



Antitrust Update

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The FTC Flexes Its Section 5 Muscles in Intel Case

By Dotan Weinman

On December 16, 2009, the Federal Trade Commission (“FTC”) filed a controversial administrative complaint against Intel Corp.¹ After conducting an investigation, the FTC charged that Intel had unlawfully used its dominance in the personal computer microprocessor market to entrench its monopoly in that market and has taken steps to extend it to other markets. Intel has been attacked on several fronts. The FTC administrative complaint was filed one month after Intel agreed to pay \$1.25 billion to its main competitor, Advanced Micro Devices (“AMD”), to settle a civil suit involving similar antitrust allegations. Intel has also been accused of similar antitrust violations by the European Commission (“EC”), where it is currently appealing a \$1.45 billion fine (the largest fine ever imposed by the EC), and by the New York State Attorney General. The FTC’s charges, brought principally under Section 5 of the FTC Act as an “unfair method of competition,” though claims under Section 2 of the Sherman Act were also asserted, go beyond the allegations in the civil suit and EC action, and clearly signal the FTC’s intent actively to pursue an expansive reading of its Section 5 jurisdiction.

The Administrative Complaint

In its administrative complaint, the FTC alleges that Intel waged a systematic campaign to block its competitors’ access to the market. The complaint alleges a broad range of allegedly anticompetitive behavior, among other things, (1) instituting a system of threats and rewards aimed at leading personal computer manufacturers, including incentives to avoid purchasing central processing units (“CPUs”) manufactured by Intel’s competitors; and (2) redesigning “compiler” software to make it falsely appear that competing CPUs were inferior to Intel’s.²

In addition, moving beyond the scope of the parallel antitrust challenges by AMD, the EC and the New York Attorney General, the FTC charges that Intel also employed similar allegedly unlawful practices against manufacturers of graphics processing units (“GPUs”) – chiefly Nvidia – and related products that could pose a threat to Intel’s monopoly power. The complaint alleges a “dangerous probability” that Intel’s unfair methods of competition could allow it to obtain a monopoly in the GPU microprocessor market.³

In its complaint, the FTC seeks extensive relief, including an order preventing Intel from using threats, bundled prices and other means that allegedly encourage exclusive dealing. It also proposes that Intel be required to submit certain business decisions for FTC pre-approval and that the FTC be allowed to monitor many of Intel’s practices.

Treading Beyond the Reach of the Sherman and Clayton Acts

The complaint reflects an evolving FTC effort to use Section 5 to challenge conduct that may fall short of the reach of the Sherman and Clayton Acts. Indeed, the FTC declares at the outset of the complaint that Section 5 confers on the FTC “a unique role in determining what constitutes unfair methods of competition” and also provides it with the power “to stop in their incipiency” acts that, if allowed to continue,

manufacturers] below cost,” the FTC argues that proof of recoupment “is not a necessary element [of predatory pricing] under a Section 5 claim.”⁷

Another example of the FTC’s intent to reach beyond the scope of the Sherman and Clayton Acts is its “course of conduct” allegations against Intel. The complaint alleges that when a monopolist “engages in a course of conduct tending to cripple rivals or prevent would-be rivals from constraining its exercise of that power, and where such conduct cumulatively

discretion and expertise to use Section 5 to reach such a course of conduct.”¹¹

In an accompanying statement outlining the rationale for bringing a stand-alone Section 5 unfair method of competition claim, Chairman Leibowitz and Commissioner Rosch explain that the FTC had chosen to pursue such claims in response to recent court decisions limiting the antitrust relief available to private plaintiffs under the Sherman Act.¹² Consequently, the Commissioner argues, “some conduct harmful to consumers may be given a ‘free pass’ under antitrust jurisprudence, not because the conduct is benign but out of a fear that the harm might be outweighed by the collateral consequences created by private enforcement.”¹³ Thus, said Chairman Leibowitz and Commissioner Rosch, “it is more important than ever that the Commission actively consider whether it may be appropriate to exercise its full [and unique] Congressional authority under Section 5.”¹⁴

The FTC’s decision to pursue its case against Intel primarily under Section 5 may have been impelled by the ultimate failure of the Commission’s high profile case against Rambus.¹⁵ The FTC proceeded there primarily under Section 2, alleging that Rambus intended to monopolize the market for certain types of DRAM technology by inducing a standard setting organization into adopting a standard which incorporated patents that Rambus had failed to disclose and, thereafter, asserting its patents against companies that sold products that utilized the standard. The D.C. Circuit held that the FTC failed to demonstrate that Rambus’s conduct was exclusionary – a necessary element under Section 2 of the Sherman Act.¹⁶ Whether the Commission could have proceeded against Rambus on a Section 5 “unfair

The FTC seeks to bar Intel from using threats, bundled prices and other devices that allegedly encourage exclusive dealing. It also wants Intel to be required to obtain FTC approval on some business decisions.

would violate the Sherman and Clayton Acts.⁴ For example, the FTC alleges that Intel’s offer of volume or market share discounts resulted in “taxing” purchases of non-Intel CPUs.⁵ The FTC thereby departs from case law that considers above marginal cost discounting to be legitimate hard competition rather than “predatory.”

In charging Intel’s discounts as “predatory,” the FTC defines the minimum cost threshold that Intel must adhere to as “average variable cost *plus* an appropriate level of contribution toward sunk costs.”⁶ The complaint, however, does not contain any allegations that further illuminate what the FTC means by an “appropriate level of contribution.” Nevertheless, it is quite clear that the FTC is asserting a lower pleading standard of proof under Section 5. In that regard, it should be noted that while the complaint alleges that Intel “is likely to recoup any losses that it suffered as a result of selling any of its products to certain [computer

or individually has anticompetitive effects or has a tendency to lead to such effects, that course of conduct falls within the scope of Section 5.”⁸ It alleges that, even if each of Intel’s alleged practices are not anticompetitive on their own, “collectively, [they] had the tendency to hamper and exclude rivals, and to maintain, create, or enhance Intel’s monopoly power in the relevant markets.”⁹ In his Concurring and Dissenting Statement, Commissioner Rosch notes that “a number of courts have disparaged ‘course of conduct’ claims made under Section 2 [of the Sherman Act] as mere ‘monopoly broth’ claims or claims that ‘0 plus 0 plus 0 equal 1.’” Indeed, as recently as last year, the Supreme Court in *LinkLINE* rejected a “course of conduct” type claim, holding that two lawful acts (above-cost discounts and refusal to deal) could not, in combination, make out a Section 2 “price squeeze” violation.¹⁰ For Commissioner Rosch, however, the courts’ interpretation of Section 2 further “militates in favor of the Commission exercising its

method of competition” theory is an open question, but it is quite clear that one of the objectives of the Intel challenge is to confirm (or establish) that Section 5 of the FTC Act is more fluid (and perhaps less predictable in application) than Section 2 of the Sherman Act.

Even if each of Intel’s alleged practices are not anticompetitive on their own, “collectively, [they] had the tendency to hamper and exclude rivals, and to maintain, create, or enhance Intel’s monopoly power in the relevant markets.”

Commissioner Rosch’s Dissent

Commissioner Rosch dissented from the Commission’s choice to include “tag-along” claims under Section 2 of the Sherman Act, arguing that, for policy reasons, including preserving the FTC’s freedom to assert Section 5 claims without encouraging derivative private antitrust litigation (private plaintiffs cannot use a Section 5 finding as prima facie evidence of an antitrust violation). Commissioner Rosch would therefore have preferred that the FTC proceed solely under Section 5.¹⁷

Expedited Administrative Trial

Procedurally, the FTC brought its suit against Intel as an administrative

action (as opposed to filing in federal court). Thus, the case will be heard before a single administrative law judge (“ALJ”) within the FTC. This move may reflect a desire by certain commissioners to restore administrative trials as an important component of the FTC enforcement function, especially where the charges are brought under Section 5. The ruling of the ALJ can be appealed to the five FTC Commissioners (the same commissioners who voted to file the complaint), who act as appellate judges. The Commissioners’ decision, in turn, can ultimately be challenged in a federal appeals court. Pursuant to the FTC’s recently updated Part 3 Rule of Practice, the Intel case is subject to an expedited schedule, with an administrative trial on the merits currently scheduled for September 15, 2010 and a Commission appellate decision expected within approximately twenty months.

Conclusion

The FTC’s action against Intel makes it clear that the FTC intends to pursue an aggressive interpretation of its Section 5 powers. The action may also spur more private litigation. While the FTC Act does not provide for a private right of action, numerous states have enacted acts modeled on the FTC Act (commonly known as “Little FTC Acts”), which do allow private damages actions.¹⁸ Ultimately, the federal courts may have the opportunity to weigh in on the FTC’s evolving aggressive approach. It should be noted that the FTC’s previous attempt to extend its

Section 5 authority beyond the Sherman and Clayton Acts – in the early 1980s – was generally rejected by the federal courts.

- 1 *In the Matter of Intel Corp.*, No. 9341 (“Complaint”), available at www.ftc.gov/os/adjpro/d9341/091216intelcmpt.pdf.
- 2 Complaint ¶¶ 56-61.
- 3 Complaint ¶ 91.
- 4 Complaint ¶ 1.
- 5 Complaint ¶ 53.
- 6 Complaint ¶ 53 (emphasis added). The complaint does not elaborate and/or define the “appropriate level of contribution toward sunk costs.”
- 7 *Id.* Recoupment is a necessary element of a Sherman Act Section 2 claim.
- 8 Complaint ¶ 1.
- 9 Complaint ¶ 47. *See also, Concurring and Dissenting Statement of Commissioner Rosch* at 2 (available at www.ftc.gov/os/adjpro/d9341/091216intelstatement.pdf) (“Rosch’s Statement”), arguing “it is improper to slice and dice each constituent part of the alleged course of conduct to determine whether it, standing alone, had the purpose or effect to hinder competition and injure consumers in violation of Section 2” of the Sherman Act.
- 10 *Pac. Bell Tel. Co. v. linkLINE Comm., Inc.*, 129 S. Ct. 1109 (2009).
- 11 *Id.*
- 12 *Statement of Chairman Leibowitz and Commissioner Rosch* (“Commissioners’ Statement”), available at www.ftc.gov/os/adjpro/d9341/091216intelchairstatement.pdf. The Supreme Court has heard 15 antitrust cases since 1993, holding for the defendants in each and every case. *See* Daniel A. Crane, *Antitrust Business Regulation: linkLINE’s Institutional Suspicions*, 2008-09 *Cato Sup. Ct. Rev.* 111.
- 13 Commissioners’ Statement at 1.
- 14 *Id.*
- 15 *See Rambus, Inc. v. FTC*, 522 F.3d 456 (D.C. Cir. 2008), cert. denied, 129 S. Ct. 1318 (2009).
- 16 *Id.* at 462.
- 17 Rosch’s Statement at 3.
- 18 Discussion of the Little FTC Acts is available on the FTC’s website at www.ftc.gov/os/comments/section5workshop/537633-00002.pdf.

DOJ and FTC Horizontal Merger Guidelines Workshops Explore Changes on Approach to Mergers

By Kristina Sadlak and Claire Webb

In September 2009, the Department of Justice (“DOJ”) and the Federal Trade Commission (“FTC”) (the “Agencies”) announced a series of hearings to explore the possibility of updating their Horizontal Merger Guidelines (the “Guidelines”). The Agencies are exploring whether the Guidelines accurately reflect current merger review practice and are considering substantive changes based on legal and economic developments that have occurred since the last significant revision to the Guidelines in 1992. The Guidelines are not expected to be radically overhauled, but modified to bring them into line with existing practice at the Agencies. The FTC’s Chair, Jon Leibowitz, has been quoted as saying that the changes “will be more evolutionary than dramatic.”¹

The review of the Guidelines was widely anticipated. In its Report and Recommendations released in 2007, the Antitrust Modernization Commission recommended that the Agencies update the Guidelines, and more recently, at the ABA Section of Antitrust Law 2009 Spring Meeting, Carl Shapiro, the new chief economist at the DOJ’s Antitrust Division, spoke of the need for revisions to the Guidelines.

Christine Varney, Assistant Attorney General, Antitrust Division at the DOJ (see remarks here), and FTC Chair Leibowitz (see remarks here) have noted that the review of the Guidelines will focus on three areas:

(1) Market Definition – whether to clarify the product and geographic market definitions in the Guidelines to reflect more accurately current Agency practice;

(2) Market Concentration – reviewing the relevance and utility of the current concentration (HHI) thresholds; and

(3) Competitive Effects – whether to revise the Guidelines to reflect current academic and economic learning regarding the treatment of unilateral effects in markets with differentiated products.

The role of market definition has generally proven useful throughout history and should therefore remain part of a revised set of Guidelines.

Prior to the workshops, the Agencies released Questions for Public Comment (available here), to which 48 responses have been submitted (available here).

As of this writing, five workshops are being held. The first three workshops were held in Washington, D.C. (December 3), New York (December 8), and Chicago (December 10). The workshop schedule, along with a list of panelists that participated in each workshop can be found here. Although each panel at the workshops focused on a different area, the following themes were common to several panels or were of particular note:

The Formalistic Nature of the Current Guidelines

Throughout the first set of workshops on December 3, 2009, the panelists consistently emphasized the importance of revising the Guidelines to reflect current Agency practice and

reflect new economic learning. In his opening remarks at the December 3 workshop, FTC Chair Leibowitz stressed that the existing Guidelines exaggerate the extent to which the Agencies use a step-by-step process to conduct merger analysis. The panelists also agreed that the current Guidelines are too formalistic, setting forth what appear to be a mandated step-by-step analysis, along with stringent sets of rules and presumptions.

The panelists generally suggested that rather than setting forth formalistic rules, the Guidelines should instead discuss the various analytical tools currently used by the Agencies in merger analysis. Along these lines, the panelists emphasized that the Guidelines should be revised to include discussions of: (a) the role of innovation markets; (b) the role of efficiencies; (c) how the Agencies review non-horizontal mergers; and (d) how the Agencies currently analyze unilateral effects cases.

The Role of Direct Evidence in Merger Analysis

One of the panels (on December 3), focused on aligning the Guidelines with current practice regarding how the Agencies treat “direct evidence” in their merger analysis. Direct evidence in a merger review provides an indication as to how the proposed (or consummated) merger will likely affect post-merger competition. In the case of a proposed, but unconsummated merger, such evidence could consist of internal company documents discussing the rationale for the merger, or the combined parties’ post-merger plans (such as pricing or manufacturing plans). In the case of a consummated

merger, direct evidence may also include econometric studies of how the merger has already affected competition. This could include, for example, econometric analyses of the parties' pre- and post-merger pricing practices. The 1992 Guidelines do not fully address the role of direct evidence in merger analysis, and the Agencies sought public comment on this issue in their Questions for Public Comment.²

The panelists agreed that the Guidelines should reflect the Agencies' current practice of placing significant weight on direct evidence in a merger analysis, and that the Guidelines could usefully provide examples of the types of direct evidence typically used in merger analyses.

Defining the Relevant Market

The current Guidelines provide a detailed methodology for defining the relevant product and geographic markets in which the merging parties compete. A common theme discussed throughout the December 3 panels was whether engaging in such a market definition analysis is necessary and useful in practice. It was suggested that where there is strong direct evidence regarding the likely or actual effects of a merger, it may not be necessary for the Agency or court to even go through the process of defining a relevant market.

Many of the panelists noted that even though the role of market definition has its limitations, it has generally proven useful throughout history and should therefore remain part of a revised set of Guidelines. Several of the panelists suggested that market definition tends to be more useful in analyzing the potential coordinated effects of a merger, and that the revised Guidelines might, therefore, downgrade the importance of market definition only in conducting a unilateral effects analysis.

Relevance and Utility of the Current HHI Thresholds

A common theme discussed in several of the panels was how the Herfindahl-Hirschman Index ("HHI") thresholds should be revised.

The current Guidelines provide that the post-merger HHI is used as an "aid to the interpretation of market data."³

New Guidelines could discuss the treatment of "failing" firms – firms not meeting the failing company requirements but nevertheless weakened as a competitor.

The Guidelines divide the spectrum of market concentration into three regions: unconcentrated (HHI below 1000), moderately concentrated (HHI between 1000 and 1800), and highly concentrated (HHI above 1800).

The current HHI thresholds in the Guidelines were criticized because (i) they are too low when compared to actual agency practice of whether to investigate or challenge a proposed merger; and (ii) HHI thresholds are not a sufficient demonstration of the likely competitive effects of a potential transaction.⁴ In comments submitted by the American Bar Association's Section of Antitrust Law, it was noted that the vast majority of challenges by the Agencies between 1999 and 2003 involved market concentration levels far above the Guidelines' thresholds.⁵

In the December 8 panel discussion, there was almost uniform agreement that the current HHI thresholds are too low. There was also a suggestion that the Agencies consider including different HHI thresholds for industries

that have typically been analyzed somewhat differently (e.g., healthcare and petroleum).

The panelists also discussed the challenges of using structural presumptions in dynamic industries with high innovation, when it may be difficult accurately to define the market. It was suggested that the Guidelines would benefit from commentary as to how the Agencies will approach structural presumptions in such markets.

Assessing Minority Ownership Interests

The treatment of minority interests in the Guidelines was considered by the December 8 panel. The current Guidelines are silent on the subject.

The panelists were asked if and when the acquisition of partial ownership interests should be analyzed as a merger under the Guidelines. The panelists had mixed views on this issue; some believed that while acquisitions of partial ownership can raise competitive issues (such as access to information and de facto control), they should not be treated as a merger under the Guidelines. Others believed that partial acquisitions that result in some form of control should be treated as a merger, but that there should be a safe harbor for purely passive investments (e.g., calculated on the percentage of stock ownership).

Application of the Failing Firm Defense

Section 5 of the current Guidelines discusses the treatment of failing and exiting assets, and lists four factors that must be satisfied for the failing firm defense. In their Questions for Public Comment, the Agencies asked if this section should be revised.

This topic was also considered by the December 8 panel. The panelists

discussed if and how the Guidelines should be revised regarding failing firms. Some panelists suggested that the burden of proof required to show two of the necessary factors (not being able to reorganize successfully under Chapter 11 of the Bankruptcy Act; and absent the acquisition, the assets would exit the relevant market) should be modified. It was also suggested that the Guidelines could discuss the treatment of “failing” firms – firms not meeting the failing

company requirements but nevertheless in a weakened or weakening state as a competitor.

- 1 John D. McKinnon & Brent Kendall, *Regulators Weigh New Merger Rules*, Wall St. J., Sept. 23, 2009, available at <http://online.wsj.com/article/SB125362797596530767.html>.
- 2 The types of direct evidence on which they specifically sought public comment are:
 - (a) For an already consummated merger, evidence of actual, adverse competitive effects; (b) evidence based on so-called “natural experiments,” such as variations across geographic markets, time periods, customer categories, or similar product markets showing

how customers are affected by competitive conditions whose variation may be comparable to the change to be wrought by the merger; (c) evidence of the merging firms’ post-merger plans; (d) evidence from customers about how they will respond to, and be affected by, the merger; (e) evidence that the merging firms have engaged in significant head-to-head competition leading to lower prices or other customer benefits; and (f) Historical evidence of actual or attempted coordination in the industry.

- 3 Merger Guidelines at Section 1.5.
- 4 See Comments of the ABA Section of Antitrust Law Regarding the Federal Trade Commission and Department of Justice Horizontal Merger Review Project, November 9, 2009.
- 5 *Id.* at 22.

Ninth Circuit Reaffirms its Holding in *PeaceHealth* but Leaves Door Open for Exclusive Dealing Claim

By Caitlin Somerman

Introduction

In *Masimo Corp. v. Tyco Health Care Group, L.P.*,¹ the Ninth Circuit suggested that the discount attribution standard laid down by the court in *Cardinal Health Solutions v. PeaceHealth*² may not be applicable in circumstances in which the conduct involves exclusive dealing. This may allow plaintiffs seeking to challenge the legality of bundling to avoid *PeaceHealth*’s below-cost test and have their claim assessed as an exclusive dealing claim, which, in some circumstances, may be easier to satisfy.

Background

Bundled discounts occur when a seller offers a bundle of two or more goods or services for a lower price than if the goods or services were purchased individually. Bundled discounts are pervasive and are often considered procompetitive because they allow consumers to realize lower prices. Bundled discounts can also be

anticompetitive when used by a monopolist to exclude a smaller competitor. How to distinguish between procompetitive and exclusionary bundling arrangements has long troubled courts and economists and remains an issue on which the Supreme Court has yet to opine.

In its *PeaceHealth* decision in 2008, the Ninth Circuit articulated a standard to determine whether a bundled discount should be considered “exclusionary” under Section 2 of the Sherman Act.³ The court held that bundled discounts are not exclusionary “unless the discounts result in prices that are below an appropriate measure of the defendant’s costs,”⁴ and adopted a “discount attribution test” that defines the appropriate measure of costs in bundled discount cases. Under the test, “a plaintiff who challenges a package discount as anticompetitive must prove that, when the full amount of the discounts

given by the defendant is allocated to the competitive product or products, the resulting price of the competitive product or products is below the defendant’s incremental cost to produce them.”⁵

Facts and Procedural History

In 2002, Masimo Corporation (“Masimo”) commenced an action against Tyco Healthcare Group L.P. (“Tyco”) and its subsidiary, Mallinckrodt, Inc., claiming that the companies violated Sections 1 and 2 of the Sherman Act and Section 3 of the Clayton Act by unreasonably restraining trade in the market for pulse oximetry systems.⁶ Pulse oximetry systems are medical devices used to measure a patient’s heart and lung functions. The pulse oximetry systems market consists of sensors that attach to a patient to measure oxygenation, patient cables, and pulse oximetry monitors that analyze the measured data.

Masimo alleged that certain of Tyco's business practices were anticompetitive. These business practices included:

- providing market share discounts to hospitals;
- entering into sole-source exclusive dealing arrangements with hospital group purchasing organizations, obligating their member hospitals to purchase pulse oximetry systems from Tyco;
- entering into co-marketing agreements with original equipment manufacturers that effectively required OEMs to manufacture monitors compatible only with Tyco's pulse oximetry systems;
- entering into financing agreements that imposed financial penalties on hospitals if they switched to a competitor's pulse oximetry technology before the end of the agreement; and
- offering bundled discounts.

With respect to Tyco's bundled discounts, Masimo asserted that Tyco offered hospitals the highest level of discounts if they committed to purchasing from Tyco a substantial portion (at least 90-95%) of their requirements in four unrelated product areas, including pulse oximetry systems. Masimo argued that, in order to compete in the market for pulse oximetry systems against Tyco's bundled discounts, it would have to sell its products substantially below cost. Masimo claimed that by offering substantial discounts contingent on buying a large portion of the hospital's requirements of a group of unrelated products from Tyco, Tyco induced hospitals to purchase their pulse oximetry needs from Tyco, thereby excluding competitors from the market.

In 2005, a jury found for Masimo, awarding it \$140 million in damages

(which would be trebled to \$420 million).⁷ The district court sustained the jury's liability award under Sections 1 and 2 of the Sherman Act and Section 3 of the Clayton Act, but ordered a new trial on damages and vacated the jury's award with respect to Tyco's co-marketing agreements and bundled discounts.⁸

While bundled discounts are not exclusionary unless below cost, different rules may apply where there is tying or exclusive dealing.

In its analysis, the district court concluded that since Tyco's bundled discounts were voluntary and customers remained able to purchase pulse oximetry systems separately, they did not constitute an unlawful exclusive dealing arrangement. The district court noted that "absent evidence of a tying arrangement or predatory pricing, there is nothing problematic about a company offering increased discounts if two or more products are purchased together."⁹ Breaking from the Third Circuit's standard in *LePage's, Inc. v. 3M* for evaluating bundled discount practices,¹⁰ the district court extended this reasoning to its Section 2 analysis as well.¹¹ Since Masimo did not argue that Tyco's bundled discounts were predatory or that they functioned as tying arrangements, and the district court concluded that there was insufficient evidence introduced at trial to support such a finding, the district court vacated the jury's award.

Masimo appealed, arguing that Tyco's bundled discounts should be viewed as exclusive dealing arrangements. Exclusive dealing arrangements violate the antitrust laws when they

are used to maintain a monopoly or foreclose competition in a substantial portion of the relevant market. Masimo argued that by conditioning its discounts on near-exclusive market share requirements, Tyco's bundled discounts resulted in de facto exclusive dealing arrangements.

The Ninth Circuit Decision

The Ninth Circuit affirmed the district court's decision and reaffirmed its recent holding in *PeaceHealth*.¹² The court applied *PeaceHealth's* discount attribution test to Tyco's bundled discounts and concluded that, because Masimo did not allege that Tyco had priced its pulse oximetry systems below an appropriate measure of Tyco's cost, Tyco's bundled discounts could not, as a matter of law, violate Section 2.

The court also addressed Masimo's claim that Tyco's bundled discounts should be viewed as de facto exclusive dealing arrangements. The court noted that "[d]espite the fact that this court has held that bundled discounts may not be considered exclusionary conduct unless they fail the discount attribution test, . . . *PeaceHealth* did leave open the possibility that application of the discount attribution test may be inappropriate 'outside the bundled pricing context, for example in tying or exclusive dealing case.'"¹³ The court gave merit to Masimo's argument, noting that Tyco's bundled discounts, which prevented customers from purchasing their requirements of pulse oximetry systems from a Tyco competitor in order to receive Tyco's discounts, could arguably constitute exclusive dealing arrangements. Nonetheless, the court held that the jury's liability verdict regarding Tyco's bundling arrangements could not be sustained because there was insufficient evidence on the record to find that the arrangements foreclosed competition in a substantial portion

of the pulse oximetry systems market, which is an essential component of a finding of an unlawful exclusive dealing arrangement.

Analysis

The Ninth Circuit's decision suggests that if Masimo had shown that Tyco's bundling practices foreclosed competition in a substantial share of the relevant market, the court could have sustained the jury's liability verdict regarding these practices. Thus, after leaving this issue open in *PeaceHealth*, the court's decision implies that in cases where plaintiffs allege that bundled discounts equate to exclusive dealing arrangements, *PeaceHealth's* discount attribution test is not the only test to be applied.

This leaves room for plaintiffs challenging arrangements in which the bundled discounts do not result in below-cost pricing.

- 1 Nos. 07-55960, 07-56017, 2009 WL 3451725 (9th Cir. Oct. 28, 2009).
- 2 515 F.3d 883 (9th Cir. 2008).
- 3 515 F.3d 883.
- 4 *Id.* at 903.
- 5 *Id.* at 909.
- 6 Complaint, *Masimo Corp. v. Tyco Health Care Group L.P.*, No. CV02-4770 MRP (AJWX), 2002 WL 33952793 (C.D. Cal. 2002).
- 7 The jury found Tyco's market share discounts, sole-source exclusive dealing arrangements, co-marketing agreements and bundled discounts to be anticompetitive under the antitrust laws; however, the jury found Tyco's financing agreements to be lawful.
- 8 *Masimo Corp. v. Tyco Health Care Group, L.P.*, No. CV-02-4770-MRP, 2006 WL 1236666 (C.D. Cal. Mar. 22, 2006).
- 9 *Id.* at *17 (citing *Jefferson Parish Hosp. Dist.*

No. 2 v. Hyde, 466 US 2, 11-12 (1984)).

- 10 324 F.3d 141, 156 (3d Cir. 2003) (citing *SmithKline v. Eli Lilly & Co.*, 575 F.2d 1056 (3d Cir. 1978)) (holding that bundled discounts violate Section 2 when they "link[] a product on which [the Defendant] face[s] competition with products on which it face[s] no competition").
- 11 2006 WL 1236666, at *24 (noting that "[t]here may be factual circumstances that warrant consideration of the antitrust implications of bundling practices, separate and apart from predatory pricing and tying, but those circumstances are not present in this case"). Additionally, the court noted that Masimo's argument would not have succeeded even under the standard set forth by the Third Circuit, because Masimo "failed to demonstrate that Tyco did not face competition in the non-oximetry products it included in some bundles." *Id.* at *23-24.
- 12 *Masimo Corp. v. Tyco Health Care Group L.P.*, Nos. 07-55960, 07-56017, 2009 WL 3451725 (9th Cir. Oct. 28, 2009).
- 13 *Id.* at *3 (quoting *PeaceHealth*, 515 F.3d at 916 n.27).

International Antitrust Update

2009: An Eventful Year for Merger Law in Canada

By Anthony F. Baldanza*

2009 was an eventful year for merger practice in Canada. This article discusses the most noteworthy developments.

Fundamental Changes to the Pre-merger Notification Regime in Part IX of the Competition Act

Part IX of the *Competition Act*¹ sets out the pre-merger notification regime. Prior to the *Bill C-10*² amendments, which for the most part came into effect on March 12, 2009, pre-merger notification was required only where a C\$400 million size-of-parties and a C\$50 million size-of-transaction threshold were exceeded. Effective March 12, 2009, the size-of-transaction

threshold was increased to C\$70 million.³ Moreover, the threshold will in the future be adjusted annually based on changes in national GDP.⁴ In fact, the threshold for 2010 is likely to be less than C\$70 million.

The previous 14- and 42-day waiting periods for short-form and long-form notifications have been replaced with a single process for merger notification and review that is similar to that in the United States under the *Hart-Scott-Rodino Antitrust Improvements Act of 1976*⁵ ("HSR"), whereby an initial 30-day waiting period applies but can be extended by the Commissioner of Competition (the

"Commissioner") issuing a supplementary information request ("SIR"), in which case completion is prohibited until 30 days after compliance with such request.⁶ The information required in connection with the merger notification requirement is to be outlined in amendments (that have yet to be implemented) to the *Notifiable Transactions Regulations*.⁷

The Canadian Competition Bureau ("Bureau") has stated that it does not anticipate issuing a large number of SIRs.⁸ We understand that five such requests were issued in 2009. Moreover, the *Merger Review Process Guidelines*⁹ effectively state that the Bureau prefers to restrict the use of SIRs (where they are needed) to mergers it classifies as "very complex".¹⁰ Our experience to date is consistent with that guidance. The new process eliminates the information gathering and timing

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problems that the Bureau was experiencing in connection with the section 11 (record and data production order) process, though section 11 orders still have a place in the merger review process.

The *Bill C-10* amendments also established a mechanism for the imposition of administrative monetary penalties of up to C\$10,000 per day for each day that a party, without good and sufficient cause, has completed a transaction prior to expiration of the applicable waiting periods, contrary to Part IX of the *Competition Act*.¹¹ This is in addition to the pre-existing (and as yet unused) ability of the Commissioner to impose a fine of up to C\$50,000 for failing to comply with the merger notification regime without good and sufficient cause.¹² It remains to be seen if and in what circumstances the new authority may be invoked.

Change to the limitation period for proceedings under the Competition Act in respect of completed mergers

Effective March 12, 2009, the *Bill C-10* amendments reduced the time the Commissioner has to challenge a merger before the Competition Tribunal (“Tribunal”) to one year after the merger’s substantial completion, down from three years.¹³

Draft Notifiable Transactions Regulations

On April 4, 2009, draft regulations amending the Notifiable Transactions Regulations were published for comment.¹⁴ The amendments are intended in large part to support the amendments to the *Competition Act* pre-merger notification provisions and also to accomplish long overdue housekeeping such as correcting outdated references. The most significant changes in the draft regulations

relative to the existing regulations (apart from the removal of information requirements for short and long form notifications) is the addition of requirements that copies of legal documents that are to be used to implement a notifiable merger transaction and studies, surveys, analyses and reports prepared or received by a senior officer

The merging parties carry the burden of proving that the claimed gains in efficiency are likely to occur, are merger specific and outweigh any anti-competitive effects.

of the notifying party or its relevant affiliates for the purpose of assessing the proposed transaction be supplied with the notification. This latter requirement is virtually identical to that in item 4c of the HSR Notification and Report Form¹⁵ and, in fact, the Bureau has accepted productions that have been tendered in satisfaction of item 4c as satisfying this requirement. The new regulations are expected to be promulgated in the near term.

Merger Review Process Guidelines

The guidelines describe the Bureau’s general approach to administering the two-stage merger review process established by the *Bill C-10* amendments. Specifically, they describe the process the Bureau will follow during the initial 30-day waiting period and after a decision to issue a SIR has been taken. Among other things, in relation to SIRs, the guidelines provide for a pre-issuance dialogue with the parties,¹⁶ limiting the number of custodians to be searched¹⁷ and limiting the time period to which record and data requests are to relate.¹⁸ All of this will be familiar

terrain for US antitrust lawyers.

The guidelines also borrow from the US the “timing agreement” device, which the Bureau may use where its review has not been completed within the initial 30-day waiting period and the Commissioner has elected not to issue a SIR.¹⁹ (Indeed, as we have already noted, the guidelines effectively state that the Bureau prefers to restrict the use of SIRs (where they are needed) to mergers it classifies as “very complex,” i.e. those raising significant competition concerns.²⁰) A timing agreement will address key milestones and production requirements.

Importantly, the guidelines stipulate that where multi-jurisdictional mergers give rise to reviews by multiple foreign competition agencies, the Bureau will, subject to certain conditions, generally agree to the production by the parties of data and records produced to foreign competition agencies in response to a Bureau SIR where such data and records are responsive to the SIR.²¹ Moreover, we understand the Bureau is amenable to harmonizing its SIR with an HSR second request where such will permit the Bureau to assess competitive effects in Canada.

Other devices used in Canadian merger law such as advance ruling certificates, no-action letters and service standards remain in place.

New Efficiencies Bulletin

In March 2009, the Bureau issued its *Bulletin on Efficiencies in Merger Review*²² (“Efficiencies Bulletin”), which is described as a “supplement” to the *Merger Enforcement Guidelines*.²³

By way of background, the *Competition Act* contains an efficiencies exception that provides that a merger that is likely to prevent or lessen competition substantially or has already done so, may nonetheless not be the subject of

a Tribunal order under the substantive merger provisions of the *Competition Act* if the merger has brought about or is likely to bring about efficiencies that are greater than and will offset the merger's anti-competitive effects, and those efficiencies would likely not be realized if the proposed Tribunal order were made.²⁴

Remedies may be structural, quasi-structural or behavioral and foreign enforcement remedies may suffice.

The Efficiencies Bulletin includes a description of the information that the Bureau states would be useful in its analysis of efficiency claims in general and clarifies its approach to, among other things, assessing dynamic efficiencies and gains in efficiency that are likely to be generated outside of Canada. Importantly, the Efficiencies Bulletin states that a thorough assessment of efficiency claims is only necessary in relation to those mergers that raise significant competition concerns.²⁵

The Efficiencies Bulletin states that the merging parties carry the burden of proving that the claimed gains in efficiency are likely to occur, are brought about by the merger, are greater than and offset the anti-competitive effects, and would not likely be attained if an order under the substantive merger provisions were made.²⁶

Merger Litigation and Consent Agreements

In contrast to 2008, which saw important merger litigation including in relation to the *Labatt-Lakeport*²⁷ merger and the *American Iron & Metal Company Inc.-SNF Inc.*²⁸ merger, there was no new merger jurisprudence in 2009. (The Bureau, after failing to

secure an injunction in relation to the *Labatt-Lakeport* merger and enduring the controversy attached to its application for a section 11 (production) order in relation to that same merger, decided in early 2009 not to challenge the merger based on "insufficient evidence to establish that the transaction is likely to substantially lessen or prevent competition."²⁹)

The Bureau has, however, secured the following five merger-related consent agreements in 2009:

- an agreement to divest a landfill in Alberta by Clean Harbors, Inc. in relation to its acquisition of Eveready, Inc., on the basis of concerns that the transaction would likely substantially lessen or prevent competition in Class I solid hazardous waste disposal in Alberta;³⁰
- an agreement by Pfizer and Wyeth to divest a significant number of animal pharmaceutical and vaccine products to Boehringer Ingelheim Vetmedica; in addition, Pfizer was to amend the terms of its arrangement with Paladin Labs governing the distribution, marketing and sale of Pfizer's human pharmaceutical product, Estring, to ensure continued competition in the supply of hormone replacement therapy products;³¹
- an agreement with Merck and Schering-Plough to divest to OPKO Health, a human health product in development for the treatment of chemotherapy-induced and post-operative side effects, and to divest Merck's interest in the Merial animal health business to Sanofi-Aventis;³²
- an agreement with Agrium Inc. in relation to its long-running and not yet consummated unsolicited bid for CF Industries, whereby Agrium

will, if it succeeds in its bid, divest half of its nitrogen-based fertilizer production facility in Carseland, Alberta to Terra Industries, a new entrant in Western Canada, and will supply a certain quantity of urea to Terra Industries pursuant to a five-year supply contract;³³ and

- in relation to Suncor's merger with Petro-Canada, an agreement for the divestiture of gasoline stations in Southern Ontario, the supply for a 10-year period of 1.1 billion litres of terminal storage and distribution capacity for refined petroleum products in the Greater Toronto Area, and a 10-year commitment to supply 98 million litres of gasoline to independent gasoline marketers.³⁴

In both the Pfizer-Wyeth and Merck-Schering Plough matters, there was close cooperation between the Bureau and the FTC.

The Bureau has adopted a flexible approach to resolution of merger issues, including accepting structural, quasi-structural and (occasionally) behavioural remedies and not insisting on a Canadian consent agreement where competition concerns in Canada are being adequately addressed by foreign competition law authorities.³⁵ For example, in the BASF acquisition of Ciba Holding AG, the Bureau concluded that commitments made to the FTC and the European Union Competition Directorate adequately addressed the Bureau's concerns respecting anticompetitive effects in the supply of certain pigments and no separate consent agreement for Canada was required.³⁶ A similar approach was adopted in relation to the Dow Chemical acquisition of Rohm and Haas.³⁷

1 R.S.C. 1985, c. C-34, as am. by Bill C-10, *Budget Implementation Act*, 2nd Sess., 4th Parl., 2009, (assented to 12 March 2009), S.C. 2009, c. 2.

- 2 *Bill C-10, ibid.*
- 3 *Competition Act*, s. 110(7).
- 4 *Competition Act*, s. 110(8).
- 5 15 USC, § 18a.
- 6 *Competition Act*, s. 123(1).
- 7 S.O.R./ 87-348.
- 8 See Standing Senate Committee on Banking, Trade and Commerce, *Recent Competition Act Changes: A Work in Progress* (Ottawa: Senate Canada, 2009) at 9, online: Parliament of Canada <http://www.parl.gc.ca/40/2/parbus/commbus/senate/com-e/bank-e/rep-e/rep02jun09-e.pdf>, where Melanie Aitken, at the time the Interim Commissioner and now the Commissioner, stated to the Senate Committee in relation to the new SIR regime that approximately 4 to 6 mergers each year are potentially harmful to competition and require additional information for the Bureau's analysis.
- 9 Competition Bureau Canada, *Merger Review Process Guidelines* (Ottawa: 2009), online: Competition Bureau Canada <http://competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/03128.html>.
- 10 See *Merger Review Process Guidelines* at Part 2.4.1. A "very complex" case is typically characterized by indications early in the preliminary examination that the transaction is likely to create or enhance market power and where Tribunal proceedings are a strong possibility: Competition Bureau Canada, *Fee and Service Standards Handbook* (Ottawa: 2003) at 13, online: Competition Bureau Canada <http://competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/01338.html>.
- 11 *Competition Act*, s. 123.1(1)(d).
- 12 *Competition Act*, s. 65(2).
- 13 *Competition Act*, s. 97.
- 14 *Regulations Amending the Notifiable Transactions Regulations*, C. Gaz., 2009.I.902.
- 15 16 C.F.R. Part 803.
- 16 *Merger Review Process Guidelines*, at Part 3.2.
- 17 *Ibid.* at Part 3.3.1.
- 18 *Ibid.* at Part 3.3.2.
- 19 *Ibid.* at Part 3.4.
- 20 *Ibid.* at Part 2.4.1.
- 21 *Ibid.* at Part 3.5.
- 22 Competition Bureau Canada, *Bulletin on Efficiencies in Merger Review* (Ottawa: 2009), online: Competition Bureau Canada <http://competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/02982.html>.
- 23 *Ibid.* at Part I.
- 24 *Competition Act*, s. 96.
- 25 *Efficiencies Bulletin*, at Part I.
- 26 *Efficiencies Bulletin*, at Part II.
- 27 *Canada (Commissioner of Competition) v. Labatt Brewing Company Limited et al.* 2008 FC 59; *The Commissioner of Competition v. Labatt Brewing Co. Ltd. et al.*, 2007 Comp. Trib. 9, upheld on appeal, 2008 FCA 22.
- 28 *Commissioner of Competition vs. American Iron & Metal Company Inc. et al.*, 2008 Comp. Trib. 1.
- 29 Competition Bureau Canada, Press Release, "Competition Bureau Completes Review of Labatt's Acquisition of Lakeport" (16 January 2009), online: Competition Bureau Canada <http://competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/02951.html>.
- 30 Competition Bureau Canada, Press Release, "Competition Bureau Requires Divestiture in Consent Agreement with Clean Harbors" (27 July 2009), online: Competition Bureau Canada <http://competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/03113.html>.
- 31 Competition Bureau Canada, Press Release, "Competition Bureau Requires Significant Divestitures in Merger of Pfizer and Wyeth" (14 October 2009), online: Competition Bureau Canada <http://competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/03141.html>.
- 32 Competition Bureau Canada, Press Release, "Competition Bureau Resolves Issues in Merger of Merck and Schering-Plough" (29 October 2009), online: Competition Bureau Canada <http://competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/03146.html>.
- 33 Competition Bureau Canada, Press Release, "Competition Bureau Secures Remedy for Agrium's Proposed Acquisition of CF Industries" (4 November 2009), online: Competition Bureau Canada <http://competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/03149.html>.
- 34 Competition Bureau Canada, Press Release, "Competition Bureau Acts to Preserve Competition in Suncor / Petro-Canada Merger" (21 July 2009), online: Competition Bureau Canada <http://competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/03103.html>. Ultramar was ultimately approved as purchaser of the terminal storage and distribution capacity. Husky Energy was approved as the purchaser of the gasoline stations.
- 35 Competition Bureau Canada, *Information Bulletin on Merger Remedies in Canada* (Ottawa: 2006), online: Competition Bureau Canada <http://competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/02170.html>.
- 36 Competition Bureau Canada, Press Release, "BASF Acquisition of Ciba cleared following divestiture commitment" (6 April 2009), online: Competition Bureau Canada <http://competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/03043.html>.
- 37 Competition Bureau Canada, Press Release, "Competition Bureau Clears Dow Chemical's Acquisition of Rohm and Haas" (23 January 2009), online: Competition Bureau Canada <http://competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/02954.html>.

Recent European Developments

By Douglas Nave and Dean O'Connell

This article summarizes four key developments in the European Commission's enforcement of the competition rules: the issuance of official guidance on the Commission's approach to potential abuses of dominance (Article 102); the initiation of public consultation on revision of the rules relating to distribution and other vertical agreements (Article 101)¹; the appointment of Mr Joaquin Almunia as Commissioner of the Directorate-General for Competition; and the settlement reached between Microsoft and the Commission in relation to its allegedly abusive tying of Internet Explorer web browser with its desktop operating system.

Guidance on Abuse of Dominance

In February 2009, following a three-year consultation period, the

Commission published its first official Guidance on its enforcement policies with respect to Article 102 (the fundamental warrant in EU law for the regulation of exclusionary single-firm conduct, commonly known as "abuse of dominance").² Prior to the issuance of this Guidance, firms and their advisers were almost wholly reliant on the case law of the European Courts, which was widely considered to be overly formalistic and showed little regard for economically oriented, effects-based analysis; rather, certain forms of conduct, by firms that were found to have some measure of market power, were essentially treated as per se violations of Article 102. The lack of any possibility for formal exemption of potentially problematic conduct under Article 102 generated significant debate whether such conduct could be saved by proof of an

objective business justification or pro-competitive economic efficiencies.

In its Guidance, the Commission has moved away from this *per se* approach, making clear that its enforcement priorities will be informed by consideration of the economic effects of potentially abusive conduct. The Commission also has distanced itself, at least as a matter of policy, from a traditional approach that was criticized as giving too much weight to the protection of competitors rather than consideration of what is ultimately in the best interests of consumers. The Commission, perhaps mindful that its Guidance is not completely aligned with the existing jurisprudence of the European Courts, has made clear that the Guidance is only a non-binding statement of its own enforcement priorities.³

Three points of particular note in the Guidance relate to the treatment of efficiencies, price-cost assessments, and possibilities of recoupment from alleged predation:

- **Efficiencies:** Consistent with an effects-based approach, the Commission has stated that even conduct that may lead to foreclosure of competitors may be found to be lawful if its benefits for consumers outweigh the negative effects on competition. This statement brings the Commission into line with the approach in other key jurisdictions, including the US. Nonetheless, how this principle will be applied remains to be seen; in its high-profile investigation of Intel this year, the Commission assessed the potential effects (under a price-cost analysis) of rebate practices that traditionally have been treated as illegal *per se*, and then imposed a record-breaking €1.06 billion fine

over Intel's objections that the Commission failed properly to consider Intel's efficiency arguments.

- **Price-cost tests:** The Commission has proposed a new price-cost test for the assessment of price-based abuses (e.g. predation, margin squeezes, and certain rebate programs). The Guidance states that foreclosure of competitors generally will not render a dominant firm's practice unlawful if the practice would not exclude a hypothetical competitor that is as

Commission enforcement priorities will be informed by consideration of the economic effects of potentially abusive conduct.

efficient as the dominant firm. The Commission applied this so-called "AEC" (as-efficient competitor) test in condemning Intel's rebates because, given the substantial volumes Intel sold to its customers, even an efficient rival would have to sell below cost in order to match Intel's pricing. The Guidance states that exclusion of an AEC may be assumed, and the dominant firm's pricing found to be unlawful, if the prices at issue are below "average avoidable costs" (a measure similar to average variable costs that also includes an element of fixed costs which would not have been incurred if the firm had not made the output associated with the alleged abuse). The Guidance also states that a dominant firm may be assumed to be recovering its costs and pricing lawfully where its prices are above long-run average incremental costs (a measure similar to average total cost that also includes

fixed costs incurred before the alleged abuse). The Guidance leaves unaddressed a "grey area" between these two measures of cost.

Recoupment: The Guidance addresses a longstanding debate, whether a finding of predation requires a finding that the dominant supplier, after eliminating its rival, could recoup the losses it incurred in its allegedly abusive pricing. In this regard, the Guidance states that the Commission may intervene even if it is not shown that the dominant firm is "able to increase its prices above the level persisting in the market before the alleged conduct." Not requiring proof of a possibility of recoupment appears to be inconsistent with the Commission's adoption of an effects-based approach. However, this was affirmed by the European Court of Justice, following issue of the Guidance, in a recent judgment against practices by France Télécom.

As a matter of policy, the Guidance reflects a movement towards an economics-based approach to single-firm conduct that can significantly enhance market function and as such reduces potentially arbitrary legal exposure for large firms. Whether this approach will be applied consistently in practice, however, is a different question, and cases now pending before the Commission will provide some interesting tests of the Commission's resolve in this area.

Consultation on Vertical Agreements

In July 2009, the Commission launched a public consultation on a draft block exemption and draft policy guidelines relating to vertical (i.e. customer-supplier) agreements. Under Article 101, various provisions commonly found in such agreements may be deemed to be anti-competitive

(unenforceable and subject to fining), unless their positive effects on economic development and consumer welfare can be shown to outweigh the negative effects on competition.

Current regulation generally provides that such agreements fall outside the Article 101 prohibition if the supplier has less than a 30% market share and no “hardcore” restrictions (e.g. price fixing or absolute territorial protection) are included.

While the Commission’s draft materials do not change the rules significantly in most areas, they do make clear the Commission’s desire to move towards a more economically oriented, effects-based approach, while taking account of developments in the business landscape since the current block exemption and guidelines were published almost 10 years ago. In particular:

- “Hardcore” restraints: The Commission proposes to make rebuttable the traditional presumption that minimum resale price maintenance (“RPM”) and a supplier’s grant of “absolute” territorial protection to its distributors are anti-competitive. In particular, the Commission has suggested that RPM may be permitted for a limited period, where it is used in the context of a new product introduction or to coordinate a short-term promotional campaign among franchisees or members of a selective distribution system. The Commission also has suggested that absolute territorial protection might be justified where, e.g., a distributor has incurred significant sunk costs and is protected for only a limited period of time. In these regards the Commission has moved more towards the US rule of reason approach to such restraints.

- Growing retailer/distributor power: The Commission proposes to cut back on the automatic market-share exemption, noted above, so that this applies only if *both* the supplier and its customer have shares of less than 30%. This change is a response, in particular, to significant consolidation of grocery and other retailers across Europe in the last 10 years, increasing the possibilities of foreclosure that originates downstream.

A dominant firm may be assumed to be pricing lawfully where its prices are above long-run average incremental costs (a measure similar to average total cost that also includes fixed costs incurred before the alleged abuse).

- Internet selling: The Commission has addressed widespread uncertainty about how Internet sales are treated under existing rules that allow a supplier to prevent exclusive distributors from making “active” sales in each other’s territory. Under the proposed rules, a supplier may prohibit its online distributors from sending unsolicited emails and targeted online advertising into territories that have been allocated exclusively to other operators. However, the supplier may not require that an online distributor prevent extra-territorial customers from viewing its website, re-route them to another distributor’s website, or terminate their online transactions if their contact or credit card details indicate that they reside outside the distributor’s territory.

Whether these proposals make their way unchanged into a final

regulation and guidelines (to be published sometime in 2010) remains to be seen. However, these materials, again, present a welcome focus on economically oriented, effects-based enforcement policy.

Spain’s Joaquin Almunia appointed to the EU’s top Antitrust Position

On 26 November 2009, the Commission’s returning President, José Manuel Barroso, appointed Joaquin Almunia as Europe’s new Competition Commissioner. Mr Almunia, who is both an economist and a lawyer, will take over from the existing Competition Commissioner, Neelie Kroes, once the full College of Commissioners has been approved (assumedly on 26 January 2010).

Mr Almunia previously served as the EU’s Commissioner for Economic and Monetary Affairs, helped develop the Commission’s response to the global financial crisis, and is widely regarded as having shown both hard-headed pragmatism and a willingness to stand up to serious political pressures. Before he joined the Commission in 2004, Mr Almunia served in Socialist governments in Spain, heading ministries for employment and public administration.

Mr Almunia will take over the Competition post at a critical time, when the Commission’s policies and initiatives across a range of commercial conduct, discussed above, are being tested. He follows the high-profile tenure of Neelie Kroes, who developed a reputation (particularly from her challenges to Microsoft, Intel, and pharmaceutical companies) as a tough enforcer of competition rules. Growing criticism of the Commission’s increasingly severe fines, and the fact that the same body determines both infringement and penalty, will bring pressure to justify or reform

those policies. Finally, Ms Kroes leaves Mr Almunia with the task of completing the Commission's investigation into the proposed *Sun/Oracle* merger, a situation that is perhaps reminiscent of the *GE/Honeywell* case (where the Commission and US regulators came to different conclusions in their investigations of a sizeable deal between important US companies). How Mr Almunia addresses that challenge, and carries forward the significant policies announced this year by the Commission, could well set the tenor of cross-Atlantic cooperation, and the legal climate in which companies do business in Europe, for years to come.

Microsoft and Commission Settle Internet Explorer Article 102 Proceedings

In what outgoing Competition Commissioner Neelie Kroes described as a "Christmas present for hundreds of millions of Europeans," the Commission announced on 16 December 2009 that it had accepted undertakings offered by Microsoft to settle Commission allegations that it tied its proprietary browser software, Internet Explorer, with its Windows operating system. Microsoft agreed to introduce an online "ballot screen" that will allow Windows users to

select which of the 12 most frequently used browser applications they would like to download and use.

Microsoft agreed to introduce an online "ballot screen" that will allow Windows users to select which of the 12 most frequently used browser applications they would like to download and use.

The commitments effectively close an investigation that the Commission opened in January 2009 in response to a competitor's complaint that Microsoft's integration of its Internet Explorer with its Windows operating system was an abuse of dominance contrary to Article 102. The Commission preliminarily agreed that, since Windows is used in more than 90% of all PCs, such product integration gave Microsoft an unfair distribution advantage unconnected to the merits of Internet Explorer itself. The Commission further opined that this could hinder innovation and create disincentives for software developers and media content providers to design products that are compatible with other internet browsers.

Microsoft's commitments were proffered and accepted without any acknowledgement or finding that Microsoft's conduct was in fact inconsistent with Article 102. The principles by which technological advances that benefit consumers are to be distinguished from unlawfully exclusionary product design therefore remain fraught with uncertainty, and are an area of significant importance for the new Competition Commissioner to address.

- 1 Nearly two years after it was signed, and after numerous referenda and judicial challenges to its validity, the Lisbon Treaty (officially known as the "Treaty on the Functioning of the European Union") came into effect on 1 December 2009. The fundamental treaty provisions for the regulation of cartels and restraints of trade (originally known as Article 85, and then Article 81) are now in Article 101, while the provisions on anti-competitive single-firm conduct (originally known as Article 86, and then Article 82) are now in Article 102.
- 2 The Guidance deals only with "exclusionary" abuses such as contentious rebate programmes, predatory pricing, bundling and tying, margin squeezes, and refusals to supply) and does not address potentially "exploitative" abuses such as excessive pricing. There remains no guidance on the latter types of abuse beyond what little jurisprudence has come out of the courts.
- 3 More particularly, the Commission has cautioned that its Guidance is not "intended to constitute a statement of the law and is without prejudice to the interpretation of Article 82 [now 102] by the Court of Justice or the Court of First Instance."

Insurance Antitrust Exemption Under Attack

By Ausra Pumputis

With debates over health care and health insurance costs dominating the political agenda, it is unsurprising that the antitrust exemption afforded to the insurance industry by the McCarran-Ferguson Act¹ has come under fire. While critics charge the Act with promoting higher health insurance costs, few have been able to articulate a causal link between the exemption and higher insurance costs. Indeed, the McCarran-Ferguson Act may simply be a scapegoat in these larger debates.

Health insurance premiums are unlikely to change significantly as a result of the proposed legislation.

Proposed legislation² in both the Senate and the House of Representatives seeks to repeal the antitrust exemption as to health insurance companies. The exemption has shielded insurance companies from antitrust claims in limited circumstances for more than six decades.³ The Health Insurance Industry Antitrust Enforcement Act of 2009 has been described as “an important step forward toward opening up health and medical malpractice insurance markets to real competition.”⁴ In addition, the Department of Justice, the American Bar Association, several state attorney generals and President Obama have supported efforts to repeal the antitrust exemption for health insurers. Notwithstanding this political groundswell, it is questionable whether new antitrust enforcement will have a significant impact on health insurance or the cost thereof.

The McCarran-Ferguson Act was adopted in 1945 to preclude preemption of state insurance regulation by federal statutes, especially in the area of “cooperative ratemaking efforts” which allow insurers to share historic loss and risk data to better set rates to cover costs.⁵ The McCarran-Ferguson exemption affords insurers an exemption from the federal antitrust laws only if the challenged conduct is (1) part of the business of insurance and (2) regulated by State law,⁶ but (3) not an act of boycott, coercion or intimidation.⁷ Although every state has adopted a framework for regulating insurance, state attorney generals have denounced the McCarran Act because, they argue, the exemption also constrains state antitrust enforcers who are required to adhere to federal antitrust law by state statutes or case law.⁸ The state attorney generals of Connecticut, Massachusetts, Maine, Oregon, Arizona, Iowa, Montana, Florida and Wyoming have endorsed the Health Insurance Industry Antitrust Enforcement Act in their recent letter to the Senate which describes the exemption as “a historical anomaly and an accident- serving no purpose except to exempt insurers from anti-competitive conduct prohibitions that apply to almost every other industry.”⁹ The above mentioned state attorney generals also argue that the exemption creates uncertainty for market participants because states are required to enforce anti-competitive behavior inconsistently from the enforcement efforts of federal antitrust agencies.¹⁰ (States have, however, on several occasions, diverged from the DOJ’s enforcement efforts in the health insurance

industry for acts which have not been immunized by the McCarran Act. For example, the state insurance commissioners and attorney generals have challenged and/or imposed stricter conditions on some health insurance mergers, including the mergers of Harvard Community Health Plan/Pilgrim Health Care¹¹ and Anthem/WellPoint Health Networks, which were cleared by the Department of Justice.)

As noted above, not all actions by health insurance companies are immune from federal antitrust scrutiny, even if regulated by a state. The federal antitrust agencies, primarily the Department of Justice (DOJ), may still challenge insurance company mergers, monopolization and other conduct not constituting “the business of insurance” such as insurers’ dealings with third parties.¹² For example, in *United States v. Medical Mutual of Ohio*, the DOJ filed suit under §1 of the Sherman Act to prohibit Ohio’s largest health care insurer from using most favored nations (MFNs) clauses in its contract with hospitals.¹³ The MFNs required the hospitals to charge Medical Mutual’s competitors 15 to 30% more for services than hospitals charged Medical Mutual.¹⁴ The DOJ has also reviewed and challenged several mergers, including UnitedHealth Group/Sierra Health Services,¹⁵ UnitedHealth Group/PacifiCare Health Systems,¹⁶ and Aetna/Prudential Insurance Company of America.¹⁷

Given the DOJ’s and states’ active antitrust enforcement, it is far from clear that the Health Insurance Industry Antitrust Enforcement Act would have a significant impact on the health insurance industry. The Congressional Budget Office (CBO) released a report in late October that forecast that only a small number of new cases could be brought under the

proposed law.¹⁸ State insurance regulators informed the CBO that state laws already prohibit health insurers from engaging in practices such as price fixing, bid rigging and market allocations.¹⁹ Thus, the CBO concluded that the health insurance premiums are unlikely to change significantly as a result of the proposed legislation.²⁰ Moreover, the ability to share loss and risk data as currently permitted, lowers barriers to entry and enables smaller insurance firms to compete as the cost of obtaining the historical data could be prohibitive if each company had to aggregate it on its own. Low barriers of entry are pro-competitive and promote lower prices because the threat of a new competitor will either prevent a monopolist from raising prices or actual entry of a competitor will make the exercise of monopoly power short lived.

The legislation may thus be a matter of form over substance. As a general matter, both the DOJ and the American Bar Association are opposed to exemptions from the antitrust laws.²¹ Trust in antitrust laws, belief in the rule of law and confidence in the ability of the antitrust agencies and the courts to reach an outcome that is in the public interest contribute to the skepticism of antitrust exemptions.²² Furthermore, as Assistant Attorney General Varney noted at a hearing of the US Senate Judiciary Committee, the McCarran Act is no longer necessary to protect the ability of individual states to shield loss and risk data exchange from antitrust liability.²³ Jurisprudence following *Parker v. Brown*²⁴ has enabled the “state action” defense to effectively shield²⁵ anticompetitive behavior from federal antitrust scrutiny if the challenged restraint is “one clearly articulated and affirmatively expressed as state policy” and “the policy is actively supervised by the State itself.”²⁶ Moreover, the use of a rule of reason approach also provides

for flexible application of antitrust laws, Assistant Attorney General Varney also noted nothing in the federal antitrust laws prevents insurers from sharing loss and risk data as long as the data is “blind” and not used for price-fixing or market allocation.²⁷ Nonetheless, the amended bill now provides for a safe harbor provision clarifying that insurers do not violate the antitrust laws by cooperating in the collection and dissemination of past loss-experience data.²⁸ The safe harbor is intended to provide certainty for market participants and deters private litigation challenging pro-competitive conduct.²⁹

Some commentators contend that the Health Insurance Industry Antitrust Enforcement Act is merely a symbolic gesture to deflect criticism of the benefits that the insurance companies will reap if the health reform is passed. Under the proposed health reform package, the insurance companies will be guaranteed new customers and will receive government subsidies to cover the premiums of new customers who could not afford insurance otherwise. In addition, mandated minimum reimbursement levels may be lowered.

While the proposed antitrust enforcement act may not have a significant near term impact on health insurers directly, it may signal tougher enforcement by the federal antitrust agencies. The federal antitrust agencies continue to have the power to review and challenge health insurance mergers, for example. Furthermore, the federal antitrust agencies have expressed a willingness to challenge even consummated mergers. For example, in the last year, the FTC challenged Carillon Clinic’s acquisition of two outpatient clinics³⁰ and the DOJ sued to unwind Microsemi’s asset purchase of Semicoa.³¹ Hence, even if the new legislation modestly circumscribes the

current McCarran-Ferguson immunity, antitrust will continue to be an issue for health insurers and the current debate on health care will continue to result in sharp government focus on the industry.

1 15 US C. §§1011-1015 (1945).

2 Health Insurance Industry Antitrust Enforcement Act of 2009, S. 1681, 111th Cong. (2009); Health Insurance Industry Antitrust Enforcement Act of 2009, H.R. 3596, 111th Cong. (2009).

3 See Conyers, Johnson, DeGette Introduce Legislation to End Antitrust Exemption for Health Insurers, Sept. 17, 2009, http://judiciary.house.gov/news/090917_1.html (last visited Dec. 1, 2009).

4 Conyers Applauds Bipartisan Passage of Health Insurance Industry Antitrust Enforcement Act, Oct. 21, 2009, <http://judiciary.house.gov/news/091021.html>.

5 The McCarran Act exemption was enacted in response to *United States v. South-Eastern Underwriters Ass’n*, 322 US 533 (1944).

6 The state regulation requirement is also satisfied in states that do not require rate or form filing so long as the insurance commissioner has the power to investigate and suspend. *Feinstein v. Nettleship Co.*, 714 F.2d 928 (9th Cir. 1983).

7 15 US C. §§1011-1015 (1945).

8 Letter from William Sorrell, Richard Blumenthal, Martha Coakley, Janet Mills, Terry Goddard, John Kroger, Tom Miller, Steve Bullock, Bruce Salzburg, Bill McCollum, State Attorney Generals, to Patrick J. Leahy, Senate Committee on the Judiciary Chair, and Jeff Sessions, Senate Committee on the Judiciary Ranking Member (Nov. 13, 2009) available at <http://judiciary.senate.gov/resources/documents/111thCongress/upload/111309StateAttorneysGeneralToLeahy-Sessions.pdf>.

9 *Id.*

10 *Id.*

11 No. 95-0331E (Mass. Sup’r Ct. Jan. 18, 1995) (assurance of discontinuance).

12 See, e.g., *Podiatrist Ass’n v. La Cruz Azul de Puerto Rico, Inc.*, 332 F.3d 6, 10 (1st Cir. 2003) (contracts between health care providers and managed care companies are not exempt); *Hahn v. Oregon Physicians’ Serv.*, 689 F.2d 840, 844 (9th Cir. 1982) (contract with provider is not exempt); *Portland Retail Druggists Ass’n v. Kaiser Found. Health Plan*, 662 F.2d 641, 646-47 (9th Cir. 1981) (contractual arrangements with drug manufacturers, wholesalers, and distributors are not exempt); *St. Bernard Hosp. v. Hospital Serv. Ass’n*, 618 F.2d 1140, 1145 (5th Cir. 1980) (contract with hospital is not exempt). These cases take care that the McCarran exemption not be interpreted to affect competition in health care or other noninsurance markets.

13 Case No. 1:98-CV-2172 (N.D. Ohio 2008). The parties entered into a settlement agreement whereby MMO was enjoined from using most

- favored nations clauses or any other practice or contract provision having the same purpose or effect. Final Judgment, 1999-1 Trade Cas. (CCH) ¶72,465 (1/29/1999).
- 14 *Id.*
- 15 *US v. UnitedHealth Group, Inc.*, C.A. No. 1:08CV00322 (D.D.C. Feb. 25, 2008).
- 16 *US v. UnitedHealth Group, Inc.*, C.A. No. 1:05CV02436 (D.D.C. Dec. 20, 2005).
- 17 *US v. Prudential Insurance Company of America*, C.A. No. 3-99CV 1398-H (N.D. Tex. Dec. 7, 1999).
- 18 Congressional Budget Office, Cost Estimate: H.R. 3596 Health Insurance Industry Antitrust Enforcement Act of 2009 (Oct. 23, 2009), available at <http://www.cbo.gov/ftpdocs/106xx/doc10673/hr3596.pdf>.
- 19 *Id.*
- 20 *Id.*
- 21 *See e.g.*, Concerning H.R. 3596, The Health Insurance Industry Antitrust Enforcement Act of 2009: Hearing Before the Subcomm. on Courts and Competition Policy of the H. Comm. on the Judiciary, 111th Cong. (Oct. 8, 2009) [hereinafter *ABA Chair Statement*] (statement of Ilene Knable Knotts, Chair, ABA Section of Antitrust Law), available at <http://judiciary.house.gov/hearings/pdf/Gotts091008.pdf>; *see also* Prohibiting Price Fixing and Other Anticompetitive Conduct in the Health Insurance Industry: Hearing Before the H. Comm. on the Judiciary, 111th Cong. (2009) [hereinafter *Statement of Assn. Attorney General Varney*] (statement of Christine Varney, Assistant Attorney General, Antitrust Division, US Department of Justice), available at <http://www.justice.gov/atr/public/testimony/250917.htm>.
- 22 *See e.g.*, ABA Chair Statement, *supra* note 21.
- 23 *See* Statement of Assn. Attorney General Varney, *supra* note 21.
- 24 317 US 341 (1943).
- 25 *See, e.g., Sandy River Nursing Care Ctr. v. Aetna Cas.*, 985 F.2d 1138 (1st Cir. 1993).
- 26 *California Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc.*, 445 US 97,105 (1980).
- 27 *See* US Dep't of Justice & FTC, Antitrust Guidelines for Collaborations Among Competitors (2000), available at <http://www.ftc.gov/os/2000/04/ftcdojguidelines.pdf>.
- 28 *See* H.R. 3596, *supra* note 29.
- 29 *See e.g.*, ABA Chair Statement, *supra* note 21.
- 30 Complaint, *In the Matter of Carilion Clinic*, No. 9338 (F.T.C. July 23, 2009) at <http://www.ftc.gov/os/adjpro/d9338/090724carilioncmpt.pdf>.
- 31 *See* Verified Complaint, *US v. Microsemi*, No. 1:08-cv-1311 (E.D. Va. Dec. 18, 2008), at <http://www.usdoj.gov/atr/cases/f240500/240537.htm>.

No Antitrust Injury in Alleged Monopolization and Division of Louisiana Casino Market

By Jennifer Brace

One of the most perplexing issues in antitrust law is determining whether a private plaintiff has standing to bring a claim. Business relationships are numerous, including for example, consumers, competitors, creditors, suppliers, lessors, and lessees. A single business decision may harm one or more of these relationships, but not all parties will have standing to assert an antitrust claim. An antitrust plaintiff must allege injury “by reason of”¹ an antitrust violation, i.e. the plaintiff must have suffered an injury that the antitrust laws were designed to prevent. Any injury will not suffice. Whether a party has suffered such an injury has perplexed plaintiffs and courts alike. In *Jebaco Inc. v. Harrah's Operating Co.*,² the Fifth Circuit Court of Appeals addressed the question of whether a landlord has standing to challenge a conspiracy to monopolize and divide the riverboat gambling market even though the landlord is neither a competitor nor consumer of the conspirators. The court held that the plaintiff did not

suffer the antitrust injury and upheld dismissal of the claim. In so holding, the court was critical of the district court for failing to address this preliminary issue and was likewise critical of the plaintiff for fundamentally misconstruing the purpose of the antitrust laws.

“The federal antitrust laws protect competition, not competitors” and “the focus of remedies available under federal antitrust laws is principally upon consumers or competitors affected by anticompetitive conduct.”

Facts

Harrah's and Pinnacle Entertainment both operated gambling Casinos in Louisiana. Together, the parties held 6 out of the state's 15 gambling licenses, which generated over 60 percent of the gambling revenue in the state, including

80 percent of the gambling revenue in the New Orleans metropolitan statistical area.³ Harrah's operations included riverboat gambling casinos that were docked in berths on Lakes Charles, LA. Pursuant to a settlement agreement between plaintiff Jebaco Incorporated and a company that was later purchased by Harrah's, Jebaco received a per-person boarding fee for each patron that entered the riverboats.⁴ Jebaco claimed that it was entitled to receive over \$23 million yearly from the boats through 2023. In 2005 the berths and riverboats were damaged by Hurricane Katrina, after which Harrah's ceased operations at Lake Charles.

Following the halt in operations, Harrah's stopped payments to Jebaco and opted to offer the boats for sale rather than resume operations.⁵ Jebaco, which owned no casinos or gambling operations, placed a bid for the boats but was outbid by casino operator Pinnacle Entertainment.⁶ Pinnacle then decided to move the boats to a different location such that

it would no longer need to provide any per-patron proceeds to Jebaco. That decision was approved by the Louisiana Gaming Control Board, which approved the transfer of the license after a public vote.⁷

Claims

Jebaco's sued, asserting federal antitrust and state law claims, seeking \$34 million in damages. Jebaco alleged that Harrah's and Pinnacle conspired to monopolize and divide the Louisiana gambling market. Specifically, Jebaco's claimed injuries included (1) deprivation of the per-patron fee had received before Harrah's ceased operations at the Lake Charles berths, and (2) deprivation of the opportunity to enter the gambling business through the acquisition of Harrah's Lake Charles assets.⁸ According to Jebaco, Harrah's rejected this bid because competing bidder Pinnacle's price included an anticompetitive premium since Pinnacle could provide the parties with the opportunity to engage in an anticompetitive scheme to divide the gambling market.⁹

Ruling

The defendants moved to dismiss the complaint because (1) the plaintiff lacked antitrust standing, and (2) because the defendants' conduct was meant to lobby the state and secure their licenses and was thus protected by the *Noerr-Pennington* doctrine. The *Noerr-Pennington* doctrine provides immunity from the antitrust laws for legitimate activities that are intended to influence governmental actions. The district court did not reach the standing issue, but dismissed the complaint holding that the defendants' petition to the Louisiana Gaming Control Board was protected conduct under *Noerr-Pennington*.¹⁰

On appeal, the Fifth Circuit criticized the district court's analysis on the

immunity issue,¹¹ but nevertheless affirmed dismissal because Jebaco had neither alleged nor suffered antitrust injury and therefore lacked standing. The Court reasoned that first, any lost per-patron fees were suffered by Jebaco in its capacity similar to that of a landlord. Second, Jebaco's alleged deprivation of the opportunity to compete when Harrah's sold its boats to Pinnacle was in its capacity as a "would-be competitor."

The Court held that these two injuries were "not the type of injury the antitrust laws were designed to prevent," because they did not "flow from the alleged anticompetitive conduct."¹² First, the injury from a market division such as that alleged by Jebaco is an increase in prices or a decrease in output; not the loss of rental income.

Had Pinnacle remained at Jebaco's preferred berths and kept paying the fees, the alleged market division would still have occurred and Jebaco would be uninjured. Alternatively, if a different firm had purchased Harrah's assets, it too might have chosen not to operate at Jebaco's preferred berths. No antitrust violation would have occurred, but Jebaco would have suffered the same injury. Pinnacle's choice to change berths, a choice wholly independent of any antitrust violation, was the cause of Jebaco's injury.¹³

In claiming antitrust injury as a "landlord," Jebaco fundamentally misconstrued the concept of antitrust injury. Jebaco argued that it should prevail because "the purpose of the antitrust laws is to protect small business from larger ones"¹⁴ As the Fifth Circuit emphatically stated, "This is wrong."¹⁵ Rather, "[t]he federal antitrust laws protect competition, not competitors"¹⁶ and "the focus of remedies available under federal antitrust laws is principally upon consumers or competitors

affected by anticompetitive conduct."¹⁷

Second, Jebaco's "conclusory"¹⁸ claim that it had standing as a potential competitor is also flawed.¹⁹ Jebaco's inability to enter the casino market was not caused by the alleged market division. "Jebaco would have suffered the same harm whether Harrah's retained its Lake Charles assets or sold them to any party other than Pinnacle. The anticompetitive harm caused by the alleged illegal market division is not connected to Jebaco's thwarted hopes."²⁰ That is, if after the acquisition Pinnacle had remained at the berths and continued to pay the fees to Jebaco, the alleged Harrah's-Pinnacle division of the market could still have occurred and yet Jebaco would not have been injured.²¹

1 15 USC. 15a (2003) (permitting recovery of damages by "any person injured in his business or property by reason of anything forbidden in the antitrust laws.")

2 2009 US App. LEXIS 23973 (5th Cir. 2009).

3 *Id.* at *5-6.

4 *Id.* at *4.

5 *Id.*

6 *Id.*

7 *Id.* at *23.

8 Jebaco also alleged that Harrah's essentially abandoned its boats by failing to move the boats to a safer corner of Lake Charles before the storm; Harrah's intended to sell the boats even prior to the hurricane; and that Harrah's received significant insurance proceeds from the hurricane damage but failed to pass on any of those proceeds to Jebaco.

9 *Id.* at *7; Complaint at 10-13, *Jebaco, Inc. v. Harrah's Operating Co.*, 2008 US Dist. LEXIS 16775 (E.D. La. 2008) (No. 06-4175).

10 *Id.* at *28-30.

11 See generally *Jebaco*, 2009 US App. LEXIS 23973. While lack of antitrust standing was fully briefed by defendants at the lower court level, the lower court declined to rule on this issue, choosing to dismiss based on the *Noerr-Pennington* argument instead.

12 *Id.* at *21.

13 *Id.* at *16. (citations omitted).

14 *Id.* at *17.

15 *Id.*

16 *Id.* (citations omitted).

17 *Id.* at *13.

18 The Court in dicta noted that Jebaco's claim that it was a potential competitor could have been subject to a motion to dismiss for failure to state "enough facts to state a claim to relief

that is plausible on its face” pursuant to recent Supreme Court rulings in *Bell Atlantic Corp. v. Twombly*, 550 US 544 (2007) and *Ashcroft v. Iqbal*, 129 S. Ct. 1937 (2009). For example, Jebaco should have alleged that it had met the necessary “threshold of preparedness” to enter the market and that it

had the financial ability to enter. However, because Defendants failed to make this argument, the Court did not opine on the sufficiency of the pleadings. *Jebaco*, 2009 US App. LEXIS 23973 at *11 n. 8.
19 *Jebaco*, 2009 US App. LEXIS 23973 at *13.

20 *Id.* at *19.

21 The court also refused to allow the defendants to amend their answer in order to allege diversity jurisdiction and reinstate state law claims, and found that it did not have jurisdiction over plaintiff’s state law claims. A state law action is still pending in this matter.

Big Pharmaceutical Mergers Challenged by FTC

By Jeff L. White

The pharmaceutical industry has undergone significant consolidation in the last year. Two of the largest transactions in 2009 included Pfizer Inc.’s \$68 billion acquisition of Wyeth and Schering-Plough Corp.’s \$41.1 billion acquisition of Merck & Co., Inc. Not surprisingly, neither of these transactions escaped the watchful eye of the Federal Trade Commission.

In October 2009, the FTC announced that it had challenged both of these transactions and negotiated consent orders requiring divestitures to remedy its antitrust concerns. In addition, the FTC released a statement in connection with its investigation of *Pfizer/Wyeth* that explained its decision and described its framework for analyzing transactions in the pharmaceutical industry. The FTC has made clear that the health care and pharmaceutical industry remains a top antitrust enforcement priority.

Pfizer/Wyeth

On October 14, 2009, the FTC announced that it had challenged Pfizer’s proposed \$68 billion acquisition of Wyeth and accepted a proposed consent order requiring divestitures in numerous US markets for animal pharmaceuticals and vaccines.¹ The FTC noted that the transaction did not raise anticompetitive concerns in any markets involving human health products.

The FTC’s complaint alleged that the proposed acquisition of Wyeth by

Pfizer would violate Section 7 of the Clayton Act and Section 5 of the FTC Act in 21 US markets for the manufacture and sale of various animal pharmaceuticals and vaccines.²

The proposed consent order requires Schering-Plough to divest all assets related to its development product to Opko Health Inc.

The FTC found that the transaction would combine two of the largest suppliers of animal health products in the US.³ In each of the relevant markets, the combination of Pfizer and Wyeth would reduce the number of significant suppliers of animal health products, leave veterinarians and other customers with fewer alternatives, and lead to higher prices. The FTC cited historical evidence demonstrating that prices increase when competitors experience supply problems and decrease after new suppliers enter the relevant markets.

To remedy the alleged competitive effects, the proposed consent order requires Pfizer to sell approximately half of Wyeth’s Fort Dodge US animal health business to Boehringer Ingelheim Vetmedica, Inc. In addition, the proposed consent order requires Pfizer to transfer its exclusive distribution rights to certain products

used to treat tapeworms in horses back to Virbac S.A.

The FTC’s Statement in Pfizer/Wyeth

The FTC also released a statement explaining its decision in *Pfizer/Wyeth* and describing the framework used in its analysis.⁴ The FTC’s statement explained that FTC staff investigated numerous potential overlaps where the parties may compete against each other, now or in the future. Beyond the areas addressed by the proposed consent order, the FTC evaluated three principle theories of potential competitive harm:

- Whether the merger might substantially reduce competition in any relevant human health market;
- Whether the evidence supported a challenge on a theory that the transaction threatened to eliminate potential future competition in any relevant market; and
- Whether the transaction would give the combined company a greater ability to engage in anticompetitive bundling, block new drug development with a merger-created patent thicket, or adversely impact the market for basic research and innovation in any human health markets.

Although the FTC concluded that anticompetitive effects were unlikely in these areas, it cautioned that

agency staff would closely monitor these areas and continue to evaluate future transactions under this framework to determine their likely effect on health care competition.

Schering-Plough/Merck

On October 29, 2009, the FTC announced that it had challenged Schering-Plough's proposed \$41.1 billion acquisition of Merck and accepted a proposed consent order requiring divestitures to remedy alleged anticompetitive effects in the US markets for:⁵

- the manufacture and sale of neurokinin ("NK1") receptor antagonists for chemotherapy-induced nausea and vomiting ("CINV") and post-operative nausea and vomiting ("PONV") in humans; and
- the manufacture and sale of various animal health products (including live poultry vaccines, killed poultry vaccines, and cattle gonadotropins).

In the market for NK1 receptor antagonists, the FTC's complaint alleged that Merck's Emend product is the only approved NK1 receptor antagonist for CINV and PONV in the US.⁶ Schering-Plough is one of a very limited number of firms with an NK1 receptor antagonist in development and had been in the process of out-licensing this product for sale by a third-party. According to the FTC, the proposed transaction would diminish the combined firms' incentive to license the Schering-Plough product because its launch by a third-party could have a significant impact on sales of Merck's product.⁷

For animal health products, the FTC's complaint alleged that Schering-

Plough and Merck are two of the four leading US suppliers of animal pharmaceuticals and vaccines. In poultry vaccines, the FTC found that Schering-Plough and Merial Limited, a Merck joint venture with Sanofi-Aventis S.A., are the two largest producers in the US and together account for approximately 75% of US sales. In cattle gonadotropins, the FTC's complaint alleged that Merck and Schering-Plough are two of only three suppliers in the US. In addition, the FTC noted that other animal health product markets would likely be adversely impacted by the acquisition, but the Commission did not have to reach a conclusion because the proposed remedy would eliminate any potential concerns it may have in these areas.

To remedy the alleged competitive effects in the market for NK1 receptor antagonists, the proposed consent order requires Schering-Plough to divest all assets related to its development product to Opko Health Inc. To remedy the alleged competitive effects in markets for the various animal health products, the proposed consent order requires Merck to divest all of its interest in Merial to its joint venture partner, Sanofi-Aventis.

Notably, the proposed consent order also includes a "prior approval" provision that prohibits the combined Schering-Plough/Merck from re-acquiring any of Merial's animal health assets without the prior approval of the Commission. According to the FTC, the parties had reached an agreement to divest Merck's interest in Merial to Sanofi-Aventis, which included a call option granting it the right to combine the animal health businesses of Merial and Schering-Plough and to recreate

the 50/50 joint venture between Merck and Sanofi-Aventis. The FTC stated that it included the prior approval provision given that the parties might seek to re-combine their animal health businesses after the divestiture.

Implications

These cases are consistent with the FTC's prior statements that antitrust enforcement in the health care and pharmaceutical industry remains a top priority. While it may be notable that the FTC took an enforcement action in only one market involving human health products, the FTC's statement in *Pfizer/Wyeth* makes it clear that it will continue to analyze this kind of merger under a variety of theories of harm, including whether a combined firm would have a greater ability to engage in anticompetitive bundling, block new entry with a broader patent portfolio, or limit research and development and reduce innovation. Finally, the FTC has reiterated its commitment to monitoring markets post-transaction to determine whether enforcement actions are necessary to restore any lost competition.

1 See *In the Matter of Pfizer Inc. and Wyeth*, FTC File No. 091-0053, Oct. 14, 2009, at <http://www.ftc.gov/os/caselist/0910053/index.shtm>.

2 See *In the Matter of Pfizer Inc. and Wyeth* (Complaint).

3 See *In the Matter of Pfizer Inc. and Wyeth* (Analysis to Aid Public Comment).

4 See Statement of the Federal Trade Commission Concerning *Pfizer/Wyeth*, FTC File No. 091-0053, Oct. 14, 2009, at <http://www.ftc.gov/os/caselist/0910053/091014pwyethstmt.pdf>.

5 See *In the Matter of Schering-Plough and Merck & Co. Inc.*, FTC File No. 091-0075, Oct. 29, 2009, at <http://www.ftc.gov/os/caselist/0910075/index.shtm>.

6 See *In the Matter of Schering-Plough and Merck & Co. Inc.* (Complaint).

7 See *In the Matter of Schering-Plough and Merck & Co. Inc.* (Analysis to Aid Public Comment).

Antitrust Update

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