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Subtracting Plus Factors: First Circuit Finds Recycling Company's Pleading Plausible Under *Twombly* Standard

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Admonishing courts to be wary of conflating the *Twombly* pleading requirements to withstand a motion to dismiss with the standard applicable to a summary judgment motion, the First Circuit held, in its recent *Evergreen Partnering*[1] decision, that a recycling company's circumstantial allegations of a horizontal boycott among producers of polystyrene products plausibly stated a conspiracy claim under Section 1 of the Sherman Act and should not have been dismissed. In *Evergreen*, the three-judge panel vacated the district court's dismissal of plaintiff Evergreen's claims that the defendant producers of polystyrene products conspired to keep Evergreen out of the market for polystyrene recycling, and faulted the district court for improperly occupying a fact-finder's role when it "chose among plausible alternative theories interpreting defendants' conduct."[2]

The appellate court also rejected the notion that, in order to meet the Supreme Court's standard for a pleading to survive a motion to dismiss set out in *Twombly*, a plaintiff must allege "plus factors," or specific circumstances indicating that defendants entered into an agreement. Even without such allegations, the First Circuit seemed to suggest, the complaint can still place defendants' challenged parallel conduct in a context that plausibly suggests a conspiracy. In earlier articles, we examined 2012 and 2013 Second Circuit decisions in which the allegation of such "plus factors" to support motions to dismiss conspiracy claims featured prominently

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and, indeed, appeared crucial to a complaint's survival under *Twombly*—at least in the Second Circuit.[3] By contrast, in *Evergreen*, the First Circuit noted that while plus factors are "certainly helpful," they are not necessary for a plaintiff to survive a motion to dismiss[4]—although, as noted below, potential plus factors were alleged in the complaint.

Background

According to the complaint, Evergreen was the first company to develop a business model to recycle polystyrene products by using a post-consumer polystyrene resin (PC-PSR) to create what it called "Poly-Sty-Recycle."[5] Evergreen's business model involved collecting polystyrene products from large school systems, processing them into PC-PSR, and then using the PC-PSR to manufacture new products for use in the same school system, as well as in other products.[6] According to Evergreen, its initial partnerships were successful, including pilot programs with school systems.[7] However, Evergreen lacked the production capacity to meet the growing demand from bulk consumers such as large school systems, fast-food operators, supermarkets and institutional cafeterias, and its success was thus dependent on partnering with at least one of the five polystyrene producers that made up an estimated 90 percent of the market for single-service polystyrene food service packaging and tableware.[8]

In 2005, one of those producers, Dolco Packaging, allegedly expressed an interest in working with Evergreen.[9] According to the complaint, however, in late 2005 or 2006, during a meeting of a business group consisting of manufacturers of food service packaging made from polystyrene, representatives of two of the allegedly dominant producers announced that recycling polystyrene products was not an option, in view of the industry's battles with polystyrene critics.[10] These two companies allegedly used their dominant market positions, and the fact that they provided significant funding to the business group, to prevent the other large polystyrene food service product manufacturers from working with Evergreen.[11] Shortly after the meeting, Dolco broke off most aspects of its agreement with Evergreen.[12] Additionally, other large producers not only refused to work with Evergreen, but, according to the complaint, took other steps to undermine Evergreen's efforts to expand its business model, including the promotion of what Evergreen claimed was a sham competitor.[13] In December 2008, allegedly as a result of defendants' conduct, Evergreen was forced to shut down its operations.[14]

Evergreen filed a lawsuit against the five large polystyrene food service product manufacturers and their trade association, alleging that they had agreed to boycott Evergreen in violation of Section 1 of the Sherman Act and the Massachusetts Fair Business Practices Act (commonly known as Chapter 93A).[15] The defendants moved to dismiss for failure to state a claim.[16] The district court granted defendants' motion, noting that, as in the Supreme Court's decision in *Twombly*, there were "legitimate business reasons" that could "as easily explain defendants' refusal to deal with Evergreen or to compete with one another for market share as [could] any insinuation of a conspiratorial agreement."[17] Evergreen appealed. The First Circuit reversed, declaring that Evergreen's allegations were sufficient under *Twombly* to support a plausible conspiracy claim under Section 1.[18]

Court of Appeals Decision

The First Circuit initially noted that the Supreme Court's directive in *Bell Atlantic v. Twombly* that in order to survive a motion to dismiss, a complaint must allege a "plausible" agreement, rather than mere parallel conduct, had "elicited comparable confusion among the lower courts."[19] This confusion, according to the First Circuit, has led to a "slow influx of unreasonably high pleading requirements at the earliest stages of antitrust litigation," including improper citations to case law evaluating antitrust claims at the summary judgment or post-trial stage, rather than at the motion to dismiss stage.[20] The court

stressed that it was "imperative" that it "correct this confusion and clarify the proper pleading requirements for sufficiently alleging agreement in §1 complaints."[21]

The First Circuit panel began by examining the Supreme Court's "guidance" in *Twombly* as to how to plead an agreement properly.[22] The court first noted that the *Twombly* court required more than a complaint based exclusively on allegations of parallel conduct—the allegations contained in the complaint must be "placed in a context that raises a suggestion of" of an agreement.[23] Specifically, the complaint must "at least allege the general contours of when an agreement was made, supporting those allegations with a context that tends to make said agreement plausible."[24] According to the First Circuit, *Twombly* also clarified that there is no probability requirement at the pleading stage; rather, a plaintiff need only plead "enough facts to raise a reasonable expectation that discovery will reveal evidence of illegal agreement."[25] The court went on to note that "[i]t is not for the court to decide, at the pleading stage, which inferences are more plausible than other competing inferences, since those questions are properly left to the factfinder."[26]

The court then turned to a discussion of what it perceived to be the lower courts' increasing examination of "plus factors" in determining the plausibility of an alleged agreement.[27] The court pointed to the genesis of the use of plus factors as a footnote in *Twombly* in which the Supreme Court referred to commentators' examples of the types of evidence that may indicate collusion, including:

> . . . parallel behavior that would probably not result from chance, coincidence, independent responses to common stimuli, or mere interdependence unaided by an advance understanding among the parties[;] . . . conduct [that] indicates the sort of restricted freedom of action and sense of obligation that one generally associates with agreement.[28]

The First Circuit commented that, although "many courts have referenced 'plus factors' in analyzing the plausibility of § 1 claims at the pleadings stage," such references have "invariably been drawn from cases evaluating the merits of an antitrust plaintiff's conspiracy claim at the summary judgment and trial stages of litigation, when there is significantly more information available regarding whether complex analyses of pricing structures and other information suggest agreement."[29] While the court recognized that a conspiracy claim could "be made more plausible by bolstering factual allegations of parallel conduct with appropriate 'plus factors,'" it added that it was not necessary for a plaintiff to allege such factors at the motion to dismiss stage, provided the plaintiff provided "other, more general allegations informing the context of an agreement . . . ."[30]

In the complaint before it, the court concluded that Evergreen had properly alleged the general contours of an agreement, and had supported its allegations with context that tended to make the agreement more plausible. Specifically, the First Circuit emphasized that Evergreen had pointed to the 2005–2006 business trade meeting as "the locus of the agreement," alleging that all defendants were members of the trade association, and that two dominant defendants specifically had expressed their position at that meeting that recycling polystyrene products—of which Evergreen was the sole provider—was not an option in light of the industry's battle with polystyrene critics.[31] The court stated that Evergreen's claim was further supported by defendants' parallel conduct after the meeting, including their "global failure" to adopt Evergreen's closed-loop system.[32] The court declared particularly noteworthy Evergreen's allegation regarding defendants' promotion of an allegedly sham competitor, which the court believed described "proactive destructive conduct" that was "difficult to explain outside the context of a conspiracy."[33] The court added that the complaint provided other allegations setting forth circumstantial

evidence that, taken together, established a context for a plausible agreement in the form of industry information and facilitating practices, including the following facts: (i) that the polystyrene food services industry was highly concentrated, (ii) that Evergreen's success was dependent on the participation of at least one of the defendants, (iii) that defendants' alleged conduct stifled innovation in the market for recycling polystyrene food service products, and (iv) that defendants in an email had denied a request from Evergreen for funding.[34]

Finally, the court said it was of no moment at the pleading stage that defendants had asserted that their refusal to deal with Evergreen was based on legitimate business reasons, such as the fact that Evergreen's PC-PSR was, in fact, more expensive than virgin resin.[35] The court remarked that while the reasons provided by defendants for their parallel refusal to deal with Evergreen could prove, during later states of litigation, enough to prevent Evergreen from sufficiently ruling out the possibility of independent action, it was not up to the court to choose among plausible alternative theories for interpreting defendants' conduct at the motion to dismiss stage.[36]

Analysis

The First Circuit's *Evergreen* decision quoted extensively from the Second Circuit's recent decision in *Anderson News, L.L.C. v. American Media, Inc*. [37] to support its proposition that, in the case of competing plausible explanations for parallel behavior at the motion to dismiss stage, the benefit of the doubt must go to the plaintiff. However, the First Circuit's statements regarding plus factors seem to depart from both *Anderson News* and another recent Second Circuit case, *Mayor and City Council of Baltimore, Maryland v. Citigroup, Inc.,*[38] each of which emphasized plus factors in considering dismissal motions.

First, the three-judge *Anderson News* panel denied a motion to dismiss a complaint challenging parallel conduct in the magazine distribution industry, stressing that the plaintiffs had referred to various dates during which specific executives had met or communicated with their competitors and others, and statements that plausibly could have been interpreted as evincing defendants' agreement to eliminate competitors from the market.[39] These plus factors, according to the Second Circuit, were sufficient to differentiate the allegations from those made in *Twombly,* thereby allowing the complaint to survive a motion to dismiss.[40]

Second, in *Citigroup*, in which a group of securities buyers and dealers alleged that financial institutions had conspired to simultaneously exit the market for auction rate securities, a partly distinct panel of three judges noted that a horizontal agreement could be inferred on the basis of conscious parallelism when such interdependent conduct "is accompanied by circumstantial evidence *and plus factors*."[41] The Second Circuit *Citigroup* panel concluded that the plus factors alleged by plaintiffs—including a handful of interfirm communications—evidenced merely conscious parallelism and not agreement, and dismissed the complaint.[42]

Can the First Circuit's *Evergreen* opinion be harmonized with the Second Circuit's recent decisions? Importantly, despite the First Circuit's dicta regarding plus factors, the *Evergreen* plaintiffs *did* allege specific circumstances that could be considered plus factors—a trade association meeting Evergreen claimed was the "locus of the agreement," and the promotion by the defendants of an alleged sham competitor—and the First Circuit gave considerable weight to these factors in its analysis. Thus, the apparent conflict between the two appellate courts about whether "plus factors" are necessary to survive a motion to dismiss may be more semantics than substance, and it is possible the *Evergreen* plaintiffs would have likewise survived a motion to dismiss in the Second Circuit. However, the specific

requirements necessary for a plaintiff to allege an agreement plausibly and survive a motion to dismiss in a conspiracy case remain murky and may, at this point, be circuit court panel-dependent.

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1 *Evergreen Partnering Grp., Inc. v. Pactiv Corp*., No. 12-1730, Slip Op. at *37 (1st Cir. June 19, 2013), available here.
2 *Id.*
3 *See* Emily Sickelka, The Power of Plus Factors: Rational Business Behavior Leads to Dismiss of Conspiracy Claim Against Broker-Dealers in Second Circuit, Greenberg Traurig Antitrust Quarterly, Spring 2013, available here; Scott Martin, Second Circuit Finds Anderson News Pleading is Plausible ... Enough, Greenberg Traurig Antitrust Quarterly, Spring 2012, available here.
4 Evergreen Partnering Grp., Inc., No. 12-1730, Slip Op. at *29.
5 *Id*. at *3–4.
6 *Id.* at *4.
7 *Id.* at 7.
8 *Id.* at *5, 8.
9 *Id*. at 9.
10 *Id.*
11 *Id.*
12 *Id.* at 10.
13 *Id*. at 10–17.
14 *Id*. at 17.
15 *Id.*
16 *Id.*
17 *Evergreen Partnering Grp., Inc. v. Pactiv Corp*., 865 F. Supp. 2d 133, 140 (D. Mass. 2012).
18 Evergreen Partnering Grp., No. 12-1730, Slip Op. at *18.
19 *Id*. at *22.
20 *Id*. at *23.
21 *Id.* at *22–23.
22 *Id.* at *23.
23 *Id.* at *24 (quoting *Bell Atlantic v. Twombly,* 550 U.S. 544, 556–57 (2007)).
24 *Id*. at *28.
25 *Id*. at *25 (quoting Twombly, 550 U.S. at 556)).
26 *Id.*
27 *Id*. at *28.
28 *Id.* at *25 (quoting Twombly, 550 U.S. at 557 n.4).
29 *Id*. at *28.
30 *Id.* at *29.
31 *Id.* at *31.
32 *Id.* at *32.
33 *Id*. at *33.
34 *Id.* at *33–36.
35 *Id*. at 37.
36 *Id.* at 37–38.
37 680 F.3d 162 (2d Cir. 2012).
38 709 F.3d 129 (2d Cir. 2013).
39 Anderson News, L.L.C., 680 F.3d at 187.
40 *Id.*
41 709 F.3d at 136 (emphasis added).
42 *Id*. at 137–38.

Ninth Circuit Decision Addresses Standards for Claim That Buyer Knowingly Received Unlawfully Discriminatory Prices in Violation of Robinson-Patman Act

By Irving Scher - New York, NY

Background

On July 19th, the Ninth Circuit Court of Appeals issued a *per curiam* decision in *Gorlick Distribution Centers, LLC v. Allied Exhaust Systems, Inc.*,[1] a rare Robinson-Patman Act (R-P) court of appeals decision addressing a claim that a purchaser knowingly received unlawfully discriminatory prices from a supplier in violation of Section 2(f) of the statute.[2]

The case involved the automotive parts industry, in this instance, muffler and catalytic converters manufactured by Car Sound Exhaust System, Inc. (Car Sound). Car Sound had earlier settled Gorlick Distribution Centers, LLC's (Gorlick) claim under Section 2(a) of the R-P Act that Car Sound had unlawfully discriminated in price against Gorlick in favor of Allied Exhaust System (Allied). Gorlick thereafter continued its companion claim that Allied had violated Section 2(f) of the R-P Act by knowingly receiving unlawfully discriminatory prices from Car Sound. In particular, Gorlick contented that Allied received volume discounts when it did not meet the requirements for such discounts, was given free shipping on some of its purchases when Car Sound did not offer such a benefit to customers, and was awarded higher year-end sales rebates than were merited.

A purchaser in a Section 2(f) case has available to it all of the defenses that are available to a supplier charged with providing discriminatory prices to the favored purchaser in violation of Section 2(a) of the R-P Act. In other words, a Section 2(a) violation by the supplier is a preliminary requirement of a Section 2(f) claim against a purchaser. Moreover, it must be proven in a 2(f) case that the allegedly favored purchaser had "knowledge" that it was receiving an unlawfully discriminatory price from the supplier involved.

The Ninth Circuit Decision

The Ninth Circuit panel, which included Chief Judge Kozinski, noted at the outset that in granting summary judgment dismissing the suit, the district court had assumed that the prices Allied was charged were prohibited by the R-P Act.[3] Allied argued in defense, however, that it didn't know what prices other distributors received, and therefore it couldn't "knowingly" have received unlawfully discriminatory prices. The Ninth Circuit agreed, and ruled that Gorlick had not provided sufficient evidence to establish that Allied was more than an "innocent beneficiary" of discriminatory prices, and therefore Gorlick had not established the "knowledge" requirement of Section 2(f).[4] In reaching this conclusion, the court considered and rejected in turn each of the three arguments raised by Gorlick: (i) that Allied in fact had knowledge that it was receiving illegal prices from Car Sound; (ii) even if it did not have such knowledge, Allied's "trade experience" should have put it on notice that those prices were prohibited by the R-P Act; and (iii) Allied's dealings with Car Sound put it on " inquiry notice" that it was receiving prohibited prices.

1. Actual Knowledge

The Ninth Circuit panel first considered whether Gorlick had established "actual knowledge" by Allied that it was receiving unlawfully discriminatory favored prices from Car Sound. It concluded that Gorlick had not done so, based on the following facts brought out in pretrial discovery:

- Gorlick and Allied were very different types of Car Sound customers. Allied made Car Sound its "flagship" brand, and purchased Car Sound products in much higher volumes than Gorlick, and provided promotional services that Gorlick did not. According to the Ninth Circuit panel, there was no evidence that Allied knew that its pricing benefits resulted from anything other than the significant differences in how the two customers did business. [5]
- Although Allied received discounts below Car Sound's price list, the R-P Act "doesn't prohibit buyers from haggling for a better deal. To put a buyer at risk of liability any time he asks for a lower-than-listed price would do enormous damage to the 'sturdy bargaining between buyer and seller for which scope was presumably left' by our antitrust laws"[Citing the Supreme Court 1953 *Automatic Canteen* Section 2(f) decision[6]].
- In any event, it was possible that discount prices were made available to Gorlick as well, because there was evidence that at times it also purchased below list prices.[7]
- The fact that an e-mail the supplier Car Sound had sent to Allied saying that because of its settlement with Gorlick, it "unfortunately" would have to offer Gorlick the same prices that it provided to Allied did not establish that Allied *knew* what prices Gorlick was getting before the suit was brought [a somewhat surprising conclusion in a summary judgment ruling]. [8]
- An Allied meeting agenda showing it actually had planned to ask Car Sound to raise Gorlick's prices did not establish that Allied in fact made such a request, or that that the request was granted [another surprising determination in a summary judgment ruling].[9]

2. Trade Experience Knowledge

The Ninth Circuit panel next considered Gorlick's argument that Allied's "trade experience" should have placed it on notice that the favorable prices it received were unlawful. The court declared that because Allied and Gorlick were very different types of customers, purchasing in very different quantities and with very different promotional assistance to Car Sound, the only argument open to Gorlick was that Allied should have known that these differences did not justify the price breaks it received. But, according to the court, Gorlick had not presented evidence that the deals Allied received were anything more than an incentive for the continued loyalty Allied had shown to Car Sound through Allied's development of an electronic ordering system that reduced errors and streamlined its dealings with Car Sound, and for the fact that Allied had purchased roughly 15 times the dollar amount of Car Sound products than Gorlick did.[10]

In reaching its conclusion, the Ninth Circuit distinguished a 55-year-old FTC auto parts decision in which the allegedly favored buyers belonged to buying groups and knew that they were getting better prices than they could have gotten through their individual purchases.[11] Allied, however, was not part of such an organization, and Gorlick had not explained why Allied nevertheless should have known that the favorable prices it received from Car Sound were unwarranted.[12]

3. Duty To Inquire

Finally, the court rejected Gorlick's argument that the very favorable prices Allied received required it to inquire whether Car Sound was offering it unlawfully discriminatory prices. According to the Ninth Circuit, the only decision relied on by Gorlick for this alleged obligation was a 47-year-old Ninth Circuit decision in which the buyer had sought and obtained an assurance from its suppliers that none of the buyer's competitors would be offered the same deal—a Most Favored Nations Plus requirement of a nature that Allied had not sought from Car Sound. [13]

In sum, the Ninth Circuit concluded that Gorlick had failed to show that Allied had actual knowledge, trade knowledge or a duty to inquire whether the favorable prices it received might be prohibited by the R–P Act, and summary judgment dismissal was affirmed.[14]

Analysis

The Ninth Circuit *Gorlick* decision underscores why an allegedly injured customer has a very difficult task in proving that a competing customer violated Section 2(f) of the R-P Act—even when the applicable supplier has violated the statute and the favored customer is actually aware that it has received discriminatory prices. The receipt of better-than-published prices, without more, is insufficient, at least according to the Ninth Circuit. The plaintiff must also prove that the favored customer had actual knowledge, or should have known from its trade experience, that the prices it was charged were in fact unlawful. As the Ninth Circuit pointed out, R-P:

> "doesn't prohibit buyers from haggling for a better deal...To put a buyer at risk of liability any time he asks for a lower-than-listed price would do enormous damage to the 'sturdy bargaining between buyer and seller for which scope was presumably left' by our antitrust laws."[15]

Thus, if the buyer is purchasing at a much higher volume than the plaintiff, and/or is offering more marketing and promotional services to the supplier, the plaintiff may find it very difficult to prove that the favored customer has "knowingly" obtained an *unlawfully* lower price in violation of §2(f). This suggests that a buyer should not demand a price advantage, and should not seek information about the prices being charged to competitors.

While not mentioned in the Ninth Circuit decision, there often is another statutory protection available in cases such as *Gorlick*. If the favored customer has requested that the supplier meet the pricing offered by a competitor, both the supplier and the buyer likely have avoided R-P entirely under the "meeting competition" defense available to the supplier.[16]

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[1] 2013 WL 3766902 (9th Cir. July 19, 2013).
[2] 15 U.S.C.A. §13(f).
[3] 2013 WL 3766902, at *2.
[4] *Id.* at *4.
[5] *Id.* at *2.
[6] *Automatic Canteen Co. of America v. FTC,* 346 U.S. 61, 74 (1953).
[7] 2013 WL 3766902 at*3.
[8] *Id.*
[9] *Id.*
[10] *Id.* at *3.
[11] In re D & N Auto Parts Co., 55 F.T.C. 1279 (1955).
[12] 2013 WL 3766902, at *3.
[13] Id. at *4, distinguishing *Fred Meyer, Inc., v. FTC*, 359 F.2d 351 (9th Cir. 1966), rev'd on other grounds, 390 U.S. 341, 358 (1968).

[14] The Ninth Circuit also affirmed summary judgment granted to Allied with respect to a Sherman Act claim that it had devised a conspiratorial shipping policy with Car Sound, declaring 2-1 that there was no evidence that the alleged restraint that was involved injured marketplace competition as distinguished from injury to Gorlick, an individual competitor. The dissenting judge argued that the Sherman Act issue had not been thoroughly developed by the lower court and should be remanded for further proceedings.
[15] 2013 WL 3766902, at *2.
[16] See *Great Atlantic & Pacific Tea Co. v. FTC*, 440 U.S. 69, 76 (1979).

It May Be Steel, but Its Supply is Elastic: Eleventh Circuit Rejects Market Definition That Fails to Account for Ease of Entry

By Scott Martin – New York, NY

In a decision undergirded by fundamental principles of economics, burden of proof and common sense, the Eleventh Circuit affirmed the entry of summary judgment dismissing attempted monopolization claims against a producer of untreated hot rolled steel in *Gulf States Reorganization Group, Inc. v. Nucor Corp.*,[1] on the ground that manufacturers of another product easily could – and likely would – enter the market in response to a significant price hike by a potential monopolist. What the *GSRG* opinion lacks as gripping drama based on the facts, it makes up for as a lesson on what is often the most crucial element of a Sherman Act Section 2 case: product market definition.

Commonly litigated are issues of cross-elasticity of demand and the potential exclusion of substitute products resulting in a too-narrow market definition – or, in the familiar words of Justice Fortas, the "strange, red-haired, bearded, one-eyed man with a limp" market criteria.[2] Perhaps less often the focus of judicial opinion, but no less important to the viability of a monopolization-related offense, are issues of cross-elasticity of supply – *i.e.*, the ease with which other manufacturers could enter the market. The failure of plaintiff GSRG to account for that cross-elasticity doomed its attempted monopolization claim.

"Like a swallow returning to Capistrano,"[3] GSRG's case – which arose out of the bankruptcy of Gulf Coast Steel in 1999 – had returned to the Eleventh Circuit, following a reversal of the dismissal of its initial complaint, after an extended post-remand sojourn in the Northern District of Alabama. GSRG was an entity that wished to enter the market for black hot rolled coil steel by purchasing the assets of Gulf Coast Steel out of bankruptcy. Nucor is a leading manufacturer of black hot rolled coil steel that GSRG alleged had conspired with other entities to purchase the steel-producing assets of Gulf Coast in order to block competition in and monopolize the black hot rolled coil steel market. GSRG further alleged that Nucor had attempted to monopolize the same market. The district court granted summary judgment, accepting the reports and recommendations of the special master.[4] The Eleventh Circuit affirmed based on those reports and also the district court's order, but wrote specifically to address cross-elasticity of supply as it related to the attempted monopolization claim against Nucor.[5]

As the Eleventh Circuit panel[6] underscored, a necessary element of an attempted monopolization offense is the "dangerous probability of success [that] arises when the defendant comes close to achieving monopoly power in the relevant market," which a plaintiff can show "only if it can properly define the relevant market."[7] Of particular note with respect to GSRG's assertion of a black hot rolled coil steel product market is the fact that, with the additional process of an acid bath and oil coating, new black hot rolled coil steel can be made into "pickled and oiled" steel – and conversely, *merely by skipping that step*, manufacturers of pickled and oiled steel could produce black hot rolled coil steel.[8] Citing the Ninth Circuit's *Rebel Oil* decision,[9] the Eleventh Circuit panel observed that GSRG's assertion that "pickled and

oiled steel is not the equivalent of black hot rolled coil steel from the perspective of purchasers ... misses the point."[10] In addition to demand considerations, market definition must also take into account cross-elasticity of supply, which is another way in which producers can take business away from a monopolist. The panel concluded, "the black hot rolled coil steel market ... has a high cross-elasticity of supply."[11]

Thus, had Nucor obtained a monopoly in black hot rolled coil steel and inflated its prices, the court reasoned, it would be likely that pickled and oiled steel manufacturers would skip the "pickling" process (and save the attendant costs) and sell black hot rolled coil steel, thus introducing price discipline. Indeed, and unfortunately for GSRG, one of its own experts conceded that manufacturers of pickled and oiled steel would produce black hot rolled coil steel if the latter were selling at a higher price[12] - leaving GSRG in a pickle of its own: unable to establish a likelihood that Nucor could succeed in an attempted monopolization.

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[1] No. 11-14983, ___ F.3d ___ (11th Cir. July 15, 2013) (*GSRG*).
[2] *See United States v. Grinnell Corp.*, 384 U.S. 563, 591 (1966) (Fortas, J., dissenting). The author's first antitrust trial – coincidentally, also affirmed in the Eleventh Circuit – turned (to the client's advantage) on this very element. *See United States v. Engelhard Corp.*, 126 F.3d 1302 (11th Cir. 1997).
[3] *GSRG*, Slip Op. at 1.
[4] *See Gulf States Reorganization Group v. Nucor Corp.*, 822 F. Supp. 2d 1201 (N.D. Ala. 2011).
[5] *GSRG*, Slip. Op. at 2-3.
[6] The unanimous opinion was authored by Judge Jordan, joined by Judges Carnes and Tjoflat (the court's resident antitrust scholar).
[7] *GSRG*, Slip. Op. at 7 (citations omitted).
[8] *Id.* at 8.
[9] *Rebel Oil Co. v. Atlantic Richfield Co.*, 51 F.3d 1421, 1436 (9th Cir. 1995).
[10] *GSRG*, Slip Op. at 8.
[11] *Id.* at 9.
[12] *Id.* at 11.

Supreme Court Rules That Reverse-Payment Patent Litigation Settlements are Subject to Judicial Review Under the Antitrust Rule of Reason

By John J. Elliott - New York, NY

On June 17th, the U.S. Supreme Court resolved a decade of conflicting circuit court opinions when it held in *Federal Trade Commission v. Actavis, Inc.,*[1] that "reverse-payment" settlements of Hatch-Waxman Act patent lawsuits "can sometimes violate the antitrust laws,"[2] and for that reason are to be analyzed under the rule of reason standard. These settlements have become a common method of settling patent disputes between branded and generic pharmaceutical companies, yet their legality under the antitrust laws had been in sharp dispute in the federal appellate courts.

The Supreme Court's decision to apply the rule of reason standard was novel, as the Circuit Courts had previously either found such settlements presumptively unlawful (subject to a "quick look" review standard) or generally permissible. Chief Justice Roberts' dissent vigorously attacked the majority's "unruly" rule of reason standard, wishing "[g]ood luck" to the district courts that must apply it.[3]

Regulatory Background: The Hatch-Waxman Act and Why Reverse-Payment Settlements Exist

The Hatch-Waxman Act (formally, The Drug Price Competition and Patent Term Restoration Act) was passed by Congress in 1984 to encourage innovation and increase the availability of low cost generic drugs.[4] It sought to do this by, among other things, making it easier for generic drug companies to challenge patents covering branded drugs.[5] Under the Act, a pharmaceutical company that wishes to sell the generic form of a branded drug must file an Abbreviated New Drug Application (ANDA) with the FDA. The first generic company to file an ANDA obtains a 180-day exclusivity period during which it is the only generic company authorized to compete with the brand-name drug. However, to obtain such exclusivity, the manufacturer must certify under paragraph IV of the Act that its generic product either does not infringe the patent(s) protecting the branded drug patents, or that those patents are invalid.[6] The generic manufacturer's act of certifying that its product does not infringe the innovator's patents (or that those patents are invalid) "automatically counts as patent infringement; however, the ANDA is automatically stayed for 30 months if the patent owner files a patent infringement lawsuit within 45 days of the ANDA filing.[7] During the stay, the FDA is prohibited from approving another ANDA. The patent-holder is thereby incentivized to accept the generic's challenge to its patent and file a lawsuit. [8]

The Hatch-Waxman Act inadvertently encourages reverse-payment settlements through these provisions. The generic manufacturer does not have to risk damages in order to challenge the patent in court. Conversely, the innovator does not sue in search of damages; rather, it only seeks to protect its patents. Typical settlement considerations are thereby reversed. The innovator, while nominally the plaintiff, is *de facto* the defendant, willing to provide some form of consideration to the upstart generic manufacturer, the nominal defendant, to stop challenging its patents. A reverse-payment settlement, pursuant to which the generic manufacturer agrees to keep its generic product off the market for a period of time, may constitute consideration acceptable to the generic manufacturer. Such agreements have been challenged a number of times by the FTC and private parties as antitrust violations.

Antitrust Challenges to Hatch-Waxman Act Reverse Payment Settlements: The Circuit Court Decisions

The Federal Trade Commission first challenged the validity of reverse-payment patent settlements as unreasonable restraints of trade in the late 1990s. It argued, and continues to argue, that by paying the generic manufacturer to settle, the patent holder obtains protection from competition in the market (i.e. by precluding the possibility of the patent being held invalid or not infringed), while the generic manufacturer shares in the patent holder's monopoly profits instead of competing.[9] Five circuit courts have weighed in: the Second, Eleventh, and Federal Circuits essentially immunized such settlements if market foreclosure did not extend beyond the statutory exclusionary period granted to a patent holder,[10] and the Third and Sixth Circuits have considered them presumptively illegal.[11]

The Supreme Court granted *certiorari* to the Eleventh Circuit's decision in *F.T.C. v. Watson Pharmaceuticals, Inc.*[12] to address this circuit split. In *Watson*, the FTC had claimed that a reverse-payment settlement agreement between Solvay Pharmaceuticals Inc., the branded manufacturer of AndroGel, a testosterone supplement, and Actavis, Inc. (among others) violated Section 5(a) of the Federal Trade Commission Act. The 2006 settlement at issue resolved Solvay's patent infringement lawsuit against Actavis and the other generic manufacturers which had filed an ANDA with the FDA. The defendants had agreed not to enter their generic versions of AndroGel into the market until more than five years prior to the patent's expiration, and agreed in the interim to promote AndroGel to doctors. In return Solvay agreed to pay the defendants tens of millions of dollars.[13] The FTC contended that the settlement agreements were "attempts to 'defer' generic competition with branded AndroGel by postponing the entry date of the generic drugs, thereby maintaining Solvay's monopoly and allowing the parties to share monopoly profits at the expense of the consumer savings that would result from price competition."[14]

The Eleventh Circuit affirmed dismissal of the FTC's complaint. While recognizing that the "antitrust laws typically prohibit agreements where one company pays a potential competitor not to enter the market," the "proper analysis" in a case involving patents, the Eleventh Circuit held, requires "evaluation of whether the settlement agreements contain provisions that restrict competition beyond the scope of the exclusionary potential of the patent."[15] This analysis is known as the "scope of the patent" approach. The Court found that the anticompetitive effects of the agreement fell "within the scope of the exclusionary potential of the patent" because it allowed generic entry before the expiration of the patent.[16] Accordingly, the Eleventh Circuit held that the agreement was "immune from antitrust attack."[17]

Shortly thereafter, the Third Circuit explicitly rejected the "scope of the patent" test in *In re K-Dur Antitrust Litigation*, disagreeing with what it characterized as the "test's almost un-rebuttable presumption of patent validity." It concluded that "reverse payments permit the sharing of monopoly rents between would-be competitors without any assurance that the underlying patent is valid."[18] The Third Circuit remanded the case, and directed the district court to apply a "quick look" rule of reason, "treat[ing] any payment from a patent holder to a generic patent challenger as *prima facie* evidence of an unreasonable restraint of trade, which could be rebutted by showing that the payment (1) was for a purpose other than delayed entry or (2) offers some pro-competitive benefit."[19]

The Supreme Court's Decision: A Novel Approach to Reverse-Payment Settlements

In a 5-3 opinion written by Justice Breyer, the Supreme Court declined to adopt either the Second, Eleventh and Federal Circuits' "scope of the patent" test or the Third and Sixth Circuits' (and FTC's) "quick look" rule of reason test. The Court rejected the "scope of the patent" test for several reasons, chief among them because "what the holder of a valid patent could do does not by itself answer the antitrust

question," because "patent and antitrust policies are both relevant in determining the 'scope of the patent monopoly.'"[20] The patent, in a reverse-payment settlement, according to the Court, does not preclude antitrust examination because the "patent may or may not be valid, and may or may not be infringed."[21] Paying the challenger to settle, and stopping consideration of those questions, is not only "unusual," it "tend[s] to have significant adverse effects on competition."[22] Those adverse effects cannot be measured "solely against patent law policy;" procompetitive antitrust policies must be considered as well.[23]

The Court declared that the best way to consider these various "complexities" is under the rule of reason test, rejecting the FTC's argument that a quick look approach was appropriate. According to the majority decision, a "quick look" is only appropriate when the anticompetitive effects of a challenged practice are clear to an "observer with even a rudimentary understanding of economics."[24] Reverse payments are not so easily considered: the "likelihood of a reverse payment bringing about anticompetitive effects depends upon its size, its scale in relation to the payor's anticipated future litigation costs, its independence from other services for which it might represent payment, and the lack of any other convincing justification."[25]

Declaring that "the FTC should have been given the opportunity to prove its antitrust claim,"[26] Justice Breyer offered five "considerations" for the majority's conclusion: (1) reverse payment patent settlements have the "potential for genuine adverse effects on competition," because the patentee is in effect "purchas[ing]" the right to sell its product exclusively – a right it could lose if it lost the patent litigation;[27] (2) the "anticompetitive consequences will at least sometimes prove unjustified;"[28] (3) "where a reverse payment threatens to work unjustified anticompetitive harm, the patentee likely possesses the power to bring that harm about in practice;"[29] (4) "it is normally not necessary to litigate patent validity to answer the antitrust question … An unexplained large reverse payment itself would normally suggest that the patentee has serious doubts about the patent's survival" and can "provide a workable surrogate for a patent's weakness;"[30] and (5) there are means of settling patent litigations without "large, unjustified reverse payments" to the challenger in return for staying out of the market for a period of time.[31]

While perhaps providing some guidance to the lower courts, Justice Breyer concluded with the following question to be considered on remand and in future reverse-payment cases: What are the reasons for including a reverse payment in the settlement? "If the basic reason is a desire to maintain and to share patent-generated monopoly profits, then, in the absence of some other justification, the antitrust laws are likely to forbid the arrangement."[32]

Chief Justice Roberts' dissent took issue with nearly every statement in the majority opinion, arguing that "this is a fairly straightforward case" because under the Court's precedent, if a patent holder's actions "are within the scope of the patent, they are not subject to antitrust scrutiny."[33] This is so, according to the dissent, because the scope of the patent, "i.e., what rights are conferred by the patent – should be determined by reference to patent law."[34] Further, the dissent noted, each of the cases cited by the majority were distinguishable because they all involved a defendant acting outside the scope of its patent: "The majority points to *no* case where a patent settlement was subject to antitrust scrutiny merely because the validity of the patent was uncertain. Not one. It is remarkable, and surely worth something, that in the 123 years since the Sherman Act was passed, we have never let antitrust law cross that Rubicon."[35]

The dissent then turned to the five "considerations" offered by the majority, contending that they were nearly all "unresponsive" to the practical concern they supposedly addressed: that reverse-payment

antitrust cases will inevitably address the patent's validity. Contrary to the majority, Chief Justice Roberts warned that the patent holder will always raise the validity of its patent as a defense, and that "depriving him of such a defense – if that's what the majority means to do – defeats the point of the patent, which is to confer a lawful monopoly on its holder."[36]

Finally, the dissent took issue with the "unruly rule of reason," wishing "[g]ood luck to the district courts that must, when faced with a patent settlement, weigh the 'likely anticompetitive effects, redeeming virtues, market power, and potentially offsetting legal considerations present in the circumstances.'"

Analysis

The *Actavis* Court provided suggestions to the lower courts to look for indicators of illegality, particularly payments to the generic challenger "even larger than what the generic would gain in profits" if it won the lawsuit.[37] Working through the factors involved will be no easy task, but the majority commented, "[a]s in other areas of law, trial courts can structure antitrust litigation [to best suit the facts of the case]."[38] Ultimately, the majority declared that it would "leave it to the lower courts the structuring of the present rule-of-reason antitrust litigation."[39] Chief Justice Roberts' concern that each patent holder will raise its patent in defense, however, likely can be expected.

The majority also pointed out that the Hatch Waxman Act requires "parties to a patent dispute triggered by a paragraph IV filing to report settlement terms to the FTC and the Antitrust Division of the Department of Justice."[40] It is possible that, just as the Hart-Scott-Rodino Act requires preclearance, and any concerns raised by the FTC and DOJ typically result in the renegotiation of the proposed merger, the FTC and DOJ may raise their concerns about planned reverse-payment settlement agreements. The setting parties may respond by renegotiating the reverse payment settlement, lowering the proposed payment to the generic company, and potentially allowing the generic to enter the market earlier than originally agreed.

In *Actavis*, the fundamental public policy goals of encouraging innovation and promoting competition clearly collided. Calling on the antitrust laws to reign in potential abuses of patent law, particularly when a patent is not strong, is the result. The issue facing lower courts, of course, will be how to determine whether the patent is strong and what settlement payment is "unduly large," taking into consideration the services that the generic manufacturer may agree to provide to the patent holder in return for the payment. The Supreme Court has offered little guidance in that regard.

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1 *Federal Trade Commission v. Actavis, Inc.*, Case No. 12-416 (June 17, 2013), Slip Opinion ("Slip Op."), available here.
2 Slip Op. at 2.
3 Slip Op. at 15.
4 H.R. Rep. No. 98–857, pt. 1, at 14, reprinted in 1984 U.S.C.C.A.N. 2647 at 2647.
5 S. Rep. No. 107–167, at 4 (2002) ("Under Hatch–Waxman, manufacturers of generic drugs are encouraged to challenge weak or invalid patents on brand name drugs so consumers can enjoy lower drug prices.").
6 21 U.S.C. §§355(j)(2)(A)(ii), (iv).
7 Slip Op. at 4.
8 Slip Op. at 4 (*citing* 35 U.S.C. §271(e)(2)(A) (2006 ed., Supp. V)).
9 Slip Op. at 6.
10 *Ark. Carpenters Health & Welfare Fund v. Bayer AG*, 604 F.3d 98, 106 (2d Cir. 2010) (applying scope of the patent test); In re Ciprofloxacin Hydrochloride Antitrust Litig., 544 F.3d 1323, 1333 (Fed. Cir. 2008) (applying scope of the patent test); *In re Tamoxifen Citrate Antitrust Litig.*, 466 F.3d 187, 213 (2d Cir. 2006) (applying scope of the patent test); *Schering-Plough Corp. v. FTC*, 402 F.3d 1056, 1076 (11th Cir. 2005) (applying scope of the patent test); *Valley Drug Co. v. Geneva Pharms., Inc.*, 344 F.3d 1294, 1308 (11th Cir. 2003) (applying scope of the patent test).

11 *In re K-Dur Antitrust Litig.*, 686 F.3d 197, 214 (3d Cir. 2012) (holding that the district court should have applied "quick look" rule of reason test because reverse payments are prima facie evidence of unreasonable restraint of trade); *In re Cardizem CD Antitrust Litig.*, 332 F.3d 896, 908 (6th Cir. 2003) (finding agreement per se illegal where generic drug maker not only agreed to stay out of the market, but also agreed (using a statutory idiosyncrasy since corrected) to block all other generic makers from proceeding with their own patent challenges).
12 *F.T.C. v. Watson Pharm., Inc.,* 677 F.3d 1298, 1312 (11th Cir. 2012) (applying scope of the patent test).
13 Slip Op. at 5-6.
14 *Watson Pharm., Inc*., 677 F.3d at 1305.
15 *Id*. at 1307, 1310.
16 Slip Op. at 2.
17 *Watson Pharm., Inc*., 677 F.3d at 1312 (noting the only time such agreements were not immune involved sham litigation or fraud in obtaining the patent).
18 *In re K-Dur Antitrust Litig*., 686 F.3d at 214, 216.
19 *Id.* at 218.
20 Slip Op. at 8-9.
21 *Id.* at 8.
22 *Id*.
23 *Id.* at 9.
24 *Id.* at 20.
25 *Id*.
26 *Id.* at 14.
27 Slip Op. at 14-15.
28 *Id.* at 17.
29 *Id*. at 18.
30 *Id.* at 18-19.
31 *Id*. at 19.
32 Slip Op. at 19.
33 Dissent at 3 (also noting two inapplicable exceptions: sham litigation and a fraudulently issued patent).
34 *Id*. at 5.
35 *Id.*at 8.
36 *Id.* at 12.
37 Slip Op. at 15.
38 *Id.* at 21.
39 *Id*.
40 *Id.* at 13.

Practical Implications of Supreme Court's American Express Decision Confirming That Arbitration Agreements with Class Action Waivers are Enforceable With Respect to Antitrust Claims

By Robert J. Herrington - Los Angeles

In an important and much anticipated decision, the U.S. Supreme Court rejected plaintiffs' efforts to avoid arbitration by arguing that individual arbitration would prevent them from having an effective opportunity to vindicate their rights under the federal antitrust laws (the so-called "effective vindication" doctrine) due to the expense and relatively low payoff in pursuing those claims on an individual basis. *American Express Co. v. Italian Colors Restaurant*.[1] The decision has several practical implications for companies using (or considering using) arbitration provisions, which are discussed below.

Second Circuit Ruled That Arbitration Provision Was Unenforceable

The plaintiffs are merchants who sued American Express under the antitrust laws. The merchants sought to avoid individual arbitration by arguing that the cost of an expert in an antitrust case would be at least several hundred thousand dollars, and up to a million dollars, while their individual potential maximum recovery was less than $40,000. This, the merchants said, prevented them from vindicating their statutory rights under the federal antitrust laws and under the "effective vindication" exception to the Federal Arbitration Act (FAA), allowed the court not to enforce the parties' arbitration agreement.[2] The Second Circuit had agreed with the merchants, concluding that the arbitration provision was unenforceable because the plaintiffs would incur prohibitive costs if compelled to arbitrate.[3]

Supreme Court Reverses, Holding That Effective-Vindication Exception Does Not Apply

The Supreme Court disagreed in a 5-3 decision overturning the Second Circuit ruling. Calling the "effective vindication" exception "dictum," the Court ruled (in an opinion authored by Justice Scalia) that it applied only when arbitration agreements act as a prospective waiver of a party's right to *pursue* statutory remedies. "[A]n arbitration agreement forbidding the assertion of certain statutory rights" would fall within the exception, the Court said, and the exception could "perhaps" cover filing and administrative fees "that are so high as to make access to the forum impracticable. In the Court's view, the fact that it is not worth the expense involved in *proving* a statutory remedy is not the same as eliminating the *right to pursue* that remedy."[4] Thus, the Court held that the effective vindication exception did not apply and reversed the decision invalidating the arbitration agreement.

Dissent Attempts to Limit Scope of Ruling

Calling the decision a "betrayal of our precedents, and of federal statutes like the antitrust laws," the dissenting opinion (authored by Justice Kagan, joined by Justices Ginsburg and Breyer) argued that the effective vindication rule should have applied. "If the arbitration clause is enforceable, AmEx has insulated itself from antitrust liability — even if it has in fact violated the law." The effective vindication rule was, according to the dissent, designed for cases like this in which the defendant is alleged to have used its monopoly power to force an arbitration provision on merchants that would "make pursuit of the antitrust claim a fool's errand." [5]

The key distinction, in the dissent's view, was that the arbitration agreement did not just prevent class actions; it precluded any type of collective action. The clause at issue barred any kind of joinder or

consolidation of claims or parties; it prevented cost shifting to American Express; and the confidentiality provision prevented the plaintiff from working with other merchants to arrange for a common expert report. Thus, the provision completely prevented the plaintiffs from sharing costs or finding another way to reduce costs.[6] The dissent criticized the majority for not considering these aspects of the agreement and, in an attempt to limit the opinion, stated that the Court "does not decide" whether these features trigger the "effective-vindication rule." [7]

Notably, in a footnote, the majority opinion did address these points, stating that the lower court's decision held that other forms of cost sharing were "not economically feasible" (rather than unavailable), thus making a class action the only viable alternative.[8] Arguably, this language leaves open whether a ban on other forms of cost sharing could be challenged based on the effective-vindication exception.

Key Takeaways from Opinion

For companies interested in limiting their exposure to class actions, the *American Express* opinion provides at least four key takeaways:

- **First,** under the majority opinion, excessive filing or administrative fees still might trigger the effective vindication exception. Companies using an arbitration provision should consider ways to limit those fees by, for example, agreeing to pay any arbitration filing or administrative fees in excess of what would be charged to file in court.
- **Second**, *American Express* and the *Concepcion* decision of 2011 were decided under the FAA. To ensure that these opinions apply and to avoid the vagaries of state arbitration laws, a company may want to consider expressly stating in its arbitration agreements that they are subject to the FAA.[9]
- **Third**, although the dissent is not a precedent, lower courts may view it as a limit on the majority opinion and be willing to consider whether other aspects of an arbitration agreement (such as a prohibition on joinder or a confidentiality requirement) trigger the effective vindication exceptions.[10] Companies may want to rethink whether to include these provisions.
- **Fourth**, for companies that have taken a "wait and see" approach before modifying their form agreements, *American Express* now confirms the enforceability of an arbitration clause coupled with the express preclusion of "any right or authority for any claims to be arbitrated on a class action basis." Now may be the time for businesses to consider updating their agreements to include a carefully crafted arbitration provision that takes advantage of the Supreme Court's recent decisions such as this one.

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[1] 133 S.Ct. 2304.
[2] *Id.* at 2308.
[3] *In re. American Express Merchants' Litigation,* 667 F.3d 204 (2d Cir. 2012).
[4] 133 s.Ct. at 2310-11.
[5] *Id.* at 2312-13,
[6] *Id.* at 2319.
[7] *Id.* at 2320.
[8] *Id.* at 2311, n.4.
[9] *See Rent-A-Ctr., W., Inc. v. Jackson*, 130 S. Ct. 2772, 2776, 177 L. Ed. 2d 403 (2010) (FAA applies to contract evidencing transaction involving commerce); *see also Valencia v. Smyth*, 185 Cal. App. 4th 153, 177 (2010) (declining to enforce arbitration provision where agreement did not expressly incorporate FAA, which meant trial court had discretion not to order arbitration where not all parties were bound by the arbitration agreement; "the FAA's procedural provisions do not apply in state court unless the parties expressly adopt them").
[10] *See also Lima v. Gateway, Inc.*, 886 F. Supp. 2d 1170, 1185 (C.D. Cal. 2012) ("confidentiality requirement contributes to the lack of mutuality that renders the arbitration agreement substantively unconscionable").

FTC Merger Guidance Roundup: Summer 2013

By Mary K. Marks - New York, NY

The FTC has not taken a vacation from providing merger guidance this summer, and Labor Day is still to come. So far, the Commission has issued guidance regarding the "pull and refile" process, levied fines for Hart-Scott-Rodino Antitrust Improvements Act (HSR Act) violations, challenged or settled merger investigations, and released a draft five year strategic plan. All of this activity provides helpful guidance for HSR practitioners and transaction parties.

Pull and Refile Rules Allow Second HSR Waiting Period

On June 28th, the FTC issued final rules that largely formalize the Commission's long-standing informal position that allows parties to voluntarily withdraw and refile their HSR notifications within two days without paying an additional filing fee.[1] It is in the parties' discretion whether to take advantage of this procedure, which allows the antitrust agencies additional time to review a transaction during an extended "initial 30 days" waiting period. The benefit of the additional review time is that the parties may be able to avoid a "second request" for information, thus saving time and resources for the parties and the government.

These new rules also establish a procedure for automatic withdrawal of parties' HSR notifications when the Securities and Exchange Commission is notified that the subject transaction has been terminated. The enforcement agencies believe that this change will allow them to make more efficient use of agency resources by reducing the need to review abandoned transactions. Commissioner Joshua D. Wright objected to the automatic withdrawal procedure, noting the "absence of evidence that the automatic withdrawal rule would remedy a problem that exists under the current HSR regime…."[2]

On August 20, 2012, a notice of proposed rulemaking was published in the Federal Register regarding the treatment under the HSR Act of certain licensing transactions in the pharmaceutical industry.[3] Three sets of comments were received by the agencies, and, according to the FTC's website,[4] the Pharmaceutical Research and Manufacturers of America has met with Commission staff and provided views regarding the legality of the proposed rulemaking as well as the potential additional costs to the pharmaceutical industry should the rules be adopted as proposed. The rules have not yet been finalized.

Fines Highlight the Need for Company HSR Compliance Program and Investment Monitoring

The FTC announced fines of $720,000 and $480,000 for technical violations of the HSR Act on June 20th and July 2nd. In the first situation, the filing party had submitted an HSR notification and observed the waiting period with respect to the subject issuer in 2007. However, the period during which a person can continue to acquire securities relying on a previously filed HSR expires after five years, in that case, in February 2012. The acquiring person failed to make a new HSR filing prior to 2012 acquisitions, made a corrective filing two months later and agreed to pay the $720,000 civil penalty. In the second situation, the acquiring person allegedly exceeded the HSR Act's notification threshold in 2010. In 2012, the issuer contacted the investor about HSR Act compliance. The acquiring person was not able to take advantage of the "passive investor" exemption because he was a director of the issuer. He therefore agreed to pay the $480,000 civil penalty to settle the charges.

Notably, in both of these situations, the acquiring person had made a previous corrective filing regarding earlier HSR Act violations. No penalties were imposed for the first violations alleged against them.

Merger Challenges Target Wide Range of Transactions

The FTC made considerable progress regarding quite a number of open merger investigations over the past few months. In some cases, the Commission was prepared to block a transaction to prevent its consummation, but it became unnecessary for it to do so.

Specifically, on June 27th, the FTC issued a statement regarding a health system merger that had been under investigation but had been abandoned. According to the Commission, the termination of the parties' proposed transaction "will preserve access to low-cost, high-quality health care for the citizens of Hot Springs, Arkansas." [5]

On May 29th, the FTC challenged a transaction involving two casino operators, alleging that the transaction would "reduce competition and lead to higher prices and lower quality for customers in the St. Louis, Missouri and Lake Charles, Louisiana areas.[6] On August 1st, the Commission and the parties filed a joint motion to withdraw matter from adjudication[7] while the terms of a consent agreement are finalized.

On July 1st, the FTC challenged a transaction involving manufacturers of glass containers for beer and spirits, alleging that the proposed transaction would combine the second and third largest manufacturers of glass containers, resulting in them controlling 75% of the approximately $5 billion U.S. glass container industry.[8] The proposed transaction was withdrawn.

Other transactions were able to close after reaching agreements that the FTC believed would preserve competition. On July 10th and 11th, the FTC responded to public comments and approved a modified final order in Hertz's acquisition of Dollar Thrifty, whereby Hertz agreed to divest its Advantage Rent A Car business, along with the rights to 29 of Dollar Thrifty's airport-based rental locations, thereby creating an independent rental car company.[9] On July 19th, the FTC agreed to settle its investigation into the acquisition of an aircraft engine component manufacturer whose part is allegedly a "critical component" for the engine its rival makes for Airbus's A320neo aircraft. Among other things, the settlement incorporates provisions of existing and new commercial agreements of the parties relating to the design and development of the "critical component" and related parts, thus making a breach of those contract provisions a violation of the agreement with the FTC.[10]

Continuing a trend of enforcement involving consummated transactions, on July 25th the FTC voted to accept a proposed consent agreement pursuant to which a manufacturer of specialized software used by the automotive recycling industry agreed to divest assets acquired in its 2012 purchase of another manufacturer of yard management systems software.[11] The FTC's complaint alleged that the acquisition significantly harmed the market for YMS, which was allegedly already highly concentrated. The action is notable both because the consummated 2012 transaction was valued far below the HSR Act's transaction size thresholds, and because the consent agreement requires the divestiture of acquired assets to a buyer formed by seller's managers to acquire the divested business.

Five Year Plan Projects Increased Efficiency, Challenges with "Significant" Results

On July 16th, the FTC issued a draft strategic plan for fiscal years 2014-2018, calling for increased efficiency of investigatory processes and enhanced enforcement outcomes. The goals stated in the plan include (i) improving timeliness of investigations and merger review under the HSR Act, (ii) negotiating merger and non-merger consent orders and seeking litigated orders that have significant remedial, precedential and deterrent effects, (iii) increasing compliance with consent decrees and orders and with HSR reporting obligations, and (iv) increasing the transparency of the FTC's decision-making process.[12]

In sum, it has been a very busy summer for merger enforcement at the FTC this year. Perhaps there is even more to come before the summer season is over.

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[1] *See* http://www.ftc.gov/opa/2013/06/hsr.shtm.
[2] *See* http://www.ftc.gov/speeches/wright/130628hsrstmtwright.pdf.
[3] *See* http://www.ftc.gov/os/comments/premergeriprights/index.shtm.
[4] *Id.*
[5] *See* http://www.ftc.gov/opa/2013/06/capella.shtm.
[6] *See* http://www.ftc.gov/opa/2013/05/pinnacle.shtm.
[7] *Available at* http://www.ftc.gov/os/adjpro/d9355/130801jointmotionwithdrawadjudication.pdf.
[8] *See* http://www.ftc.gov/opa/2013/07/ardagn.shtm.
[9] *See* http://www.ftc.gov/opa/2013/07/hertz.shtm.
[10] *See* http://www.ftc.gov/opa/2013/07/generalelectric.shtm.
[11] *See* http://www.ftc.gov/opa/2013/07/solera.shtm.
[12] *Available at* http://www.ftc.gov/opp/gpra/strategic/d-spfy14fy18.pdf.

European Developments:

The European Commission's Measures on Actions for Damages Caused by Infringements of the Competition Law Provisions

By Francesco Mazzocchi - Santa Maria Studio Legale Associato, Milan, Italy

Background

On June 11, 2013, the European Commission (Commission) released a proposal for a directive on private damages actions for infringements of EU and national competition law (the Directive).[1] The Directive was accompanied by a practical guide on the quantification of harm and a recommendation on collective redress.[2]

This initiative was driven by the Commission's desire to encourage private antitrust enforcement in Europe, and maintaining effective public enforcement of the competition rules by EU and national competition authorities. It represents the culmination of a decade-long process of debate, consultation, and Commission guidance papers on actions for damages for antitrust infringements.[3]

Although not as far reaching and ambitious as when the initiative was originally announced, the Directive should bring more legal certainty to the interplay between public and private competition enforcement in the EU, and could help level the European (uneven) playing field regarding actions for damages, making it easier for businesses and consumers to bring antitrust damages claims in the 28 EU members states.

Currently, national rules on private actions are widely diverging across Europe, and the vast majority of antitrust damages claims are brought in only three member states – the United Kingdom, Germany and the Netherlands – where the procedural rules have been perceived by some observers to be more claimant friendly.[4]

Of the instruments issued by the Commission, only the proposed Directive would be binding on the EU member states. If adopted, member states will have two years to implement the provisions of the Directive into their legal systems.

Of course, it remains to be seen whether the proposal will pass the normal EU legislative procedure without major changes.

Objectives of the Proposal for a Directive

The general principle underpinning the proposal is that private enforcement actions under national civil law and public enforcement by competition authorities, are *complementary tools* serving the objective of an effective enforcement of EU competition rules.

On this premise, the main objectives pursued by the Commission are twofold:

1. To ensure that all victims of infringements of competition law – be they consumers, undertakings or public authorities – have access to effective mechanisms for obtaining *full compensation* for the harm they suffered;[5] and

2. To limit the disclosure in private litigation of documents acquired in the context of competition authorities' proceedings, in order not to jeopardize the effectiveness of public enforcement.

The directive's most relevant provisions

Access to Evidence

Chapter II (Arts. 5-8) of the Directive is devoted to access to documents. The general principle set out in the proposal is that national courts should order defendants and third parties to disclose evidence when a claimant has presented reasonably available facts and evidence showing plausible grounds for suspecting that he/she has suffered harm caused by the infringement, provided that such evidence is relevant to the claim and that the disclosure request, subject to the scrutiny of the national judge, is proportionate and narrowly tailored.

Rules on disclosure vary on the basis of the categories of evidence involved, with an enhanced protection for documents from the file of a competition authority. Notably, the Commission proposes the following distinctions:

> Pre-existing information, existing independently from investigation competition authorities, is disclosable without limits (White list);

> Documents referred to or related to any proceeding of investigation taken by a competition authority might be revealed only after the end of the investigation (Grey List); and

> Leniency corporate statements and settlement submissions are always deemed to be confined to secrecy (Black List).

The ban on disclosure of leniency corporate statements and settlement submissions suggested by the Commission aims at addressing the position taken by the EU Court of Justice in the *Pfleiderer* decision. [6] The court ruled in that decision that, in the absence of regulation under European Union law on the subject, national courts should decide the disclosure of documents held by national competition authorities on a *case-by-case* basis (including leniency statements), balancing the diverging interests at stake. This decision, according to the Commission, generated legal uncertainty, and potentially affected the willingness of cartel participants to cooperate with the competition authorities under the leniency programs.[7]

It remains to be seen whether the Commission's rigid approach to disclosure of certain "sensitive" documents will lead to any revision in the Court of Justice's position. In *Donau Chemie,* it recently confirmed the stance it adopted in *Pfleiderer,* ruling against a *de facto* absolute ban on disclosure of leniency documents provided for under Austrian competition law.[8]

Effect of National Competition Decisions and Limitation Periods

Pursuant to Article 9 of the Directive, the finding of an infringement in a final decision of a national competition authority cannot be disputed before a civil court. This will ensure that defendants will not be able to re-litigate the same issues during a subsequent damages action, by putting national authority decisions on the same footing as those of the EU Commission, as provided for by Article 16 of Regulation 1/2003.

Article 10 sets out special provisions with regard to limitation periods. From the moment a victim has the possibility to discover that he or she suffered harm from an infringement, that victim will have a period of

at least five years to bring a claim. This period is suspended if a competition authority starts proceedings, so that the injured party can decide to wait until the public proceedings are over before bringing a claim.

Joint and Several Liability: For Many, But Not for All

Undertakings infringing competition law would be *jointly and severally liable* for the damage caused. However, pursuant to Article 11(2) of the Directive, undertakings which have been granted immunity under leniency programs are elevated to a special position: they will be liable only vis-à-vis their direct or indirect purchasers or providers, and will be liable to other injured parties only if the latter show that they are unable to obtain full compensation from the other companies that were involved in the same infringement.

Passing on Defense and Presumptions

The Directive provides some clarification of the legal consequences of the "passing on" of overcharges, declaring that a defendant should be entitled to invoke as a defense the fact that the private litigant passed on the overcharge caused by the alleged infringement. It is clear that to deny this defense could result in unjust enrichment of purchasers who passed on the overcharge, and can result in undue multiple recoveries for the illegal overcharge by the defendant. The burden of proving that the overcharge was passed on rests with the defendant.

Special consideration is devoted to indirect purchasers (usually consumers) who can rely on the rebuttable presumption that the illegal overcharge was passed on to them if certain conditions are met. Indeed, while as a general rule, the burden of proving the existence and scope of the damage suffered by the claimant/indirect purchaser rests with the claimant, the claimant will be deemed to have proven that a passing-on to him/her occurred when he/she has shown that:

1. The defendant has committed an infringement of competition law;
2. The infringement resulted in an overcharge to the direct purchaser of the defendant; and
3. The claimant purchased the goods or services that were the subject of the infringement, or purchased goods or services derived from or containing the goods or services that were the subject of the infringement.

Regarding the quantification of the passing-on, the proposal provides that national courts should have the power to estimate which share of the overcharge has been passed on to the level of indirect purchasers in the dispute.

When injured parties from different levels of the supply chain bring separate actions for damages that are related to the same competition law infringement, Article 15 sets out that national courts should take "due account" of parallel or preceding actions (or judgments resulting from such actions) in order to avoid under and over-compensation of the harm caused by that infringement, and to foster consistency between judgments resulting from such linked proceedings.

Moreover, Article 16 refers laconically to Article 30 of Regulation No 1215/2012, which should ensure coordination between private actions pending before the courts of different member states. According to that provision, any court other than the court first seized may stay its proceedings or decline jurisdiction if the court involved in the first action has jurisdiction and its law permits the consolidation of the actions.

Presumption of Harm for Cartel Conduct

The Directive introduces a rebuttable presumption, in the case of cartels, that an infringement causes harm. This is a key-provision, in the Commission's view, aimed at facilitating compensation for the victims of the cartel. However, the proposal sets out clearly that *quantification* is a matter for national rules and national courts.

The Communication and the Practical Guide on the Quantification of Antitrust Harm

These non-binding documents aim at providing practical guidance to litigants and national courts on various methods for quantifying harm in antitrust cases by providing detailed explanations of comparator-based methods (e.g., comparing prices before or after the infringement, or comparing prices in other markets), economic simulation models, cost-based models, etc.

The Recommendation on Collective Redress

The Commission's recommendation on collective redress concerns all breaches of EU law,[9] and thus is also relevant to harm suffered by victims of breaches of EU competition law-- in particular victims who individually suffered low-value damage.

The purpose of the recommendation is to facilitate access to justice and to enable injured parties to obtain compensation in "mass harm situations" caused by violations of rights granted under EU law, while ensuring appropriate procedural safeguards to avoid abusive litigation. To this aim, the Commission recommends that member states should have a system of collective redress that allows natural and legal persons to seek court orders ceasing infringements of their rights granted under EU law (injunctive relief), and to claim damages for harm caused by such infringements (compensatory relief).

Besides the obvious conceptual similarities, the Commission has set out a set of principles aimed at shaping a sort of "European class action," distant from U.S.-style class action law suits. In particular, the Commission recommends "opt-in systems" of collective redress, considering "opt-out systems" as an exception. Entities representing claimants have to be of non-profit making character or public authorities empowered to bring representative actions, and strict limitations are provided for third-party funding. In order to avoid excessive compensation for damages, the Commission proposes that punitive damages shall be avoided. With respect to the lawyers' remuneration and the method by which it is calculated, the Commission recommends that member states do not permit contingency fees; lawyers' fees shall not be calculated as a percentage of the compensation awarded.

The Commission emphasizes that collective redress actions should not jeopardize public enforcement. Thus, member states are encouraged to ensure that collective redress actions only start after the public authority has found an infringement (collective follow-on actions).

Even if not-binding, member states are asked by the Commission to implement the principles set out in this recommendation in national collective redress systems within two years from its publication. A decision on whether further action (including legislative action) is needed would then be taken by the Commission within a further two years.

Observations

The Commission's "package" on private enforcement is a welcomed initiative. Citizens and businesses need better and clearer rules, especially with respect to access to evidence and the interplay between private enforcement actions under national civil law and public enforcement by competition authorities.

If adopted, the Directive will introduce a set of basic uniform rules that will ease legal uncertainty, especially in cross-border cases.

Some provision contained in both the Directive and the recommendation, however, are already included in most national legal systems,[10] while others raise a number of issues relating, for instance, to the presumptions of injury contained in the Directive as compared with damages actions underpinning various civil legal systems, and to the practical application of such presumptions vis-à-vis different categories of claimants (direct/indirect purchasers).

More generally, beneath the surface and beyond the "diplomatic language" of the Commission, the proposal seems to have affirmed the supremacy of public enforcement over private enforcement, on one side limiting significantly the liability of leniency applicants, and on the other facilitating compensation for victims only after a public authority has found and sanctioned an infringement -- follow-on actions rather than stand-alone actions.

Time will tell whether the Commission's proposals will be the foundation for a new vogue of private litigation in the European Union. In the meantime, private damages actions will continue in national courts on the basis of applicable national law.

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[1] Proposal for a Directive of the European Parliament and of the council on certain rules governing actions for damages under national law for infringements of the competition law provisions of the member states and of the European Union, 2013/0185 (COD).

[2] Documents relating to antitrust actions for damages, including earlier policy initiatives by the Commission, are available here.

[3] *See, e.g.,* 2005 Green Paper - Damages actions for breach of the EC antitrust rules, COM (2005) 672 final; 2008 White Paper on Damages actions for breach of the EC antitrust rules COM (2008) 165 final, available at the website mentioned above.

[4] There is no reliable complete overview available, nor does a public register of actions for damages brought in national courts exist. According to the Commission, out of the 54 final cartel and antitrust prohibition decisions taken by the Commission in the period 2006-2012, only 15 were followed by one or more follow-on actions for damages in one or more member states. In total, 52 actions for damages were brought in only seven member states, the vast majority of which were brought in the UK, Germany and the Netherlands.

[5] Article 2 of the Directive recognizes the "right to full compensation" reserved to "anyone who has suffered harm caused by an infringement of Union or national competition law." Since 2001 the Court of Justice repeatedly stated that, as a matter of EU law, any individual must be able to claim compensation for the harm suffered as a result of an infringement of the EU competition rules. *See, e.g.,* Case C-453/99, *Courage and Crehan*, [2001] ECR I-6297; Joined Cases C-295/04 to C-298/04; *Manfredi*, [2006] ECR I-6619.

[6] Judgment of the Court of Justice of 14 June 2014, Case C-360/09, *Pfleiderer*, [2011] ECR I-5161.

[7] See the considerations offered by the Commission in the Impact Assessment Report – Commission Staff Working Document, p. 32 ff.

[8] Judgment of the court of 6 June, 2013, Case C-536/11, *Donau Chemie*, not yet published. The court emphasized that "in competition law in particular, any rule that is rigid, either by providing for absolute refusal to grant access to the documents in question or for granting access to those documents as matter of course, is liable to undermine the effective application of, inter alia, Article 101 TFEU and the rights that provision confers on individuals."

[9] This includes consumer protection, competition, environment protection, financial services and data protection. The recommendation is jointly issued by the Justice, Consumer Affairs and Competition departments of the Commission.

[10] In Italy, for example, collective redress schemes already exist, although actionable only by consumers. Pursuant to article 140-bis of Legislative Decree No. 206 of 6 September 2005, No. 206 (Italian Consumer Code), class actions may be brought by any consumer or user seeking damages or declaratory relief for a violation of rights that is homogeneous to those suffered by other consumers or users that arise from certain actionable breaches of contract or torts, including anti-competitive behavior. However, this kind of instrument has been used rarely and mainly with reference to unfair commercial practices. Recently, in the Italian legal system it was introduced a new specialized court, the 'Tribunale delle imprese" with jurisdiction over the claims for the enforcement of private rights provided for by the Italian Competition Act and by EU antitrust law (including claims for annulment, damages and interim measures).

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