COURTS AND AGENCIES REFINE U.S. ANTITRUST LAW

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Government enforcement action and private antitrust litigation have remained active in the U.S., despite predictions that the Bush administration would take a more relaxed posture towards antitrust enforcement and that a soft economy would lead to less transactional activity. Most notably, the U.S. Supreme Court, which had not considered an antitrust case in over five years, decided three antitrust cases in its 2003-04 term. The Court recast in sweeping terms the analysis of monopolization claims, limited the reach of U.S. courts to rule on damage claims by non-U.S. claimants, and opened U.S. courts to discovery proceedings to aid private parties before the European Commission. In addition, U.S. courts and agencies struggled with bundling and tying questions that have broad pricing implications for a range of businesses, including those in banking and financial services. On the merger front, strategic consolidations have continued to get careful antitrust review from the agencies, with a renewed, if uneven, attention to the coordinated-effects theory. There are also some signs that the enforcement agencies are taking a more flexible and practical approach to remedies that both address competitive concerns and retain merger efficiencies.

Enforcement activity remains robust at the agencies

The number of transactions reported pursuant to the Hart-Scott-Rodino Antitrust Improvements Act of 1975 (the HSR Act) dropped again in 2003, after similar declines in 2002 and 2001. In 2003, 1,014 transactions were reported to the U.S. agencies, a big drop from the high of 4,537 established in 2000. Two principal reasons explain the downturn. First, the increase in the statutory size-of-transaction threshold in the HSR Act has excluded otherwise reportable transactions from notification requirements. Second, the economic slowdown has led to fewer transactions overall.

The enforcement agencies have continued to conduct preliminary reviews of reportable transactions on a percentage basis consistent with, if not slightly higher than, historical averages achieved under the Clinton administration. During the Clinton years, regulators sought clearance to investigate 17% of the transactions notified to them under the HSR Act; clearance requests have increased to 21% of transactions since the start of the Bush Administration. Second requests continued to be issued in about 4% of all transactions notified. Interestingly, the Antitrust Division and Federal Trade Commission (FTC) actually challenged 3.3% of transactions that were eligible to receive a second request in 2002 to 2003, a higher rate of enforcement activity than in any year of the Clinton administration. All of this reflects a

broad, non-political consensus on antitrust policy that is not likely to be affected by the outcome of the U.S. elections.

New FTC chairman

After Tim Muris's decision to step down as FTC chairman, the White House appointed Deborah Platt Majoras, an experienced antitrust policy-maker and private practitioner, as his replacement. Majoras previously served along with R. Hewitt Pate, the ongoing head of the Antitrust Division, as deputy assistant attorney-general. She served as chair of the International Competition Network's Mergers Working Group and, among other responsibilities, was involved in the Antitrust Division's merger review process initiative and the mergers best practices project.

Under outgoing chairman Muris, the FTC had become a more visible enforcer of the antitrust laws. In particular, Muris sought to strengthen the agencies' emphasis on coordinated-effects analysis in merger investigations. Majoras' appointment is expected both to ensure a smooth transition and to continue these trends.

Leveraging, bundling and tying

The Supreme Court, lower courts and the enforcement agencies have struggled with pricing issues analyzed as *price bundling*, *tying* and *leveraging*, leaving considerable uncertainty in the application of antitrust principles to these practices.

Firms with monopoly power (and especially those firms that control an *essential facility*) that use exclusionary and competitively unjustified means to maintain or expand their monopoly position have been found liable for illegal monopolization. Moreover, firms that engage in anticompetitive activities with the specific intent of gaining a monopoly position have been found liable for attempted monopolization if there is a dangerous probability that the firm will succeed. Belatedly, firms with market power in one product can be held liable for illegal tying if they use that power to coerce a customer to take an unwanted product and that tie has an appreciable effect in the market of the second product. The Supreme Court has curtailed the application of monopolization and attempted monopolization theories under the essential-facilities and monopoly-leveraging doctrines. At the same time, the Supreme Court declined to review a Circuit Court decision that found a monopolist's bundled pricing to be illegal.

Verizon Communications Inc. v. Law Offices of Curtis V. Trinko

In his *Trinko* opinion, Justice Scalia recast much of the jurisprudence concerning unilateral refusals to deal by monopolists under Section 2 of the Sherman Act. In *Trinko*, a class of consumers representing New York City customers of AT&T sued Verizon, a monopolist over access to the local loop, for its failure to give AT&T, a recent entrant in the local telephone service market, non-discriminatory access to the local loop. The plaintiffs alleged that Verizon's

refusal to share with AT&T access to Verizon's systems and support operations impaired AT&T's ability to provide a competitive service. Stated differently, Verizon, according to plaintiffs, used its monopoly power in one market to deny competitive access to an adjacent market. The Second Circuit found that Verizon's conduct raised a viable monopolization or attempted monopolization claim. The Supreme Court disagreed.

Among other things, *Trinko* might signal the end of the monopoly-leveraging doctrine. Overruling *Berkey Photo* in a brief footnote, the Court rejected all monopoly leveraging claims where the plaintiff failed to establish a dangerous probability of monopolization of a second market. Thus defined, monopoly leveraging claims are nothing more than attempted monopolization by a monopolist and therefore superfluous.

The Court also drastically limited the scope of the essential-facilities doctrine. Positioning *Aspen Skiing* at the "outer boundary of Section 2 liability", the Court effectively imposed a sacrifice test as part of a plaintiff's burden of proof. In short, plaintiffs claiming Section 2 liability for denial of access to an essential facility will now need to show that the defendant sacrificed short term profits or some other economic benefit to injure or exclude the plaintiff. *Trinko* brings unilateral refusals to deal jurisprudence into line with more mainstream predatory pricing cases.

LePage's, Inc. v. Minnesota Mining & Mfg. Co.

The Third Circuit's decision in *LePage's* decided the issue of whether above-cost pricing of bundled products by a monopolist can constitute illegal monopolization. In *LePage's*, defendant 3M possessed a monopoly in the U.S. market for transparent tape under the Scotch brand name. LePage's entered the market as a competitive producer of private label tape for large retailers and, by selling its tape at a much lower cost, LaPage's quickly gained market share. In response, 3M implemented a multi-product bundled rebate programme in which large retailers were offered substantial rebates based on their total purchases in various 3M product lines. While these rebates amounted to only a fraction of the individual price (ranging from 0.2% to 2%) and, importantly, did not result in 3M pricing any product below cost, the programme yielded big incentives for participating retailers. Critically, if a retailer failed to meet its target for any single product included in the programme, the retailer would lose its rebate across the entire programme.

One of the designated products in the 3M rebate programme was transparent tape. Internal 3M documents indicated that the primary purpose of the rebate programme was to kill private label tape competition. These documents further made plain that once competition was driven from the marketplace, 3M intended to raise the price of transparent tape to more profitable levels. After the rebate programme was introduced to the market, LePage's market share fell and other smaller competitors were driven from the marketplace altogether. LePage's countered by suing 3M for illegal monopolization, claiming that 3M's bundling scheme had effectively excluded them from access to essential large retailers. In

affirming the jury's finding for LePage's, the Third Circuit greatly expanded, and perhaps confused, the law of non-price predation under Section 2.

In short, the Court rejected 3M's argument that under the well-recognized rule of *Brooke Group*, above-cost pricing can never constitute illegal monopolization. The court declared that *Brooke Group*; does not effectively bless all above-cost pricing schemes; only applies to oligopolies and not to monopolists; and only applies if the plaintiff has made a claim for predatory pricing. The Court then proceeded to analyze the merits of LaPage's claim. Relying heavily on 3M internal documents produced during discovery, the Court found that 3M had no reasonable business justification for engaging in its bundling scheme. Based on this finding, the Court ruled that, under the specific facts proven at trial, because 3M foreclosed its rivals in specific product lines by offering bundled rebates and discounts conditioned on requiring customers to buy across a range of product lines, the jury was justified in finding that 3M's conduct constituted illegal monopolization.

The *LePage's* analysis exposes any firm that may be deemed to possess a monopoly position in a market to an increased risk of liability if its bundling programme substantially lessens a rival's sales or is intended to drive competition from the marketplace.

The Supreme Court, at the government's urging, declined to review the *Le Page's* decision to allow the issue of how to treat bundling claims to further develop in the lower courts. Until such time that the Supreme Court reviews this analysis, firms will need to be cautious whenever adopting bundled discount programmes.

The Antitrust Division opines on bank tying

Even as the Third Circuit struggled to come to grips with the economic consequences of sophisticated non-linear pricing schemes in *LaPage's*, the Antitrust Division and the Federal Reserve Board debated the proper scope of the historical limitation of a different kind of bundling: tying commercial loans with investment banking services.

As a result of the Gramm-Leach-Bliley Act 1999, commercial banks and their investment bank affiliates now can provide complementary financial products and services to their customers. This practice, which is known as relationship banking, may involve a bank holding company's commercial bank subsidiary extending what has become low margin commercial credit to a corporate borrower while that same borrower receives higher margin investment banking or underwriting services from the bank holding company's investment bank affiliate. As stated in an October 2003 report by the General Accounting Office, some investment banks (that generally do not engage in low margin syndicated lending and whose investment banking business is threatened) have complained that commercial banks are tying the availability of bank credit to investment banking services by the commercial bank's affiliate in violation of Section 106 of the Bank Holding Company Act Amendments 1970 (the BHCA). The alleged tying of commercial credit to underwriting services – an allegation that the bank

holding companies vigorously deny – is not likely to be actionable under the Sherman Act because no commercial bank is likely to have enough economic power in the tying product market (that is, commercial credit) to effect an illegal, coercive tie.

This issue, which is of strategic importance both to bank holding companies and to investment banks, is currently playing out at the Federal Reserve Board. The Board has proposed an interpretation of Section 106 that notes that relationship banking (that is, cross-marketing of services by banks and their affiliates) is not, in and of itself, a violation of the bank tying provision but that leaves many practical issues unresolved. The Antitrust Division submitted its comments on the Federal Reserve Board's proposed interpretation, expressing concern that the proposed interpretation of Section 106 may restrict the ability of banks to bundle products at a discount. Accordingly, the Antitrust Division urged the Board to apply the rules of antitrust law to its interpretation of Section 106 rather than impose more restrictions and inconsistent obligations on affected financial institutions. The Board has not taken a final position on these issues.

The Supreme Court restricts antitrust standing for non-U.S. Claimants: *F. Hoffmann-La Roche Ltd. v. Empagran S.A.*

The Supreme Court also allayed concerns that non-U.S. victims of certain cartels could pursue treble damage claims in U.S. courts. The Supreme Court's *Empagran* decision denied antitrust standing under the U.S. Foreign Trade Antitrust Improvements Act (the FTAIA) to foreign plaintiffs injured solely by the effect on foreign commerce caused by the defendant's conduct. In *Empagran*, a class of foreign plaintiffs alleged a worldwide price-fixing and market-allocation conspiracy concerning the vitamins market. Critically, the *Empagran* plaintiffs suffered injuries that were unrelated to the U.S. effects of the alleged conspiracy. Declining to open U.S. federal courts to worldwide jurisdiction, Justice Breyer, writing for a unanimous Court, held that FTAIA did not extend the reach of the Sherman Act to such foreign commerce and remanded the case to the lower court to determine whether the plaintiffs' foreign injury was caused by the domestic effects of the defendants' conduct.

The Supreme Court opens U.S. courts to discovery proceedings to aid foreign claimants: *Intel v. Advanced Micro Devices*

In a recent but little-noticed decision, the Supreme Court upheld the Ninth Circuit's opinion that 28 U.S.C. § 1782(a) authorizes a federal district court to engage in discovery proceedings to aid private parties in proceedings before the European Commission. In *Intel*, AMD sought to discover documents produced by Intel in a private litigation in Alabama to assist in the preparation of its complaint to the Commission. While the Commission not only denied AMD's petition to order their production but also further represented to the Court that it did not even want to review the documents requests, Justice Ginsburg affirmed the decision to allow the requested discovery to proceed. In particular, the Court declined to impose an additional threshold requirement under Section 1782 that would

require the movant to show that the requested documents were also obtainable through the discovery mechanisms of the foreign jurisdiction. Moreover, the Court ruled that Section 1782 applied to discovery requests made by complainants who are not technically litigants in the relevant foreign proceeding. Lastly, the Court held that the Commission qualified as a tribunal as it acted as a first-instance decision-maker.

The Court noted in dicta certain factors to assist a district court in ruling on a motion under Section 1782, but the consequence of the *Intel* decision are potentially far-reaching. The immediate practical implication is that private parties that complain to the European Commission may not have to solely rely on Article 11 requests issued by the Commission to develop the factual basis for their complaint. The final scope of the decision depends on the rigor with which the lower courts will apply the *Intel* factors.

Important recent merger cases

Oracle/PeopleSoft

Earlier this year, the Antitrust Division, joined by seven state attorney generals sued to enjoin the proposed merger between Oracle and PeopleSoft. The Antitrust Division argued that Oracle and PeopleSoft are two of only three (the third is SAP) worldwide competitors in the market for enterprise software, high-function human resource management and financial management services software (HRM and FMS, respectively) designed to be integrated into suites of associated functions from a single vendor with performance characteristics that meet the demands of large customers. For these customers, the Antitrust Division found that off the shelf HRM and FMS products are not viable substitutes. Thus, the Antitrust Division concluded that reducing the competitive market from three to two participants would lead to higher prices and reduced innovation. Oracle challenged the Antitrust Division's market definition, arguing that under the correct definition, which would include low-function HRM and FMS software, the evidence would show that the market is highly competitive and not concentrated.

In pointed language, on September 9 the District Court rejected the Antitrust Division's market definition as unrealistically narrow and denied the government's request to enjoin the transaction. At press time, the Antitrust Division had not yet announced whether it will appeal the ruling.

Cephalon/Cima Labs

The FTC's settlement of its investigation of the proposed acquisition of Cima Labs by Cephalon may indicate that the FTC has backed away from its long-standing objection to licensing remedies to fix competitive concerns raised by mergers in highly concentrated industries. Cephalon held a monopoly position in the manufacture and sale of prescription drugs to treat breakthrough cancer pain (BTCP). Cephalon's BTCP product, Actiq, is scheduled

to go off patent in 2006. Cima Labs is in Phase III clinical trials for OVF, a new BTCP drug, which is scheduled to enter the market in 2006 or 2007. The FTC concluded that the transaction would substantially lessen competition in the BTCP market.

Rather than insisting on a divestiture, the FTC accepted a more limited remedy by which Cephalon agreed to grant a license to a third party to develop a generic version of Actiq. The FTC sought to distinguish this case from its historical resistance to sacrificing expected competition between two brand name products in exchange for expedited entry of a generic product. The FTC explained that the biggest anticompetitive effect of the transaction would be to defeat generic competition. Through its control over both products, Cephalon could move patients to the patent-protected OVF, thereby defeating the full competitive effect of eventual entry of a generic version of Actiq. This fact, in addition to the low likelihood of further competitive innovation between the parties in BTCP drugs, counselled in favor of accepting a licensing remedy designed to expedite generic entry rather than a divestiture of one of the branded drugs.

Despite the FTC's efforts to label this case as a *sui generis* exception to the agency's strong preference for a divestiture remedy, it is likely that players in markets with only three or four competitors might now be emboldened to test the FTC's new-found willingness to explore creative solutions for difficult transactions.

Arch Coal/Triton Coal

The D.C. District Court's decision to deny the FTC's request for a preliminary injunction preventing Arch Coal from acquiring Triton Coal may have far-reaching effects if affirmed by the D.C. Circuit. In sum, the decision casts doubt on the application of the coordinated-effects theory of merger control. Historically, the FTC has persuasively argued that it is entitled to a temporary injunction once it establishes that a transaction exceeds the relevant Herfindahl-Hirschman Index ("HHI") thresholds set forth in its 1992 Horizontal Merger Guidelines for assessing the competitive impact of a proposed transaction on concentration in a market. In *Arch Coal*, the Court accepted the FTC's market definition and its conclusion that the post-merger concentration would exceed the merger guidelines thresholds (the HHIs would range from 2292 and 2365, with an increase of between 163 to 224). Nevertheless, the Court held that the FTC's *prima facie* case was not strong and reduced the burden of proof on the parties opposing the FTC's motion.

Moreover, the Court found that the FTC was not likely to succeed on its theory that the transaction would lead to coordinated restriction of output in the marketplace. In short, the Court imposed on the FTC the burden to show that the market participants had a propensity towards tacit collusion and that the market supported the participants' ability to monitor each other's behavior. Thus, the Court's reasoning implies that in the absence of either evidence of prior examples of coordination or strong proof of market transparency, the FTC cannot establish that a transaction will cause coordinated effects.

The D.C. Circuit Court rejected the FTC's emergency motion for an injunction pending its appeal.

Courts are cautious in applying the antitrust laws when dealing with regulated industries

In the IPO Antitrust Litigation, the District Court for the Southern District of New York dismissed putative class actions based on the implied-immunity doctrine. Individuals who had purchased shares of certain technology securities alleged that 10 investment banks that underwrote the initial public offerings for those securities had conspired to inflate artificially the after-market prices for the IPO shares. These plaintiffs had brought separate lawsuits alleging that the underwriters violated the Federal Securities Laws in connection with the same conduct. The Security Exchange Commission had also investigated the conduct, and had entered into various consent agreements with the financial institutions.

The District Court dismissed the antitrust claims and applied the implied immunity doctrine because the conduct fell within the SEC's authority and application of the antitrust laws and securities laws might result in a conflict. The Court's decision, which is on appeal to the Second Circuit Court of Appeals, is therefore consistent with the Supreme Court's cautious approach in *Trinko*, where the Court gave deference to a regulatory scheme in determining the extent to which regulated conduct could constitute a basis for an antitrust violation.