Spring 2012

Weil

Antitrust Update

Federal Court Allows Silicon Valley Employee "Poaching" Suit to Proceed

By Daniel Antalics

On April 18, 2012, the U.S. District Court for the Northern District of California, San Jose Division, refused to dismiss a class-action lawsuit charging several Silicon Valley firms with conspiring to eliminate competition for skilled labor through "Do Not Cold Call" agreements.[1] Adobe Systems Inc., Apple Inc., Google Inc., Intel Corp., Intuit Inc., Lucasfilm Ltd., and Pixar had filed a motion to dismiss claims asserted by five former software engineers that the firms illegally conspired to suppress the compensation and mobility of thousands of workers by agreeing not to "cold call" one another's employees.[2] The class action is a "follow-on" suit to complaints filed against the same firms in late 2010 by the U.S. Department of Justice (DOJ).

Defendants Admitted No Liability in DOJ Settlements

In 2010, DOJ challenged the defendants' bilateral cold call agreements as *per se* violations of Section 1 of the Sherman Act, 15 U.S.C. §1.[3] Cold calling is the recruiting practice of contacting another firm's employee who has not otherwise applied for a job opening. The DOJ alleged that the agreements, entered into between 2005 and 2007, were "facially anticompetitive because they eliminated a significant form of competition to attract high tech employees."[4] Senior executives allegedly actively managed and enforced their bilateral agreements and directly communicated about them.[5] The policies also appeared in the firms' respective hiring protocol manuals, which specified that cold-calling was off-limits for certain firms.[6]

In settling with DOJ, defendants admitted no wrongdoing, but agreed not to enter any cold-call agreements and cancel any such agreements that might exist.[7] However, they did not agree to halt the use of "no direct solicitation" provisions in business contracts.[8] Furthermore, the settlements made clear that defendants could still unilaterally decide to adopt a policy not to cold call or consider applications from employees of another firm. Defendants were only prohibited from requesting or pressuring another firm to adopt or maintain such a policy.[9]

The Class Action Allegations

The class action suit contains largely the same allegations as the DOJ complaints. Plaintiffs alleged that the firms engaged in an overarching antitrust conspiracy through an interconnected web of explicit bilateral agreements.[10] By prohibiting cold calling, the firms kept salaries artificially low, plaintiffs said. According to the complaint, each pair of defendants entered agreements whereby each firm placed the names of the other firm's employees on a "Do Not Cold Call" list and instructed outside recruiters not to cold call them.[11] Plaintiffs claimed the agreements were negotiated, executed, and, in most cases, enforced by defendants' senior executives.[12] Plaintiffs described emails in which executives allegedly discussed employee poaching.[13] The complaint further described agreements between Pixar and Lucasfilm to notify one

In This Issue

another when making an offer to an employee, and refraining from making counteroffers.[14] Plaintiffs alleged that additional unknown co-conspirators also participated in the alleged conspiracy.[15]

Defendants jointly argued that the court should dismiss the case. An overarching conspiracy was implausible, they said.[16] While acknowledging the existence of six bilateral agreements between certain firms, defendants argued that cold calling otherwise was open among firms, and there was no evidence of any overarching conspiracy to suppress competition for employees.[17] Six individual agreements do not add up to a conspiracy, they argued, when there was no "meeting of the minds" to engage in such a conspiracy.[18] Furthermore, the economics of the situation evidenced the lack of a rationale for an overarching conspiracy.[19] The bilateral agreements at issue did not cover all possible pairings between defendants.[20] Defendants argued that plaintiffs failed to allege market power or antitrust injury.[21] Defendants also pointed to the legal use of "nonpoaching" agreements. As even DOJ recognized, defendants said, non-solicitation agreements can be pro-competitive and lawful to prevent the poaching of employees in the context of legitimate collaborative projects.[22]

The court ruled that plaintiffs had pled enough facts to survive a motion to dismiss. Plaintiffs had alleged such details as the actors, effect, victims, location, and timing of six agreements.[23] The court reasoned that three high-profile executives – Apple's late CEO Steve Jobs, Apple and Google board member Arthur Levinson, and Google's Eric Schmidt – had "significant influence" over at least one party to each of the six bilateral agreements at issue.[24] Defendants had argued that mere overlapping board memberships was not evidence of a conspiracy.[25] But the court said the overlaps gave the defendants "an opportunity to conspire" and lent plausibility to plaintiffs' allegations that each defendant entered the conspiracy with knowledge of other defendants' participation.[26]

Board overlaps gave defendants "an opportunity to conspire."

Furthermore, the court said it "strains credulity" that Apple and Adobe could reach an agreement that was identical to an agreement between Pixar and Lucasfilm without some communication or coordination between the two sets of defendants.[27] Because the court, on a motion to dismiss, had to accept as true plaintiffs' allegation that defendants succeeded in distorting market power, it found it reasonable to infer that defendants had the market power to do so,[28] and that Plaintiffs had alleged facts beyond mere parallel conduct.[29]

Not a Ruling on the Merits

In defeating the motion to dismiss, plaintiffs did not have to show that they could adduce sufficient evidence in discovery to prove their alleged overarching conspiracy. As the court emphasized, plaintiffs needed only to allege sufficient factual context and content that would allow a "reasonable inference" of defendants' liability.[30]

A spokesperson for Intel said, "The judge did not rule on the merits of the case. So we will continue to prepare our defense."[31]

1 Order Granting in Part and Denying in Part Defendants' Joint Motion to Dismiss; Denying Lucasfilm Ltd.'s Motion to Dismiss, *In Re: High-Tech Employee Antitrust Litigation*, No. 11-CV-02509-LHK (N.D. Cal. Apr. 18, 2012).

2 *Id.* at 10.

3 *U.S. v. Adobe Systems, Inc., Apple Inc., Google Inc., Intel Corp., Intuit, Inc., and Pixar*, No. 1:10-CV-01629 (D.C. Sept. 24, 2010); U.S. v. Lucasfilm Ltd., No. 1:10-cv-02220 (D.C. Dec. 21, 2010).

4 *U.S. v. Adobe* at 2; *U.S. v. Lucasfilm* at 2.

5 *U.S. v. Adobe* at 5; *U.S. v. Lucasfilm* at 4.

6 *U.S. v. Adobe* at 5-8.

7 Final Judgment, *U.S. v. Adobe*, No. 1:10-CV-01629 (D.C. Mar. 18, 2011) at 5; Final Judgment, *U.S. v. Lucasfilm Ltd.*, No. 1:10-CV-02220 (D.C. May 9, 2011) at 4.

8 Final Judgment, *U.S. v. Adobe* at 5; Final Judgment, *U.S. v. Lucasfilm Ltd.* at 4.

9 Final Judgment, *U.S. v. Adobe* at 7; Final Judgment, *U.S. v. Lucasfilm Ltd.* at 6.

10 Order Granting in Part and Denying in Part Defendants' Joint Motion to Dismiss, No. 11-CV-02509-LHK at 5.

11 *Id.*

12 *Id.* at 13.

13 Consolidated Amended Complaint, *In Re: High-Tech Employee Antitrust Litigation*, No. 11-CV-02509-LHK (N.D. Cal. Sept. 13, 2011) at 15. The court had ordered that defendants produce responsive, non-privileged documents already produced to the DOJ. *See* Order Granting in Part and Denying in Part Defendants' Joint Motion to Dismiss, No. 11-CV-02509-LHK at 9.

14 Consolidated Amended Complaint, No. 11-CV-02509-LHK at 14.

15 Order Granting in Part and Denying in Part Defendants' Joint Motion to Dismiss, No. 11-CV-02509-LHK at 5.

16 *Id.* at 20.

17 *Id.*

18 *Id.* at 16.

19 *Id.* at 20.

20 *Id.*

21 *Id.*

22 Defendants' Notice of Motion, Joint Motion to Dismiss the Consolidated Amended Complaint, and Memorandum of Points and Authorities Thereof [Fed. R. Civ. P. 12(b)(1) & 12(b)(6)], *In Re: High-Tech Employee Antitrust Litigation,* No. 11-CV-02509-LHK, N.D. Cal. Oct. 13, 2011 at 2.

23 Order Granting in Part and Denying in Part Defendants' Joint Motion to Dismiss, No. 11-CV-02509-LHK (N.D. Cal. Apr. 18, 2012) at 13.

24 *Id.* at 13-14.

25 *Id.* at 16.

26 *Id.* at 17.

27 *Id.* at 14.

28 *Id.* at 22.

29 *Id.* at 15.

30 *Id.* at 19.

31 Stefano Berra, *High-tech giants fail to dismiss poaching lawsuit*, GLOBAL COMPETITION REVIEW, Apr. 20, 2012, *available at* http://www.globalcompetitionreview.com/news/article/31699/high-tech-giants-fail-dismiss-poaching-lawsuit/.

With No Reliance Nor Nexus, Indirect Purchaser Plaintiffs' Claims Fall Short

In re Magnesium Oxide Antitrust Litigation (D.N.J. Apr. 5, 2012)

By Meaghan Thomas-Kennedy

Introduction

Antitrust claims by indirect purchasers of magnesium oxide did not survive defendant manufacturers' motion to dismiss a complaint alleging a price-fixing and market allocation scheme. A decision authored by Senior U.S. District Judge Debevoise on April 5, 2012, dismissed the indirect purchasers' claims for failure to plead facts that would toll the statute of limitations for the otherwise time-barred cause of action, and for lack of standing.[1] In contrast to the disposition of indirect purchasers' claims, direct purchasers' claims survived the defendant companies' motion to dismiss.[2]

Facts and Procedural History

On November 15, 2010, plaintiffs Orangeburg Milling Company, Bar Ale, Inc., and Air Krete, Inc. filed a purported class action complaint against magnesium oxide manufacturer defendants Premier Chemicals, LLC (Premier), Sumitomo Corporation of America, and YAS, Inc., alleging that the defendants had engaged in a price-fixing and market allocation conspiracy.[3] Soon thereafter, a purported class of indirect purchaser consumer plaintiffs followed with a complaint based on the same alleged facts.[4] Indirect purchasers sought injunctive relief only for the defendants' alleged violations of the Sherman Act, as well as damages under various state antitrust and consumer protection laws.

Magnesium oxide is a naturally occurring mineral used in a variety of products, including animal feeds, fertilizers, electrical insulation, and pharmaceuticals. The plaintiffs contend that defendants violated Section 1 of the Sherman Act by conspiring to allocate the market for US magnesium oxide and to raise prices. Direct purchaser plaintiffs allege that they paid supra-competitive prices for the mineral, and indirect purchasers contend they paid more for products, such as animal feed, that contained magnesium oxide.

In October 2011, the court dismissed both the direct purchasers' and indirect purchasers' complaints, ruling that the plaintiffs' claims were barred by the four-year statute of limitations and the plaintiffs had failed to plead facts to support tolling the statute on fraudulent concealment grounds.[5] The court also dismissed the indirect purchasers' complaint for its failure to establish antitrust standing. In particular, the indirect purchaser plaintiffs did not plead the specific products purchased containing magnesium oxide, nor any nexus between the price increase in those products and the alleged conspiracy.[6] Despite these deficiencies, the court found that the plaintiffs had adequately pled a meeting of the minds among the defendants to fix prices and allocate shares of the domestic magnesium oxide market, so granted leave for plaintiffs to amend their complaints.[7] Plaintiffs filed amended complaints and defendants again moved to dismiss.

The District Court's Decision

Fraudulent concealment

Plaintiffs alleged that their otherwise time-barred cause of action was timely because the statute of limitation should be tolled to account for defendants' affirmative steps to mislead the plaintiffs and conceal their conspiracy.[8] Plaintiffs also alleged that despite the conspiracy's self-concealing nature, they exercised due diligence in investigating the cause of action upon learning of an alleged conspiracy meeting from an anonymous source.[9]

Direct Purchasers

Direct purchasers alleged that defendant Premier provided pretextual reasons for the increase in magnesium oxide prices – tight supply, thinning margins, and increased energy and freight costs – and direct purchasers reasonably relied on these justifications.[10] Despite having been initially "lulled into believing that [magnesium oxide] price increases were the normal result of competitive market forces rather than the produce of collusive and unlawful efforts[,]" direct purchasers claimed that they diligently investigated the conspiracy shortly after being informed of an alleged conspiracy meeting among defendants.[11]

Defendants first argued that one defendant's allegedly misleading justifications could not establish fraudulent concealment by the remaining two defendants, and that, in the alternative, plaintiffs had not established that the purported justifications were actually false.[12] Defendants also argued that plaintiffs had not pled that the allegedly misleading justifications were directed at the direct purchaser plaintiffs.[13]

> **"To require a plaintiff to plead affirmative acts of concealment by each co-conspirator would be overly burdensome."**

Finally, the defendants argued that direct purchaser plaintiffs had not exercised due diligence in investigating the claim because the complaint did not articulate when plaintiffs were informed of the defendants' alleged conspiracy or the identity of the anonymous source, nor why the plaintiffs could not have learned of the conspiracy earlier.

The defendants' arguments were rejected. The court first dispensed with the defendants' argument that an affirmative act of concealment by one defendant could not be imputed to its alleged co-conspirator. "To require a plaintiff to plead affirmative acts of concealment by each co-conspirator," the court wrote, "would be overly burdensome, as secrecy is the natural lair of a price-fixing conspiracy."[14] Moreover, the court found that a showing of the justifications' actual falsity was "beside the point" because fraudulent concealment requires that the defendants' justifications only mislead the plaintiffs as to the existence of the conspiracy, not that they actually be untrue.[15] Whether profits were actually thinning, for example, was irrelevant to the question of whether plaintiffs misled as to the existence of the alleged conspiracy.[16]

Next, the court found that in a market characterized by regular price fluctuations, Premier's purported justifications for the price increases could reasonably have lulled direct purchasers into believing price increases were the result of market forces.[17] In this market an inference that the justifications were directed at the direct purchasers was reasonable.[18]

Finally, with regard to direct purchasers' due diligence, the court noted that assessing the underlying merits of plaintiffs' allegations of diligence was inappropriate at the motion to dismiss stage.[19] Further, plaintiffs were under no obligation to allege why they could not have discovered the conspiracy from parties who knew of it earlier.[20]

Indirect Purchasers

Though indirect purchaser plaintiffs alleged similar facts as direct purchasers to support their claim of defendants' fraudulent concealment, the court found their allegations fundamentally insufficient. As farmers and other purchasers of animal feed that contained 4% magnesium oxide, the indirect purchaser plaintiffs provided no indication that they were aware of the allegedly misleading justifications by Premier. As a result, the court found that the indirect purchaser plaintiffs could not have been misled by the purported justifications or any self-concealing aspect of the conspiracy.[21] Having failed adequately to allege reliance on defendants' efforts to cover the conspiracy, the indirect purchaser plaintiffs were not entitled to toll the statute of limitations. Accordingly, the indirect purchaser plaintiffs' claims were time-barred.

Indirect Purchasers' Article III Standing

Finally, the court also addressed indirect purchasers' antitrust standing under Article III. The court found that indirect purchaser plaintiffs had not pled a cognizable loss or injury nor that any alleged loss or injury was proximately caused by the alleged antitrust violation. The indirect purchasers' complaint alleged that they purchased cattle feed rations and mineral packs containing up to 4% magnesium oxide.[22] The court found that this "percentage of [magnesium oxide] is too small to provide a sufficient nexus between [indirect purchaser] Plaintiffs' products and the [magnesium oxide] conspiracy."[23] Though the court cautioned that a small percentage of a price-fixed ingredient in a product is not necessarily fatal to an indirect purchaser's standing, "there must be a showing that a price increase in that ingredient has a significant foreseeable effect on the price of the purchased product."[24] The alleged injury felt by indirect purchaser plaintiffs was not "inextricably intertwined with the injury that the conspirators sought to inflict,"[25] and therefore, indirect purchaser plaintiffs lacked standing to bring a cause of action.[26] The court dismissed indirect purchaser plaintiffs' claims with prejudice.[27]

Indirect purchasers must show injury that is "inextricably intertwined with the injury" the conspirators intended.

Conclusion

The decision parses the fundamentally different positions of direct and indirect purchasers in lodging claims not only of fraudulent concealment, but also antitrust injury. By disaggregating the two plaintiff groups' respective positions, the court reminds us that sometimes simple market features, such as the stream of a mineral through from manufacturer to consumer, and simple product features, such as the degree to which component parts actually affect consumer prices, can reveal fundamental infirmities in antitrust pleading.

1 *In re Magnesium Oxide Antitrust Litig.*, No. 10-5943, 2012 WL 1150123, *1 (D.N.J. Apr. 5, 2012).

2 *Id.*

3 *In re Magnesium Oxide Antitrust Litig.*, No. 10-5943, 2011 WL 5008090, *1 (D.N.J. Oct. 20, 2011).

4 *Id.*

5 *Id.* at *27.

6 *Id.* at *7.

7 *In re Magnesium Oxide Antitrust Litig.*, 2012 WL 1150123, at *1.

8 *Id.* at *4.

9 *Id.* at *8.

10 *Id.* at *6.

11 *Id.* at *7-8.

12 *Id.* at *6.

13 *Id.* at *7.

14 *Id.* (references omitted).

15 *Id.* at *6.

16 *Id.*

17 *Id.* at *7.

18 *Id.*

19 *Id.* at *8.

20 *Id.*

21 *Id.* at *9.

22 *Id.*

23 *Id.*

24 *Id.*

25 *In re Warfarin Sodium Antitrust Litig.*, 214 F.3d 396, 400 (3d Cir. 2000).

26 *In re Magnesium Oxide Antitrust Litig.*, 2012 WL 1150123, at *4.

27 *Id.* at *10.

Manufacturer Discounting Program Upheld

By Robin Cook

The United States District Court for the Northern District of California recently demonstrated the difficulty a plaintiff can face in challenging a manufacturer's above-cost discounting program, even when the manufacturer has a very large market share.[1]

The case involved Church & Dwight Co., Inc. (C&D), the manufacturer of Trojan-brand condoms and market leader with approximately 75% of the market for retail condom sales in the United States.[2] C&D had a "planogram" or "POG" program, an above-cost rebate off of the manufacturer's wholesale price earned by the retailer for dedicating a specified minimum percentage of available condom shelf-space – "facings" – to C&D products. The rebate was based on whether the retailer purchased and sold C&D's products in amounts that mirrored the percentage of the manufacturer's market share within the given category. The C&D POG program had three tiers, ranging from between 7% to 8% discounts, corresponding to between 65% to 75% of the facings.[3] In addition, C&D had a "category captain" program, under which some retailers would appoint C&D to assist the retailer with shelf space allocations and give advice on how best to present the product category. At all times, even with C&D as a category captain, the retailer maintained control of the ultimate shelf space placements.[4]

The case began when Mayer Laboratories (Mayer), a much smaller competitor, threatened suit against C&D based on these practices. C&D preemptively sued for a declaratory judgment in the District of New Jersey, and asked the court to declare that conduct described in a draft complaint provided to it by Mayer was lawful.[5]

Mayer counterclaimed, alleging that C&D's marketing programs violated Sections 1 and 2 of the Sherman Act, as well as the Lanham Act and California state law. Mayer also brought a claim of tortious interference with a rubber supply contract. The New Jersey district court transferred the action to the Northern District of California.[6]

Following the conclusion of extensive and lengthy discovery, which took three years and involved the production of more than 15 million pages of documents, C&D successfully moved for summary judgment.[7] "Despite this voluminous record, Mayer has been unable to proffer any direct, admissible evidence of retailers switching or removing rival condom brands from their shelves as a result of any coercive effect of C&D's planogram program," the judge said. "Nor has Mayer submitted any admissible evidence that C&D misused its [market] positions to the detriment of its rivals."[8] Thus, the district court granted C&D's motion as to the antitrust claims[9] on a number of independent grounds, including insufficient evidence of monopoly power, failure to demonstrate substantial market foreclosure, and lack of antitrust injury.

Analysis

The alleged exclusionary conduct was analyzed under the rule of reason. The court noted that rule of reason analysis requires a showing of market power as well as an "actual adverse effect on competition as a whole in the relevant market."[10] The court found evidence of both of these elements lacking in Mayer's claim.

Market Power

The court found that Mayer failed to present either direct or circumstantial evidence of market power by C&D. What is somewhat unusual about this conclusion is that C&D had an extremely large and, in the words of the court, "dominant," share of the relevant market, with 75% of sales.[11] Moreover, the market was highly concentrated. The next closest competitors to C&D were Reckitt Benckiser Group's Durex brand, with about 14% of the market, and Ansell's LifeStyles brand, with about 10% of the market.[12] Together with C&D, these three manufacturers accounted for 99% of the market.[13] Nevertheless, according to the court, "[m]arket share alone does not establish market power."[14] The court found that under the Ninth Circuit's test in *Rebel Oil*, Mayer had not shown that there were significant barriers to entry or that existing competitors lacked the capacity to increase their output in the short run.[15] The court found that the rebate program itself did not constitute a substantial barrier to entry.[16] Likewise, Mayer did not present evidence of restricted output.[17] The court also found that there was no evidence that C&D could charge supra-competitive prices, and noted evidence that Mayer's prices were actually higher than Trojan's.[18]

Market Foreclosure

The court found there was no market foreclosure, and that the C&D program was "arguably permissible as a matter of law" under the Ninth Circuit's holding in *Allied Orthopedic*.[19] Allied (and other similar authority)[20] stands for the proposition that "where exclusive or semi-exclusive contracts are short in duration, easily terminable, incentive-based, and leave open alternative channels to competitors, they are not exclusionary."[21]

In C&D's case, the contracts had a short duration and could be terminated at any time, for any reason, with only 30 days notice.[22] C&D did not force retailers to purchase a certain percentage of products from C&D, and the agreements did not force retailers to give any specified amount of shelf space to C&D over its rivals. Instead, retailers were free to give C&D as much or as little shelf space as they want; the only consequence for non-performance was that retailers could not receive a rebate based on those independent decisions. Other channels of distribution were open to competitors as well.[23] Indeed, the court noted that over 50% of the industry display space was not even covered by C&D's POG program.[24] C&D's average share of sales at non-POG retailers was roughly on par with its share of sales at POG retailers, and C&D's shelf share rarely exceeded its overall market share.[25] Although Mayer presented evidence that C&D has a high level of consumer brand loyalty, the court found this could not constitute an exclusionary barrier given that reputation and consumer goodwill reflect competition.[26] The court also noted that "Mayer . . . fails to account for the fact that Durex and LifeStyles have avoided the purported anti-competitive effect of C&D's POG program . . . . Without explaining how C&D's two primary competitors have escaped relatively unscathed, Mayer has not provided a plausible basis for attributing its own misfortune to C&D rather than other forces."[27]

"Where exclusive or semi-exclusive contracts are short in duration, easily terminable, incentive-based, and leave open channels to competitors, they are not exclusionary."

Antitrust Injury

The court also found that Mayer had not suffered antitrust injury through C&D's alleged conduct. With a cite to the Supreme Court's decision in *Brunswick* that the antitrust laws exist "for the protection of competition, not competitors," the court found that Mayer failed to demonstrate harm to competition.[28] While Mayer did allege harm to itself and other small manufacturers, it did not show that its losses were the result of anticompetitive conduct on the part of C&D.

Conclusion

The multiple independent grounds for summary judgment here, in a case where the defendant possessed an extraordinarily high share and a market position the court found "dominant," underscores that courts are loath to find discounting anticompetitive because there are clear consumer benefits to lower prices. The outcome might have been different had C&D offered discounts below cost. Instead, C&D behaved conservatively by propounding a discount program above cost, left retailers room to get out, provided incentives for performance in non-coercive ways, and did not foreclose open alternative channels to competitors – and thereby prevailed.

1 *Church & Dwight Co., Inc. v. Mayer Laboratories*, No. C–10–4429, 2012 WL 1231801 (N.D. Cal. Apr. 12, 2012) (*C&D I*), *motion for reconsideration on unrelated claim granted and order vacated in part*, 2012 WL 1745592 (N.D. Cal. May 16, 2012) (*C&D II*).

2 *Id.* at *2.

3 *See id.* at *4-5.

4 *Id.* at *5.

5 *Id.* at *5.

6 *Id.*

7 *Id.* at *1.

8 *Id.*

9 The judge allowed the claim of tortious interference with a rubber supply contract to proceed. *See id.* at *38-39. In addition, granting a motion for reconsideration, the court allowed trademark claims made by Mayer against C&D to proceed. *See C&D II*. The non-antitrust claims are not discussed here.

10 *C&D I* at *7 (citing *R.J. Reynolds Tobacco Co. v. Philip Morris, Inc.*, 199 F. Supp. 2d 362, 380 (M.D.N.C. 2002)).

11 *Id.* at *16.

12 *Id.* at *2.

13 *Id.*

14 *Id.* at *13 (citing *Rebel Oil Co. v. Atlantic Richfield Co.*, 51 F.3d 1421, 1439 (9th Cir. 1995).

15 *Id.* at *16.

16 *Id.* at *14.

17 *Id.* at *16.

18 *Id.* at *14.

19 *Allied Orthopedic Appliances, Inc. v. Tyco Healthcare Group LP*, 592 F.3d 991 (9th Cir. 2010).

20 *See C&D I* at *20. The court cited *Southeast Missouri Hosp. v. C.R. Bard, Inc.*, 642 F.3d 608 (8th Cir. 2011) and *Concord Boat Corp. v. Brunswick Corp.*, 207 F.3d 1039 (8th Cir. 2000) as examples of cases from other circuits. The court also pointed to a section of a leading treatise for non-Ninth Circuit authority as well. *See* XI Areeda & Hovenkamp, Antitrust Law ¶ 1821, at 186 (3d ed. 2011) ("[M]any courts hold that 'market share' agreements or discounts, which require or reward a firm for using a particular firm's goods for a specified percentage but less than all of its needs, do not amount to exclusive dealing.").

21 *C&D I* at *20.

22 *Id.* at *21.

23 *Id.* at *19.

24 *Id.* at *16.

25 *Id.* at *25.

26 *Id.* at *30 (citing *United States v. Syufy Enterprises*, 903 F.2d 659, 669 (9th Cir. 1990).

27 *Id.* at *26.

28 *Id.* at *34 (quoting *Brunswick Corp. v. Pueblo Bowl–O–Mat, Inc.*, 429 U.S. 477, 489 (1977)).

FTC Imposes Divestitures Plus "Unusual" Conduct Relief in Merger Settlement

By Megan Peloquin and Laura A. Wilkinson

On April 26, 2012, the FTC challenged CoStar Group's proposed $860 million acquisition of LoopNet and accepted a settlement that required not only divestitures, but also "unusual" additional conduct remedies.[1] CoStar is the largest provider of commercial real estate (CRE) information services in the US through its proactively researched nationwide listings database and comprehensive CRE information services.[2] LoopNet is the most heavily trafficked CRE listings database in the US, and LoopNet also offers CRE information services through Xceligent, which provides comprehensive CRE information services in 33 metropolitan areas.[3] LoopNet holds a significant ownership stake in Xceligent.[4]

The FTC's complaint alleged that CoStar's proposed acquisition of LoopNet would violate Section 7 of the Clayton Act and Section 5 of the FTC Act by lessening competition in the markets for CRE listings databases and CRE information services.[5] Listings databases allow parties to publicize and search available commercial properties (retail, office, multifamily, industrial, agricultural, health care, etc.) for sale and for lease in a user-defined area. CRE information services provide more detailed information, such as property records and comparable sales data that are required "to evaluate CRE assets and opportunities, informing decisions ranging from the determination of asking price to whether to execute a given sale or lease agreement."[6] CoStar and LoopNet both offer full-inventory, research-verified listings with broad geographic services. According to the FTC, no other provider "ha[s] achieved the critical mass of users and data that CoStar and LoopNet possess today."[7] The FTC noted that the transaction would combine "the first and second choices for many . . . customers, including CRE brokers, owners, and institutional investors."[8]

Structural Remedy: Divestitures to DMGI

The FTC's Consent Order requires the divestiture of LoopNet's interest in Xceligent and the URL "commercialsearch.com" to DMG Information (DMGI), a US-based subsidiary of British media and data firm Daily Mail & General Trust, PLC.[9] Certain LoopNet data also will be divested to DMGI in order to facilitate the expansion of Xceligent's product line and geographic coverage. According to the FTC, the divestitures will preserve the existing competition between CoStar and Xceligent and replace any competition lost between CoStar and LoopNet as a result of the transaction.[10]

Conduct Remedy: Restrictions on CoStar

In addition to divestiture, the FTC consent order imposes several behavioral restrictions on the combined CoStar-LoopNet in order to preserve Xceligent as a viable competitor and lower barriers to entry or expansion. According to the FTC, these additional conduct remedies were imposed to ensure that customers are protected in their ability to conduct day-to-day business without fear of retaliation by CoStar.[11] Specifically, the company is required to:[12]

- Not restrict any customer's ability to support Xceligent, whether "through financial investment, CRE information-sharing, or public endorsement – without fear of reprisal."[13]
- Allow current and future customers to terminate their existing contracts with 12 months notice and without penalty.
- Not bundle any of its products for sale, lease, license, or subscription.
- Not require subscription to multiple geographic areas in order to gain access to a single coverage area of interest.
- Not restrict the use of the REApplications product, a software tool for managing market research, in connection with competitor CRE database services.

Additionally, CoStar cannot inappropriately suspend or terminate service to a customer without consent, and it must allow customers to elect to resolve any disputes through arbitration. The FTC also appointed a Monitor to assure that merged company's ongoing compliance with the terms of the order.

The FTC imposed conduct restrictions to preserve the viability of its structural remedy.

Analysis

As the FTC notes, the extensive conduct remedies imposed in this action are "unusual" for FTC consent orders. Typically, the agency uses a divestiture remedy in horizontal mergers to preserve the status quo, and any supplemental conduct remedies are designed to facilitate the divestiture (*e.g.*, supplying transition services or granting intellectual property rights). The additional conduct remedies in this matter are significantly broader, and are designed to facilitate the buyer's growth and expansion in the market. In addition, the conduct remedies impose significant restrictions on the merged company's business practices and contracts with customers. The agency's remedies always are tailored to the specific industry and companies involved. However, this action may signal that the FTC is willing to entertain creative remedies that permit mergers that will result in significant efficiencies, while crafting remedies that are designed to not only preserve, but also enhance competition – even where the remedy will involve monitoring market behavior post-transaction.

---

1 *See* FTC Places Conditions on CoStar's $860 Million Acquisition of LoopNet, *at* http://www.ftc.gov/opa/2012/04/costar.shtm.

2 *Id.* at ¶1.

3 *Id.* at ¶3.

4 Xceligent is not a public company, and the exact ownership interest held by LoopNet has not been made publicly available.

5 *See In the Matter of CoStar Group, Inc., Lonestar Acquisition Sub, Inc., and LoopNet, Inc.* (Complaint).

6 *See In the Matter of CoStar Group, Inc. et al.* (Analysis to Aid Public Comment)

7 *Id.*

8 Complaint at ¶11.

9 *See In the Matter of CoStar Group, Inc. et al.* (Decision and Order ¶II).

10 *See* Analysis to Aid Public Comment; Decision and Order ¶II.G.

11 *See* Decision and Order ¶III; Analysis to Aid Public Comment.

12 *Id.*

13 *See* Analysis to Aid Public Comment.

Ninth Circuit Affirms Dismissal of Cable-and-Satellite-TV Channel Bundling Case

By Joseph D. Adamson

The Court of Appeals for the Ninth Circuit affirmed a decision from the Central District of California dismissing the antitrust claims of a putative class of consumers of cable and satellite television. The plaintiffs sought to compel programmers and distributors of cable and satellite television to sell cable channels individually, rather than bundled together in multi-channel packages.

The plaintiffs' claims arise from the widespread practice of selling cable and satellite television channels as "bundles." Programmers, such as NBC Universal and Fox Entertainment Group (two of the programmer defendants in the action), sell television channels wholesale to distributors, such as Time Warner and DirecTV (two of the distributor defendants).[1] Plaintiffs alleged that the programmer defendants, because of their ownership of certain "must-have" channels (such as Fox Entertainment Group's Fox News Channel), required distributors to purchase all of the cable channels owned by the programmer in order to gain access to the "must-have" channels.[2] In turn, the plaintiffs alleged, the distributor defendants only offered to consumers sets of channels packaged into "tiers" rather than offering individual channels to consumers.[3]

The district court granted the defendants' motion to dismiss the plaintiffs' First Amended Complaint, finding that the plaintiffs had failed to allege market power and competitive injury. The plaintiffs filed a Second Amended Complaint (SAC), which survived a motion to dismiss.[4] The SAC alleged that the programmer defendants had used their market power to foreclose independent channels from needed modes of distribution.[5] Following discovery, the plaintiffs filed a Third Amended Complaint, this time removing allegations of such foreclosure. Plaintiffs then specifically requested the court to rule that allegations of foreclosure were not required to survive a motion to dismiss.[6] The defendants moved to dismiss and opposed the plaintiffs' motion on foreclosure.[7] The parties stipulated that the question of whether foreclosure of competition is a necessary element of a tying claim was a dispositive element of the plaintiffs' claim.[8]

The district court held that foreclosure of competition is a necessary element of a tying claim and granted the motion to dismiss. The court relied on *United States v. Loew's, Inc.,* which found a motion picture block booking scheme unlawful.[9] The court held that the Supreme Court in *Loew's* condemned the defendant's conduct because the competitive effect of the block booking practices was to create barriers to entry for small or independent producers.[10]

The Ninth Circuit agreed, holding that the plaintiffs had failed adequately to allege "injury to competition." [11] The plaintiffs did not allege that the programmers' practices of tying lower demand channels with "must-have" channels excluded other sellers of low-demand channels or raised barriers to entry; plaintiffs did not allege that bundling resulted in consumers purchasing fewer substitutes for the tied products, and plaintiffs did not allege that the bundling facilitated horizontal collusion either among the programmers or among the distributors.[12]

Rather, the plaintiffs alleged that the defendants' actions resulted in higher prices to consumers; reduced consumer choice; and limits on how distributors compete with one another.[13] The court found that, even assuming all of these effects were true as alleged, they were not cognizable as antitrust injury. The court held that the plaintiffs' theory, rather than alleging injury to competition, was merely a complaint that they were forced to pay higher prices to purchase cable channels that they would have preferred not to purchase. The Ninth Circuit affirmed that this kind of harm did not comprise "injury to competition" and the plaintiffs were required to show that the defendants foreclosed competition in the market for the tied product – in this case, the low demand channels. Absent such allegations, the plaintiffs' complaint failed to state a cause of action.

1 *Brantley, et al. v. NBC Universal, Inc., et al.*, No. 09-56785 (9th Cir. Mar. 30, 2012).

2 *Brantley*, No. 09-56785.

3 *Brantley, et al. v. NBC Universal, Inc., et al.*, No. 07-6101 (C.D. Cal. Oct. 15, 2009).

4 *Brantley*, No. 07-6101.

5 *Brantley*, No. 07-6101

6 *Brantley*, No. 09-56785.

7 *Brantley*, No. 09-56785.

8 *Brantley*, No. 07-6101; *see also* *Brantley, et al. v. NBC Universal, Inc., et al.*, No. 07-6101 "Joint Report Re March 9, 2009 Status Conference" (C.D. Cal., filed March 5, 2009).

9 371 U.S. 38 (1962).

10 *Brantley*, No. 07-6101.

11 *Brantley*, No. 09-56785.

12 *Brantley*, No. 09-56785.

13 *Brantley*, No. 09-56785.

Follow-up Note – *Leegin* in Kansas

By Alan J. Weinschel

We have commented in earlier editions of this newsletter on the Supreme Court's decision in *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, 551 U.S. 877 (2007) overruling long standing precedent and holding that vertical price fixing arrangements (aka resale price maintenance) were to be tested under the Sherman Act's rule of reason standard, rather than being considered *per se* unlawful. Many commentators noted at the time that state law would not necessarily follow federal law and that, for this reason, caution was still appropriate. The Kansas Supreme Court has recently confirmed that such caution is warranted.

In *O'Brien, et al. v. Leegin Creative Leather Products, Inc.* (CCH) 2012-1 Trade Cases ¶ 77,884) the court reversed summary judgment for Leegin, based on its interpretation of Kansas Antitrust law. We will forgo parsing the intricacies of Kansas law here, and instead summarize the court's holding, which is not a model of clarity:

- Kansas courts may be guided by federal antitrust jurisprudence, but they are not bound to follow it.
- Under Kansas law, any agreement or *arrangement* that is designed to increase, reduce, or control prices is unlawful. As to "arrangements," the court noted that "plaintiff does not have to show a relationship rising to the level of an agreement," though it also held that more than unilateral conduct is required.
- The rule of reason does not apply to lawsuits under the applicable Kansas laws because those laws flatly forbid all price fixing, without regard to whether horizontal or vertical.
- In the circumstances before it, the court held that a plaintiff consumer class of purchasers of products could proceed, reversing a lower court decision that the rule of reason applied and that plaintiffs had not demonstrated that they paid higher prices than they would have paid had the manufacturer ("Leegin" or "Brighton") not controlled resale prices. The court held that under Kansas law, "it is enough to demonstrate that the combination "is for the purpose[]. . .[t]o fix prices; a plaintiff does not have to show that the combination actually succeeds in increasing prices. 'For the purpose' contemplates a subjective standard, one that requires examination of the intent behind a defendant's behavior." Moreover, while the court noted that a plaintiff must come forward with evidence of injury or damages, this did not require "concrete evidence' and that there was "adequate circumstantial evidence" that consumers paid inflated prices due to the price-fixing "combinations or arrangements."

This decision is yet another reminder that the Supreme Court's *Leegin* decision may be federal law but that state law issues must be considered in connection with any effort to control resale prices.

Epilogue: After this decision an effort was made in the Kansas legislature to enact legislation codifying the Supreme Court's *Leegin* decision as Kansas law, and "correcting" the Kansas Supreme Court's interpretation. That effort passed in the Kansas House of Representatives but was rejected by the Kansas Senate.

European Antitrust Update

By Neil Rigby

European Commission's "Priority Rule" in Multiple Notifications: First-Notified Deal Receives Unconditional Clearance While Second-Notified Deal Requires Divestiture

On May 10, 2012, the European Commission published its merger clearance decision in the proposed acquisition by Seagate Technology of the hard disk drive (HDD) business of Samsung Electronics. (*See* Case M.6214 – *Seagate Technology / the HDD business of Samsung Electronics*.) The case aroused controversy because of the application of the Commission's unofficial "priority rule" – which has no formal basis in the EU Merger Regulation – to two cases that were notified only one day apart. Under this rule, the Commission conducts its assessment strictly on the basis of the competitive situation that applied at the time of each notification, and disregards any subsequent developments, including other pending transactions in the same sector that are known to the Commission.

Applying this rule, the Commission considered the first transaction (Seagate/Samsung) without taking account of a second transaction involving its competitors (the proposed acquisition by Western Digital of Hitachi's HDD business; *see* Case M.6203 – *Western Digital Ireland / Viviti Technologies*) which had been notified to the Commission one day later, but which had been the first to commence pre-notification discussions with the Commission. The priority rule had significant implications because the Commission cleared unconditionally Seagate's acquisition, yet required Western Digital to divest assets for the production of 3.5" hard disk drives and obtain upfront approval of a purchaser, principally because the industry had become too concentrated following the clearance of Seagate/Samsung.

Both transactions involved HDDs, which are used in a range of electronic goods (such as computers, digital video recorders, camcorders) to store and access digital data. At the time of notification of the first transaction (Seagate/Samsung), there were five HDD manufacturers active worldwide: Seagate, Samsung, Western Digital, Hitachi, and Toshiba. All five HDD suppliers were also active in the downstream market for external storage devices (ESDs), where a number of ESD-only suppliers were also active. The Commission assessed the transactions on the basis of worldwide markets for HDDs according to their end-use application (such as servers, desktop computers, mobile computers).

On May 30, 2011, the Commission opened Phase II proceedings in both transactions, as it expressed concerns about the high degree of concentration and potential coordination. In Seagate/Samsung, the Commission considered that the combined entity would account for a high share of HDDs, particularly 3.5" desktop HDDs where the merged entity would face competition from only Western Digital and Hitachi. In Western Digital/Hitachi, the Commission also expressed concerns that the combined entity would become the world's largest supplier of HDDs and would face only limited competition – only from Seagate/Samsung in 3.5" desktop HDDs, and only from Seagate/Samsung and Toshiba in 2.5" mobile HDDs. The Commission was also concerned about the possible effects of vertical integration. Upstream in the supply of HDD heads (used as an input in the manufacture of HDDs), the Commission was concerned that the combined businesses may engage in customer foreclosure by purchasing fewer HDD heads from third parties, particularly from TDK (the current supplier to Samsung), which could weaken TDK and diminish competition in the supply of HDD heads, and weaken competition in the supply of HDDs (as Toshiba relied on TDK for the supply of HDD heads). Downstream, the Commission was concerned that the combined entities could favour their own ESD businesses (which used HDDs as inputs) and engage in input foreclosure of competing non-integrated ESD suppliers.

Despite identifying common concerns in relation to the two transactions, the outcome of the Commission's assessment differed markedly in each case. In Seagate/Samsung, the Commission did not even issue a statement of objections (the formal document in which the Commission sets out its preliminary concerns, issued in the vast majority of Phase II cases), but instead approved the transaction unconditionally on October 19, 2011. The Commission noted that Samsung was not a strong competitor in the two main markets under consideration – 3.5" desktop HDDs, where three major suppliers would remain (Seagate/Samsung, Western Digital, and Hitachi), and 2.5" mobile HDDs, where four major suppliers would remain (the three listed above, plus Toshiba) – and that the existence of at least three suppliers in each market would ensure customers would have the opportunity to switch suppliers.

However, in Western Digital/Hitachi, the Commission issued a statement of objections and found that the acquisition of Hitachi's HDD business would (following the Seagate/Samsung merger) result in there being only two main suppliers (Western Digital/Hitachi and Seagate/Samsung) active in the supply of 3.5" desktop HDDs and consumer electronics HDDs. The Commission considered that this would not give customers a meaningful opportunity to switch suppliers because most customers needed to multi-source from at least two suppliers in order to maintain security of supply, and it was not sufficiently certain that Toshiba, a recent entrant in 3.5" desktop HDDs, could replicate the competition lost from Hitachi's HDD business. (The Commission separately concluded that the transactions would not result in customer foreclosure of TDK or input foreclosure of non-integrated ESD suppliers, and that the acquisition of Samsung would not increase the risk of coordination.) To address these concerns, the Commission granted conditional clearance on November 23, 2011, and required Western Digital to divest production assets for the manufacture of 3.5" HDDs, including a production plant, personnel, intellectual property rights, and the supply of HDD components to the divested business, and not to complete its acquisition of Hitachi's HDD business until it had agreed a binding agreement for the sale of the divestment business to a purchaser approved by the Commission.

The Commission considered the first to file merger without considering the effects of the second to file.

Western Digital has challenged the Commission's approach by bringing two applications for annulment before the General Court. First, halfway through the Phase II investigation in August 2011, Western Digital brought an application for annulment challenging the Commission's use of the priority rule and seeking disclosure of a range of documents relevant to the Commission's application of the priority rule (*i.e.*, internal Commission documents in both cases concerning prioritisation, correspondence with the parties in Seagate/Samsung, and third-party questionnaires sent by the Commission in both cases). Western Digital alleges that the Commission: (i) has no legal power to adopt a priority rule based on date of notification, and erred in law and violated principles of fairness and good administration in adopting a priority rule; (ii) violated Western Digital's legitimate expectations that the proposed acquisition would be assessed against the market structure that prevailed at the time that the deal was signed and pre-notified to the Commission; and (iii) violated principles of good administration, fairness, proportionality and non-discrimination by imposing additional burdens and not disclosing the fact that there was a parallel transaction affecting the same relevant markets which triggered the priority rule.

Second, on March 31, 2012 details of a second application for annulment were published, in which Western Digital seeks to annul the Commission's conditional merger clearance decision on the basis that: (i) the Commission's decision is vitiated by its application of the priority rule; (ii) the Commission issued disproportionate pre-notification requests for information, contrary to the principles of good administration, fairness, and non-discrimination, thereby denying Western Digital the opportunity to be considered the first-notified transaction; and (iii) the Commission failed to give Western Digital the opportunity to assess and rebut information and assumptions on which the decision was based, committed errors of law and relied on evidence that could not substantiate its conclusions, and imposed disproportionate remedies.

Both applications are currently pending before the General Court.

UK Imposes £58.5m Fine on British Airways in Passenger Fuel Surcharge Cartel

On April 19, 2012, the U.K. Office of Fair Trading (OFT) announced that it had imposed a fine of £58.5 million on British Airways for exchanging pricing and other commercially sensitive information with Virgin Atlantic Airways in order to coordinate passenger fuel surcharges on long-haul flights to and from the United Kingdom, contrary to the UK and EU competition rules in section 2 of the Competition Act 1998 and Article 101 of the Treaty on the Functioning of the European Union. Virgin Atlantic received full immunity for disclosing the existence of the infringement.

The OFT's investigation began in 2006, prompted by Virgin Atlantic revealing the infringement to the OFT. A parallel investigation was also commenced in the United States by the Department of Justice following disclosures by Virgin Atlantic (in respect of passenger fuel surcharges) and Lufthansa (in respect of cargo fuel surcharges). In August 2007, the OFT announced that it had reached an early resolution agreement with British Airways, in which British Airways admitted that, on at least six occasions between August 2004 and January 2006, British Airways and Virgin Atlantic had discussed or informed each other about the fuel surcharges that each company proposed to implement in response to rising oil (and jet fuel) prices. The surcharges were added to ticket prices, and increased twelve-fold over the relevant period (from around £5 to £60 per ticket). British Airways agreed to pay a fine of £121.5 million (after reductions for leniency and further cooperation) – the highest fine that the OFT had ever imposed – once the OFT completed its investigation. In the parallel US investigation, the Department of Justice also announced in August 2007 that British Airways had agreed to plead guilty and pay a fine of $300 million for coordinating cargo and passenger fuel surcharges on long-haul flights to and from the United States.

Following the early resolution agreement, the OFT suspended its competition law investigation pending the outcome of its ongoing criminal investigation under the criminal cartel offence in section 188 of the Enterprise Act 2002 into whether any individuals at British Airways had dishonestly colluded to fix the level of surcharges. (Individuals at Virgin Atlantic were granted immunity from prosecution.) Four British Airways executives were charged in 2008 and put on trial in April 2010. However, the OFT withdrew the charges shortly after the trial began once it became apparent that a substantial volume of recently discovered electronic documents – including emails from a Virgin Atlantic employee due to testify on behalf of the OFT – had not been reviewed by the OFT or disclosed to the defence. The collapse of the trial led to criticism of the OFT's handling of the case, and prompted a detailed internal review of and changes to the OFT's procedures for conducting criminal investigations.

Following termination of the criminal proceedings, the OFT recommenced its competition law investigation and issued a statement of objections in November 2011. In announcing its final decision in April 2012 (which has not yet been published), the OFT indicated that it had significantly reduced the fine imposed on British Airways – from £121.5 million to £58.5 million. This reflected, in part, the fact that the value of the information provided by British Airways was much greater than had originally been anticipated at the time of the early resolution agreement. However, the OFT also reduced the fine in order to take account of recent judgments of the Competition Appeal Tribunal in a series of cartel cases in the construction sector, in which the Tribunal found that the OFT's previous approach to calculating penalties resulted in fines that were excessive, disproportionate, and failed to have sufficient regard to the specific facts of each case. The OFT is expected to publish its final decision later this year.

European Commission Prohibits Proposed NYSE Euronext/Deutsche Börse Merger

On February 1, 2012, following an in-depth Phase II investigation, the European Commission prohibited a proposed merger between NYSE Euronext and Deutsche Börse. This is only the third prohibition decision since the current EU merger regulation was adopted in 2004, following prior prohibitions in Ryanair/Aer Lingus (2007) and Olympic Air/Aegean Airlines (2011).

NYSE Euronext and Deutsche Börse both operate financial exchanges: NYSE Euronext operates equities exchanges in New York, Paris, Amsterdam, Brussels and Lisbon, and operates the Liffe derivatives exchange in London; and Deutsche Börse operates the Frankfurt equities exchange and the Eurex derivatives exchange, and is also active in clearing and settlement of financial instruments. The Commission identified concerns with respect to the parties' activities in European derivatives traded on exchange, as the parties are the two largest European derivatives exchanges and are actual or potential competitors in this sector.

The Commission found exchange and over-the-counter trading to be distinct markets.

Derivatives are financial contracts the value of which is derived from an underlying asset (such as an interest rate, equity, equity index, commodity), and may be traded on-exchange (on derivatives exchanges such as Liffe or Eurex) or off-exchange (also known as "over-the-counter" or OTC) directly between parties. The Commission noted that the parties' derivatives trading activities principally relate to on-exchange trading of (i) interest rate derivatives (short-term interest rate derivatives based on European interbank lending rates, and long-term interest rate derivatives based on European government debt), (ii) single equity derivatives (based on individual equities traded on European equities exchanges), and (iii) equity index derivatives (based on European equity indices). The Commission also noted that on-exchange trading and OTC trading had different characteristics and fulfilled different customer demands, as on-exchange contracts were based on standard terms and were of relatively lower value, while OTC contracts were much more customised and of a significantly higher value. Moreover, trading OTC tends to be more expensive than trading on-exchange, and many counterparties are unwilling or unable to trade OTC for risk management reasons. The Commission therefore considered the effect of the proposed merger on markets for European derivatives traded on-exchange.

While these markets were found to be worldwide, the Commission noted that liquidity was concentrated onto a small number of exchanges, and that other global derivatives exchanges (such as the Chicago Mercantile Exchange) had only a minimal presence in trading European derivatives. The parties combined thus accounted for more than 90% of on-exchange trading in European derivatives. The Commission also found that the parties were each other's closest competitors, as they each traded similar types of European derivatives, had similar membership bases, and had no other competitor that was able to offer a similar range of products, depth of liquidity, or scope for margining across products. This closeness of competition had prompted fee cuts and innovation, and the threat of customer switching ensured that competition remained strong between the two exchanges. The merger would eliminate this competition.

The Commission further found that the loss of competition would be exacerbated by the fact that both Liffe and Eurex operate closed "vertical silos" that integrate trading and clearing (post-trade processing) of derivatives contracts. A vertical silo structure ensures that all derivatives contracts traded on each party's exchanges are cleared through the party's own clearing system, while any other derivatives contracts that the same customer might trade on other exchanges cannot be cleared through that clearing system. This structure operates as a significant barrier to entry because it ensures that the substantial efficiencies of clearing similar contracts through a single clearing system are available only for trades made on the parties' exchanges and are not available for any trading volume that a customer might conduct on another exchange, thereby acting as a major deterrent to customers that might consider switching some of their trading volume. As a result, the Commission considered that this vertical silo structure would reinforce the monopolistic position of the parties post-merger.

The parties' efficiency arguments were insufficient to outweigh the anticompetitive effects.

The Commission rejected the parties' arguments that significant efficiencies would result from the merger. In particular, while the parties argued that exchange consolidation had the potential to increase trading liquidity, the Commission found that there was no evidence for this assertion, and that academic studies suggested that greater liquidity benefits may in fact be generated from competition between exchanges. Similarly, while the Commission accepted that the merger would likely result in some collateral savings as a result of greater cross-margining across more trading activity, some of the benefits could be achieved without the merger, and the monetary value of this benefit was relatively modest and insufficient to outweigh the detriment to competition.

To address the Commission's concerns, the parties proposed a three-part remedy, which the Commission found was insufficient to restore the competition that would be lost as a result of the merger. First, the parties offered to divest part of Liffe's European single equity derivatives business. However, the Commission found that the divested assets may not be viable on a stand-alone basis, as the range of derivatives was small and not sufficiently diversified, and it was unclear whether regulatory approvals could be obtained and whether customers would actually transfer to a new acquirer rather than simply trade out of their existing positions.

Second, the parties offered to provide third parties with access to their clearing system for any materially new derivatives contracts based on interest rates, bonds or equity index derivatives. The Commission also rejected this proposal because it did not apply to existing contracts, new products were developed only rarely (as most innovations related to existing contracts), and market testing suggested that there were no contracts that would meet the strict eligibility criteria and for which there would be customer demand.

Third, the parties offered to license Eurex's interest rate derivatives trading software. However, the Commission found that this proposal was immaterial because other competitors generally already had such software.

Given the competition concerns identified above, and the absence of any effective remedy proposals, the Commission held that the proposed merger should be prohibited because it was likely to significantly impede effective competition. The parties subsequently abandoned the transaction. A parallel United States Department of Justice investigation was then closed as moot.

Antitrust Update is published four times a year by the Antitrust/Competition practice group of Weil, Gotshal & Manges LLP, 767 Fifth Avenue, New York, NY 10153, +1 212 310 8000, www.weil.com.

Editor:

Alan J. Weinschel (NY)	alan.weinschel@weil.com	+ 1 212 310 8550

If you need further information or have questions concerning the contents of this issue, please speak to your regular contact at Weil, or to the editor, practice group leaders or contributing authors:

Practice Group Contacts and Contributing Authors:

Steven A. Newborn (DC)	steven.newborn@weil.com	+ 1 202 682 7005
Laura A. Wilkinson (DC)	laura.wilkinson@weil.com	+ 1 202 682 7260
Daniel Antalics (DC)	daniel.antalics@weil.com	+ 1 202 682 7235
Meaghan Thomas-Kennedy (NY)	meaghan.thomas-kennedy@weil.com	+ 1 212 310 8316
Robin Cook (DC)	robin.cook@weil.com	+ 1 202 682 7107
Megan Peloquin (DC)	megan.peloquin@weil.com	+ 1 202 682 7026
Joseph D. Adamson (NY)	joseph.adamson@weil.com	+ 1 212 310 8003
Neil Rigby (London)	neil.rigby@weil.com	+ 44 20 7903 0990