San Francisco
Daily Journal
SINCE 1893

WEDNESDAY,
JUNE 24, 2009

Focus

Healthy Competition

By Thad Davis and Sarah Zenewicz

Recent stories of the Department of Justice and the Federal Trade Commission investigating Silicon Valley giants Google, Intel and others, are indicative of a renewed interest in and focus on federal antitrust enforcement. The Obama administration has announced that it will seek broader and more rigorous enforcement of antitrust laws in response to the current economic downturn in the interest of maintaining competitive markets. This message was tempered somewhat recently by Carl Shapiro, chief economist for the Justice Department's antitrust division, who, speaking at the Cato Institute, likened the administration's efforts to the Clinton administration's focus on particular types of monopolization cases.

All of these efforts, whether evocative of the Clinton administration or something more, could have major effects on California-based companies. While the government has already sounded a strong note only months into the new administration, there are limits to the government's resources for enforcing antitrust laws. Private rights of action can, in theory, serve to both supplement and substitute for government enforcement, but private enforcement has its own limitations through such requirements as standing and pleading standards. Indeed, Shapiro's comments highlighted the development of rigorous pleading standards as a trend of the last 20 years in defendants' favor that shows no signs of reversal.

From the passage of the Sherman Act in 1890 until today, antitrust enforcement has experienced shifts and changes much as the national economy and policies have shifted over 120 years. With the current economic crisis, the trends in private enforcement may shift as well.

While initially the Sherman Act was interpreted broadly and literally to prohibit all agreements limiting commercial freedom, that quickly gave way to increasingly lax enforcement until the 1930s. With the economic collapse of the Great Depression and the initial floundering of the economy under the New Deal, President Franklin Roosevelt revived an aggressive antitrust enforcement focusing on monopolization and horizontal collusion. Over the next few decades with the executive branch's expanded enforcement came per se tests and the lowering of burdens of proof for the government, and facilitating prosecution with minimal or no proof of agreements.

Recent federal legislative proposals could effect the scope of available antitrust claims in industries important to California's economy.

Aggressive enforcement continued until the 1960s with expansions of behaviors that were defined as per se, as well as challenges to price discrimination and blocks to both horizontal and vertical mergers between firms with low market shares.

A major shift in antitrust theory with a concomitant effect on antitrust enforcement occurred in the late 1970s and early 1980s with the economic rationalization of antitrust law. While commentators s had long argued that antitrust law needed to be informed by modern economic theory, theory became reality when William Baxter was appointed to serve as the assistant attorney general for antitrust in the first Reagan administration. Under Baxter's "Merger Guidelines," exacting economic analysis drove the merger enforcement process and the fourth iteration of those guidelines still informs federal merger policy. Modern economic theory also began to inform non-merger antitrust enforcement as the Supreme Court ruled in a series of cases that the per se standard of antitrust liability that previously governed commercial activities such as refusals to deal in *Northwest Wholesalers Stationers Inc. v. Pacific Stationery & Printing Co.*, 472 U.S. 284 (1985), and tying in *Jefferson Parish Hospital District No. 2 v. Hyde*, 466 U.S. 2 (1984), was to be replaced with the rule of reason analysis, which balances the potential anticompetitive effect of a given activity against its potential procompetitive benefit. As a result, overall federal enforcement activity declined significantly from what had been experienced in the 1960s, attention shifted away from vertical transactions and monopolization cases and the focus of federal antitrust enforcers during the balance of the Reagan years moved toward horizontal mergers and cartel-like behavior.

There was a slight increase in overall antitrust enforcement levels in the administration of George H. W. Bush, although never reaching the enforcement levels of the 1960s. During the Clinton years, a slightly higher level of overall enforcement activity also featured a handful of monopolization cases, such as the Justice Department's case against Microsoft. The administration of George W. Bush had a diminished interest in pursuing the big monopolization cases and the focus of federal antitrust enforcement returned to horizontal mergers and cartel-like activities.

The Obama administration plans to aggressively enforce antitrust laws. Its criticism of the lax enforcement of the Bush administration as contributing to the current economic downturn marks a major shift in the tone of antitrust enforcement. The Justice Department is abandoning legal guidelines established by the most recent Bush administration that Obama officials say made it more difficult to pursue antitrust cases against large firms. Where many firms may have been largely left to

self-regulate their competition for many years, the new administration has indicated it will be taking a fresh look at what constitutes a violation of antitrust laws. For example, the current investigation into the alleged hiring practices of major Silicon Valley firms is a market that the Bush administration did not show interest in.

Activity within the legislative branch could have major implications for future antitrust suits. Recent federal legislative proposals could effect the scope of available antitrust claims in industries important to California's economy. Proposals include removing exemptions for railroads under current antitrust laws, applying antitrust laws to negotiations between groups of independent pharmacies and health plans and health insurance issuers, exempting health care professionals from antitrust laws when negotiating with health plans and insurers and prohibiting brand name drug companies from compensating generics for delaying entry into the market. Legislation proposing to increase antitrust enforcement in agriculture has been introduced, which would establish a deputy assistant attorney general for agricultural antitrust matters within the Department of Justice. Additionally, legislation was introduced that would overturn the Supreme Court decision in *Leegin Creative Leather Products v. PSKS*, 127 S. Ct. 2705 (2007). The legislation would restore the rule that minimum resale price agreements violate the Sherman Act.

If the Obama administration's increases in antitrust enforcement leads to criminal antitrust convictions, that will likely drive increased plaintiffs' suits. Under the Clayton Act, a final judgment that a firm has violated the antitrust laws is prima facie evidence for an action brought by another party under the antitrust laws, which allows for private enforcers to sue firms that have been convicted of criminal violations of the antitrust laws. The antitrust laws provide for treble damages, which along with the purpose of deterrence, encourage private enforcement. These rules may encourage firms to settle rather than litigate claims brought by the Justice Department, as a losing case opens the door for plaintiffs to seek treble damages against a firm with an arguably easier task of proving liability.

While private enforcement litigation deriving from criminal convictions may increase, increases in other private enforcement litigation are limited by whether there are willing plaintiffs, whether those plaintiffs have standing and whether they can meet pleading standards. The trend of recent Supreme Court decisions has been to limit plaintiffs' claims in antitrust actions.

A plaintiff must prove that it has suffered an "antitrust injury," which is an injury that the rules were established to prevent, and more specifically one that flows from the lessening of competition. This rule applies whether the plaintiff is seeking damages or an injunction.

A plaintiff may also need to prove that it is the direct purchaser to sue under federal law. For price-fixing cases, and potentially all cases under Section 4 of the Clayton Act, a plaintiff must prove that it is the overcharged direct purchaser to have standing to sue, and not somewhere else in the chain of manufacture or distribution. There are exceptions to the rule, however, including plaintiffs who seek injunctions, pre-existing cost-plus contract arrangements, where the first purchaser is owned and controlled by the indirect purchaser and if the direct purchaser is a co-conspirator with the defendant firm. Additionally, indirect purchasers may be able to pursue state antitrust law claims in about 20 states that have "Illinois Brick Repealer" statutes.

Foreign plaintiffs seeking remedy in U.S. courts were limited by the 2004 Supreme Court decision in *F. Hoffman-La Roche Ltd. v. Empagram S.A.*, 542 U.S. 155 (2004), which held that the Foreign Trade Antitrust Improvements Act limits the reach of U.S. antitrust laws. A plaintiff may only bring claims for conduct that have a direct, substantial and reasonably foreseeable effect on domestic commerce, and that effect must give rise to the claim. Under *Empagram*, only plaintiffs who are injured by the domestic effect can bring suit, and not those who are injured only by the foreign effect, even if the conduct affects consumers both inside and outside the U.S.

The Supreme Court has recently redefined (or refined) pleading standards. In *Bell Atlantic v. Twombly*, 127 S.Ct. 1955 (2007), the court stated that a pleading must present enough facts to state a claim for relief that is plausible on its face, rejecting the former standard of the claim needing to be merely conceivable, which meant that a complaint should not be dismissed until it appears beyond doubt that the plaintiff cannot prove facts to support the claim. The policy behind requiring plaintiffs to have some specificity to their pleadings is to avoid the extreme costs of groundless claims that would encourage defendants to settle just to avoid costly controversies.

Other recent Supreme Court cases have generally limited the scope of allowable antitrust claims, including refusals to create an exception to the rule that competitors have no obligation to work together, holding that price discrimination is only prohibited where it would threaten to injure competition, holding competitors operating a joint venture in a relevant market were no longer competitors and therefore cannot be guilty of price fixing, and rejecting that a patent is presumptive evidence of market power.

The Obama administration can direct increased resources to antitrust enforcement and use those resources to examine markets that were previously left to regulate themselves. Antitrust enforcement, both government and private, will be limited by the ongoing trend in Supreme Court jurisprudence that generally favors defendants. If the Obama administration is successful in increasing criminal antitrust convictions, there will likely be an increase in private cases due to the damages at stake and the resulting burden of proof. Private enforcement that is not based on a prior criminal conviction is less likely to increase, as recent decisions have only raised the bar for making successful claims, absent legislative changes that open the doors more to plaintiffs' claims.

Thad Davis is a partner and **Sarah Zenewicz** is an associate at Ropes & Gray in San Francisco.