is likely to be less than impressed.<sup>8</sup>"

Instead, if a company is using sophisticated techniques that show a genuine interest in ferreting out misconduct, the government is far more likely to believe it when a company claims it was doing all it reasonably could to stay on the right side of the law. Certainly, if a company is serious about prevention and early detection of nascent violations, it will want to look into the use of screens as a potent compliance tool.

### **General Guidance**

There are different levels of sophistication when developing and applying screening techniques. Some of these are more extensive and expensive, while others are more easily available and affordable. For a company deciding whether to implement these screening tools, it is not an all or nothing proposition. As practical guidance, counsel can enhance the robustness of any internal compliance program by collecting and analyzing the relevant data for areas at special risk or with

Instead, if a company is using sophisticated techniques that show a genuine interest in ferreting out misconduct, the government is far more likely to believe it when a company claims it was doing all it reasonably could to stay on the right side of the law.

<sup>8</sup> Roberts, N., 1992 "Antitrust Compliance Programs Under the Guidelines: Initial Observations From the Government's Viewpoint," 2 *Corporate Conduct Quarterly* 1, 3 (Summer).

suspicious patterns. Empirical screening tools can be developed and implemented targeting each particular area of risk. These tools will enhance the internal capability to detect illegal activity and arguably help protect the company should an investigation be initiated sometime in the future.

---



Rosa M. Abrantes-Metz is a Principal at the Antitrust, Securities and International Arbitration practices of LECG, LLC, and a Visiting Scholar at the Department of Economics at Leonard N. Stern School of Business, New York University.



Patrick Bajari is Professor of Economics at the University of Minnesota and Research Associate at the National Bureau of Economic Research.



Joseph E. Murphy is Director of Public Policy for SCCE (pro bono) and Of Counsel to Compliance Systems Legal Group.

# The New Bureau of Consumer Financial Protection – An Overview

By Amanda L. Wait

Consumer protection practitioners have a watershed year to look forward to in 2011. On July 15, 2010, Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (“Dodd-Frank Act” or “Act”),<sup>9</sup> with a vote of 60-39. The Act was signed into law by President Obama on July 21, 2010. The Act creates a new agency dedicated to consumer protection issues relating to consumer financial products and services. This new agency, to be called the Bureau of Consumer Financial Protection (“Bureau”),<sup>10</sup> is expected to “go live” in 2011. The new agency will take over certain consumer protection responsibilities currently housed in other agencies, but will also be responsible for shaping new consumer protection regulations and policies applicable to the consumer financial products and services industries. This article provides a brief overview of the new agency, its authority, and its authority will overlap with (and mitigate) the Federal Trade Commission’s current consumer protection mandate.

## Mechanics of Creating the Bureau of Consumer Financial Protection

The new Bureau will be housed “in the Federal Reserve system.”<sup>11</sup> The Act provides that the Bureau will have a Director who is nominated by the President and confirmed by the Senate for a 5-year term.<sup>12</sup>

Since the Act was signed into law, it was widely rumored that President Obama would appoint Elizabeth Warren, a professor at Harvard law school and chair of the Congressional Oversight Committee, as the inaugural Director of the Bureau. On Friday, September 17, 2010, the White House announced that Ms. Warren will serve as a special assistant to President Obama and a special advisor to Treasury Secretary Timothy F. Geithner.<sup>13</sup> In these dual roles, Ms. Warren will be responsible for the Bureau’s formation and will have significant influence over the agency’s direction. Recognizing the challenge of creating an entirely new Federal agency, the Act provides that the Secretary of the Treasury “is authorized to perform the function of the Bureau ... until the Director of the Bureau is confirmed by the Senate....”<sup>14</sup>

---

<sup>9</sup> Pub. L. No. 111-203, 124 Stat. 1376 (July 21, 2010) [hereinafter “Dodd-Frank Act”].

<sup>10</sup> *Id.* § 1017.

<sup>11</sup> *Id.* § 1011. This section also provides that the new Bureau will be both an “independent Bureau” and an “Executive agency.” *Id.*

<sup>12</sup> *Id.* § 1011(b).

<sup>13</sup> White House Press Release, President Obama Names Elizabeth Warren Assistant to the President and Special Advisor to the Secretary of the Treasury on the Consumer Financial Protection Bureau (Sept. 17, 2010), available at <http://www.whitehouse.gov/the-press-office/2010/09/17/president-obama-names-elizabeth-warren-assistant-president-and-special-a>. Ms. Warren’s role as special assistant does not preclude that she may be named Director of the agency at some point in the future.

<sup>14</sup> Dodd-Frank Act, *supra* note 1, § 1066.

The agency will have several functional units, including: research, community affairs, collecting and tracking complaints, an office of fair lending and equal opportunity, an office of financial education, an office of service member affairs, and an office of financial protection for older Americans.<sup>15</sup>

The Act requires the creation of an advisory board to “advise and consult” with the Bureau “in the exercise of its functions.”<sup>16</sup> Members of this advisory board will be appointed by the Director.<sup>17</sup>

### **The Bureau’s Broad Grant of Authority**

The Dodd-Frank Act sought to increase oversight of the financial services industry to prevent the types of perceived abuses that caused or worsened the impact of the recent financial crisis. The stated purpose of the Bureau is to “seek to implement and, where applicable, enforce Federal consumer financial law consistently for the purpose of ensuring that all consumers have access to markets for consumer financial products and services and that markets for consumer financial products and services are fair, transparent, and competitive.”<sup>18</sup> To accomplish this purpose, the Act grants the Bureau far-reaching authority over a broad range of products and services, using a full panoply of consumer protection statutes, rulemaking authority, and other tools.

The Act defines the term “consumer financial product or service” to include all products and services “offered or provided for use by consumers primarily for personal, family, or household purposes,”<sup>19</sup> that are “delivered, offered, or provided in connection with” a lengthy list of financial products and services, including:

- extending credit or servicing loans;
- extending or brokering leases;
- providing real estate settlement services;
- engaging in deposit-taking activities;
- selling, providing, or issuing stored value or payment instructions; and
- providing check cashing, check collection, or check guaranty services.<sup>20</sup>

Although the scope of the new Bureau’s authority is not unlimited,<sup>21</sup> imagining how these broadly-defined covered products could reach a vast array of commercial transactions is not difficult.

The stated purpose of the Bureau is to “seek to implement and, where applicable, enforce Federal consumer financial law consistently for the purpose of ensuring that all consumers have access to markets for consumer financial products and services and that markets for consumer financial products and services are fair, transparent, and competitive.”

---

<sup>15</sup> *Id.* § 1013.

<sup>16</sup> *Id.* § 1014.

<sup>17</sup> *Id.*

<sup>18</sup> *Id.* § 1021(a).

<sup>19</sup> *Id.* § 1002(5).

<sup>20</sup> *Id.* § 1002(15).

<sup>21</sup> The Act specifically excludes from the FCPB’s authority regulation of certain industries, including the practice of law and auto dealers. *Id.* §§ 1027(e), 1029.

Further, in addition to its broad product and service reach, the Bureau also will inherit broad statutory authority currently housed in other Federal agencies, and will develop and enforce new consumer protection law. Authorities currently scattered among several agencies, including the Federal Trade Commission, Federal Reserve Deposit Corporation, Department of Housing and Urban Development, the Comptroller of the Currency, and others, will be consolidated within the new agency. Specifically, the Act enumerates eighteen Federal laws (specifically excluding the FTC Act) for which some or all authority will be transferred to the new Bureau. These laws include the Fair Debt Collection Practices Act, parts of the FDIC Act, the Truth in Lending Act, and others.<sup>22</sup>

The creation of the Bureau specifically will diminish the authority and mandate of the Federal Trade Commission's consumer protection mission. The FTC's authority for consumer protection issues currently extends to the financial services sector, but the Dodd-Frank Act gives exclusive authority to regulate these industries to the new agency. The Act specifically provides for the transfer of functions currently housed within the FTC: "[t]he Bureau shall have all powers and duties under the enumerated consumer laws to prescribe rules, issue guidelines, or conduct studies or issue reports mandated by such laws, that were vested in the Federal Trade Commission on the day before the designated transfer date."<sup>23</sup> Additionally, "the Bureau may enforce a rule prescribed under the Federal Trade Commission Act by the Federal Trade Commission with respect to an unfair or deceptive act or practice to the extent that such rule applies to a covered person or service provider with respect to the offering or provision of a consumer financial product or service as if it were a rule prescribed under section 1031 of this title."<sup>24</sup> Despite this reduction in authority, however, the Act does not mandate the transfer of any employees from the FTC to this new agency.<sup>25</sup> And, the Act specifically reserves to the FTC its "supervisory or enforcement authority ... with respect to credit extended, or the collection of debt arising from such extension, directly by a merchant or retailer to a consumer to purchase nonfinancial goods or services directly from the merchant or retailer."<sup>26</sup> However, this exclusion does not apply if that extension of credit is assigned, sold, or otherwise conveyed to another person, the credit extended significantly exceeds the market value of the nonfinancial good or service provided, the credit extension is done as a subterfuge so as to evade or circumvent the authority of the Bureau, or if the credit provider regularly provides credit that is subject to a finance charge.<sup>27</sup>

Additionally, the Act creates new consumer protection law, largely, but not wholly, modeled on Section 5 of the FTC Act, with an important addition. In a notable departure from the time-tested language of Section 5, the Act adds the concept that "abusive" conduct may violate the Dodd-Frank

The creation of the Bureau specifically will diminish the authority and mandate of the Federal Trade Commission's consumer protection mission.

---

<sup>22</sup> See *id.* § 1002(12); (14).

<sup>23</sup> *Id.* § 1061(b)(5)(B)(i).

<sup>24</sup> *Id.* § 1061(b)(5)(B)(ii).

<sup>25</sup> The Act specifically exempts the FTC from the requirement that "[t]he Bureau and each of the transferor agencies (except the Federal Trade Commission) shall jointly determine the number of employees and the types and grades of employees necessary to perform the functions of the Bureau...." *Id.* § 1064(a)(7).

<sup>26</sup> *Id.* § 1027(a)(2)(D)(i).

<sup>27</sup> *Id.* § 1027(a)(2)(B).

Act. The Act provides that “[i]t shall be unlawful for ... any covered person or service provider ... to offer or provide to a consumer any financial product or service not in conformity with Federal consumer financial law, or otherwise commit any act or omission in violation of a Federal consumer financial law; or ... to engage in any unfair, deceptive, or *abusive* act or practice.”<sup>28</sup> The Bureau may take cues from other federal statutes prohibiting abusive conduct, including the Fair Debt Collection Practices Act (“FDCPA”).<sup>29</sup> The FDCPA is currently enforced primarily by the FTC and since its enactment in 1978, the FTC has brought more than 60 enforcement actions alleging illegal debt collection practices.<sup>30</sup> This gives the new Bureau a body of case law to consult in forming regulations and policy under its new authority under the Act.

### Focus on Consultation and Consistency

To implement this broad authority over such a wide range of potential industries and companies, many of the responsibilities and employees of the new agency will be transferred directly from other federal agencies. However, because the new Bureau’s authority extends only to consumer financial products and services, many agencies may retain overlapping authority with the Bureau for federal consumer protection laws as they apply to non-financial products and services.

One theme throughout the part of the Act that establishes the Bureau is consistency between agencies with potentially overlapping authority. For example, the Act requires the new Bureau to coordinate with other agencies exercising overlapping functions. Section 1015 provides that: “The Bureau shall consult with the Commission, the Commodity Futures Trading Commission, the Federal Trade Commission, and other Federal agencies and State regulators, *as appropriate*, to promote consistent regulatory treatment of consumer financial and investment products and services.”<sup>31</sup> Further, the Bureau is required to “consult with the appropriate prudential regulators or other Federal agencies prior to proposing a rule and during the comment process regarding consistency with prudential, market, or systemic objectives administered by such agency.”<sup>32</sup>

But the Bureau is not *required* to follow any recommendations by the consulted agency. And, importantly, if the Bureau and one or more other agencies are authorized to promulgate rules, the Bureau “shall have the exclusive authority” to prescribe those rules.<sup>33</sup> This potentially could mean that rules promulgated by the Bureau intended to apply to consumer financial products and services would be applied to non-consumer financial products and services.

Whether the new agency will give more consideration to this soft coordination mandate than lip service, of course, remains to be seen, but there are noteworthy skeptics. For example, FTC Commissioner Kovacic referred to the consultation requirement as merely “aspirational,” noting that

One theme throughout the part of the Act that establishes the Bureau is consistency between agencies with potentially overlapping authority.

<sup>28</sup> *Id.* § 1036 (emphasis added).

<sup>29</sup> 15 U.S.C. § 1692d.

<sup>30</sup> FED. TRADE COMM’N, COLLECTING CONSUMER DEBTS: THE CHALLENGES OF CHANGE, A WORKSHOP REPORT 9 (2009).

<sup>31</sup> Dodd-Frank Act, *supra* note 1, § 1015 (emphasis added).

<sup>32</sup> *Id.* § 1022(b)(2)(B).

<sup>33</sup> *Id.* § 1022(b)(4)(A).

the Act provides “no assurance ... that the [Bureau] will account properly for the FTC’s views about the appropriate content of unfairness and deception jurisprudence.”<sup>34</sup>

## Conclusion

Much debate has focused on whether the new Bureau of Consumer Financial Protection is redundant or unnecessary. Although the new agency’s mandate overlaps significantly with that of other agencies, including that of the Federal Trade Commission, the new agency will be the only agency specifically focusing on consumer protection issues in the financial services industries. Although many uncertainties remain, one thing about the new Bureau is certain: It will have broad-reaching implications for providers of goods and services to consumers in many industries that may touch upon or include any type of financial product or service.



Amanda Wait is an associate of Hunton & Williams LLP.

---

<sup>34</sup> William E. Kovacic, *The Consumer Financial Protection Agency and the Hazards of Regulatory Restructuring*, LOMBARD STREET, Sept. 14, 2009, at 27.

# California Supreme Court Rules that Pass-On Defense Is Not Available in Price-Fixing Cases under California's Cartwright Act

By Beatrice B. Nguyen and Chahira Solh

In *Clayworth v. Pfizer, Inc.*,<sup>1</sup> the California Supreme Court recently held that there is no general “pass-on” defense under the Cartwright Act,<sup>2</sup> California’s state antitrust statute. In its unanimous decision on an issue of first impression, the Court rejected the general application of the “pass-on” defense in favor of the statute’s broad deterrent purpose, but preserved the California courts’ power to consider pass-on evidence to allocate damages where plaintiffs at multiple levels of the distribution chain bring suit. Consequently, the decision has far-reaching effects for defendants in defending against antitrust claims brought under California law and the potential to complicate future Cartwright Act cases for the courts and parties.

Unlike federal law, which limits antitrust damage claims to “direct purchasers,” the Cartwright Act allows “indirect purchasers” to sue on antitrust claims. The issue presented in *Clayworth* was whether defendants could defeat a Cartwright Act claim by showing that a direct or intermediary purchaser plaintiff had passed on the entirety of an alleged price overcharge to an indirect purchaser and therefore suffered no damages. Federal antitrust law does not provide for the pass-on defense under the U.S. Supreme Court’s holding in *Hanover Shoe, Inc. v. United Shoe Machinery Corp.*,<sup>3</sup> and *Clayworth* partially adopts the *Hanover Shoe* rule for California state law. As the Court explained, “Every indication available from the Legislature demonstrates that, given a choice, it would prefer an enforcement regime in which *Hanover Shoe* is the law.”<sup>4</sup>

## Background and Previous Applications of California Antitrust Law

The action was brought by a group of retail pharmacies (“plaintiffs” or “Pharmacies”) against a number of defendants generally involved in the manufacturing, marketing, and/or distribution of brand name (or patented) pharmaceutical products throughout the United States (“defendants” or “Manufacturers”) and alleged claims of price-fixing under the Cartwright Act and for violations of California’s Unfair Competition Law<sup>5</sup> (“UCL”). Based on the Pharmacies’ admission that they passed on the entirety of the alleged overcharge to their own customers, the Manufacturers sought summary judgment on the ground that the Pharmacies suffered no damages. The trial court held

In its unanimous decision on an issue of first impression, the Court rejected the general application of the “pass-on” defense in favor of the statute’s broad deterrent purpose, but preserved the California courts’ power to consider pass-on evidence to allocate damages where plaintiffs at multiple levels of the distribution chain bring suit.

<sup>1</sup> 49 Cal. 4th 758 (2010).

<sup>2</sup> Cal. Bus. & Prof. Code §§ 16700 *et seq.*

<sup>3</sup> 392 U.S. 481 (1968).

<sup>4</sup> *Clayworth*, 49 Cal. 4th at 775.

<sup>5</sup> Cal. Bus. & Prof. Code §§ 17200 *et seq.*

that, as the Cartwright Act permitted indirect purchaser plaintiffs to rely upon pass-on evidence to bring a claim, the defendants were permitted to rely upon pass-on evidence as part of their defense as well. The court thus recognized the availability of the pass-on defense and granted summary judgment in favor of the defendants.

The Court of Appeal affirmed this decision, rejecting an argument by the plaintiffs that the California Legislature had approved application of the federal rule of *Hanover Shoe*. The Court of Appeal found that the Pharmacies were not entitled to damages from the Manufacturers, because the Pharmacies were not damaged by the allegedly higher prices they paid. The defendants argued that the Pharmacies charged correspondingly higher drug prices to their customers, thereby “passing on” any increase in their cost to pharmacy customers and never suffering any damages from the allegedly higher prices.

The Court of Appeal reasoned that a pass-on defense is available under the language, history, and purpose of the Cartwright Act, including the statutory language requiring that plaintiffs show “damages sustained”<sup>6</sup> and the fact that, unlike under federal law, California law allows claims by indirect purchasers. The Court of Appeal further held that the UCL claim failed because the Pharmacies had not “lost money or property” so as to have standing under Cal. Bus. & Prof. Code § 17204 and could not be entitled to restitutionary relief.

### The California Supreme Court Decision

In an opinion issued on July 12, 2010, the California Supreme Court reversed the Court of Appeal’s decision, holding that under the Cartwright Act, as under the federal rule in *Hanover Shoe*, the pass-on defense is generally not permitted.<sup>7</sup> Because the text of the Cartwright Act itself did not provide guidance regarding the availability of the defense, the Court looked to the legislative history of the act.

The Court read the California Legislature’s amendments to the Cartwright Act, made in response to federal antitrust laws, as demonstrating an intent by the California Legislature to incorporate the federal rule against allowing the pass-on defense. The Court based this holding on two things: (i) the California Legislature’s amendment of the Cartwright Act in response to the Hart-Scott-Rodino Act;<sup>8</sup> and (ii) the California Legislature’s amendment of the Cartwright Act in response to *Illinois Brick v. Illinois*,<sup>9</sup> which indicated that “the Legislature fully embraced the *Illinois Brick* dissent, including – critically for our purposes – its view that *Hanover Shoe* . . . was a sound rule of law.”<sup>10</sup>

The Court’s principal concern was policy-oriented: the potential under-deterrence of anticompetitive conduct if the pass-on defense were allowed. In a case such as *Clayworth* where only plaintiffs from one level of the distribution chain had brought suit, and there was no risk of

The Court’s principal concern was policy-oriented: the potential under-deterrence of anticompetitive conduct if the pass-on defense were allowed.

<sup>6</sup> Cal. Bus. & Prof. Code § 16750

<sup>7</sup> *Clayworth*, 49 Cal. 4th at 763 (“We conclude that under the Cartwright Act, as under federal law, generally no pass-on defense is permitted.”).

<sup>8</sup> *Id.* at 775- 81.

<sup>9</sup> 431 U.S. 720 (1977).

<sup>10</sup> *Clayworth*, 49 Cal. 4th at 781-82.

duplicative recovery, the Court concluded that recognizing the pass-on defense “would hamper enforcement by reducing incentives to sue and police antitrust violations.”<sup>11</sup> The Court reasoned that California antitrust laws should be interpreted to deter anticompetitive behavior – even if such deterrence results in a “windfall” to plaintiffs.<sup>12</sup> The overarching policy goals of strongly deterring antitrust violations, ensuring enforcement of the State’s antitrust laws, and providing for the full disgorgement of any improperly gained proceeds weighed heavily against a finding that the pass-on defense should be available to California antitrust defendants.<sup>13</sup>

Although the facts of *Clayworth* did not present such a situation, the Court speculated that direct or intermediary purchasers that passed on an overcharge may still have suffered an injury, for example by losing overall sales as a result of raising prices because of the overcharge, even if they paid none of the overcharge themselves. The defense should not be allowed to defeat direct or intermediary plaintiffs’ claims in such cases.<sup>14</sup>

The Court recognized two limited circumstances in which the defense may be available. First, the Court noted that *Hanover Shoe* recognized an exception for “cost-plus” contracts, and given the California Legislature’s endorsement of the federal rule in *Hanover Shoe*, the Court stated that the exception for cost-plus contracts would also apply under California law.<sup>15</sup> Second, the Court noted that in cases where direct and indirect purchaser plaintiffs from multiple levels of the distribution chain are entitled to damages, defendants would be permitted to raise the pass-on defense to prevent double recovery.<sup>16</sup> Neither of these two exceptions applied to the facts in *Clayworth*, however, and the Court did not address the scope of these exceptions.

With respect to the UCL claims, the Court found that the plaintiffs had “standing” to sue under the UCL because the voters of Proposition 64 “plainly preserved standing for those who had had business dealings with a defendant and had lost money or property as a result of the defendant’s unfair business practices.”<sup>17</sup> The Court also found that the plaintiffs had not waived and can continue to seek injunctive relief under the UCL.<sup>18</sup>

---

<sup>11</sup> *Id.* at 784.

<sup>12</sup> *Id.* at 783.

<sup>13</sup> *Id.*

<sup>14</sup> *Id.* at 785-86.

<sup>15</sup> *Id.* at 787.

<sup>16</sup> *Id.* (“In instances where multiple levels of purchasers have sued, or where a risk remains they may sue, trial courts and parties have at their disposal and may employ joinder, interpleader, consolidation, and like procedural devices to bring all claimants before the court. In such cases, if damages must be allocated among the various levels of injured purchasers, the bar on consideration of pass-on evidence must be lifted; defendants may assert a pass-on defense as needed to avoid duplication in the recovery of damages.”).

<sup>17</sup> *Id.* at 788.

<sup>18</sup> *Id.* at 789-90.

The decision is likely to make California state antitrust law and California state courts more attractive to antitrust plaintiffs, including indirect purchasers.

## Implications

There will be much critical analysis of *Clayworth* in the coming months and years. Corporate counsel should be aware that antitrust plaintiffs will almost certainly be emboldened by the Court's language regarding the importance of deterrence and particularly the Court's allowance for possible plaintiff "windfalls." The decision is likely to make California state antitrust law and California state courts more attractive to antitrust plaintiffs, including indirect purchasers. However, while defendants, with a few exceptions, will not be able to rely on the pass-on defense to defeat claims brought by plaintiffs at only one level of the distribution chain, the Court recognized that pass-on evidence could be considered in apportioning damages, which could result in reduced damages awards and avoid duplicative recovery.

In addition, it remains to be seen whether the Court's decision marks the end of the pass-on defense in California courts, or if the decision will give it new life because of the exceptions identified in the opinion, which may be raised in many cases. Since the Court did not address the scope of these exceptions or explain how California courts are to manage coordinating and managing the claims of plaintiffs at multiple levels of the distribution chain, the decision promises to present significant case management challenges in the future.

In addition, it remains to be seen whether the Court's decision marks the end of the pass-on defense in California courts, or if the decision will give it new life because of the exceptions identified in the opinion, which may be raised in many cases.



Beatrice B. Nguyen is a partner of Crowell & Moring LLP.



Chahira Solh is an associate of Crowell & Moring LLP.

Copyright 2010, American Bar Association. The contents of this publication may not be reproduced, in whole or in part, without written permission of the ABA. All requests for reprint should be sent to: Director, Copyrights and Contracts, American Bar Association, 321 N. Clark, Chicago, IL 60654-7598, FAX: 312-988-6030, e-mail: [copyright@abanet.org](mailto:copyright@abanet.org).

The Antitrust Counselor is published quarterly by the American Bar Association Section of Antitrust Law, Corporate Counseling Committee.

The views expressed in The Antitrust Counselor are the authors' only and not necessarily those of their employers, the American Bar Association, the Section of Antitrust Law or the Corporate Counseling Committee. If you wish to comment on the contents of The Antitrust Counselor, please write to:

The American Bar Association,  
Section of Antitrust Law, 321 North  
Clark Street, Chicago, IL 60654

Nothing contained in this Newsletter is to be considered to be the rendering of legal advice for specific cases, and readers are responsible for obtaining such advice from their own legal counsel.

You may also contact us by emailing our editor, Anita Banicevic at [abanicevic@dpv.com](mailto:abanicevic@dpv.com).