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ANTITRUST

Expert Analysis

Seventh Circuit Explores Antitrust Pleading Standards

By **Elai Katz**

The U.S. Court of Appeals for the Seventh Circuit took the unusual step of reviewing a lower court's decision that a complaint sufficiently alleged a conspiracy in the text messaging industry to examine pleading standards in light of recent Supreme Court opinions. The Federal Trade Commission (FTC) ruled that the completed combination of two battery separator manufacturers violated antitrust law and required a divestiture of the entire acquired business and additional ancillary relief. A district court decided that a complaint alleging unlawful tying involving the popular Webkinz stuffed animals sufficiently defined a relevant market to survive a motion to dismiss.

Other recent antitrust developments of note included the Department of Justice's challenge of a merger of rival rail joint makers and the European Commission's investigation of exclusionary practices by Google.

Pleading Standards

The Seventh Circuit agreed to hear an interlocutory appeal of a district court's decision sustaining the sufficiency of a complaint alleging that leading telecommunications companies—AT&T, Sprint, Verizon and T-Mobile—conspired to fix the prices for text messages in violation of §1 of the Sherman Act. The district court and the appellate court agreed that the non-final order should be reviewed to determine whether the U.S. Supreme Court's 2007 *Twombly* decision, 550 U.S. 544, and its 2009 successor *Ashcroft v. Iqbal*, 129 S.Ct. 1937, required dismissal of the complaint.

The Seventh Circuit, in a decision penned by Judge Richard Posner, observed that when a district court "allows a complex case of extremely dubious merit to proceed" to discovery by misapplying the *Twombly* standard, only an immediate appeal can avert "irrevocable as well as unjustifiable harm" to the defendant. The appellate panel observed that *Twombly* is a relatively recent precedent and its scope is "unsettled."

Turning to the complaint at issue, the Seventh Circuit stated that the plaintiffs alleged a conspiracy with sufficient plausibility to satisfy the *Twombly* pleading standard and warrant permitting the plaintiffs to conduct discovery. The appellate panel pointed to several allegations that were indicative, if true, of a plausibly asserted conspiracy rather than merely parallel conduct. First, the complaint alleged that defendants met in small groups and exchanged price information directly at trade association meetings. Second, defendants allegedly increased prices just as costs were falling steeply. Third, the complaint alleged that the defendants abruptly changed from complex and heterogeneous pricing structures to a uniform pricing structure at the same time that they raised prices significantly.

In re Text Messaging Antitrust Litigation, No. 10-8037, 2010-2 CCH Trade Cases ¶77,281 (Dec. 29, 2010)

The FTC ruled that a completed merger of battery separator manufacturers was likely to substantially lessen competition in violation of §7 of the Clayton Act.

Comment: The U.S. Supreme Court decided not to review another important appellate case sustaining a complaint under the *Twombly* standard, the U.S. Court of Appeals for the Second Circuit's January 2010 decision in *Starr v. Sony Music*, 592 F.3d 314 (cert. denied, No. 10-263, Jan. 10, 2011)

Merger Challenge

The FTC ruled that a completed merger of battery separator manufacturers was likely to substantially lessen competition in violation of §7 of the Clayton Act and required divestiture of the acquired company, affirming in large part the initial decision of an administrative law judge. The 2008 acquisition of Microporous, L.P. by Polypore International Inc. was not reportable under the Hart-Scott-Rodino Act's premerger notification program and was consummated before the FTC began its investigation.

Battery separators are membranes inserted between the positive and negative plates in batteries to prevent short circuits and are used in batteries for cars, golf carts, forklifts and many other end-use applications. The commission stated that separators made for one type of battery are not reasonably interchangeable with separators for other kinds of batteries, and therefore, the commission analyzed the actual and likely effects of the combination on four distinct battery separator markets, based on the end use.

The commission's unanimous opinion, authored by Commissioner Edith Ramirez, rejected the manufacturer's argument that various types of polyethylene separators compete with each other regardless of the end use, relying, among other things, on testimony that a forklift battery manufacturer was unable to find an alternative source of supply for separators used in forklift batteries. The FTC determined that in two of the four identified markets, the combination led to monopoly; in a third market the acquired firm was a competitive threat and active participant even though it had not won any contracts; and, in a fourth separator market, the acquired firm was not a participant.

The FTC stated that in addition to the presumption of illegality arising from the merger to monopoly in two relevant markets there was evidence of likely anticompetitive effects, including announced price increases, due to the elimination of pre-acquisition competition.

The commission required complete divestiture of the acquired battery separator business, including a plant in Austria, to ensure the divested business has sufficient capacity. In addition, customers will be permitted to renegotiate or terminate contracts that "reflected the exercise of post-acquisition market power" and the divestiture buyer will also receive a license to intellectual property that was used or incorporated in the divested business, so that post-acquisition improvements or alterations need not be removed.

In a concurring opinion, Commissioner J. Thomas Rosch observed that the commission's opinion "embrace[d] a traditional analytical framework" by first defining the precise relevant markets and then examining the merger's

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effects. Commissioner Rosch suggested that in consummated merger cases, relevant markets can be defined after the competitive effects are identified and the parties' motives are examined.

In re Polypore International Inc., FTC Docket No. 9327, 2010-2 CCH Trade Cases ¶77,267 (Dec. 13, 2010), also available at www.ftc.gov

Comment: The commission's classical step-by-step opinion in the enforcement action reported immediately above may seem at odds with the recently released Merger Guidelines' rejection of rigid marked-definition-first analysis, but the guidelines are intended to describe the agencies' analytic process, not to set forth a formula for writing decisions, which often benefit from orderly and familiar progression.

In any event, as Commissioner Rosch acknowledges, one cannot avoid defining the relevant market altogether—the key question that warrants further debate is the level of precision required.

Tying and Toys

Mom-and-pop toy stores and other small retailers alleged that a toy maker engaged in unlawful tying by conditioning the availability of its popular Webkinz plush stuffed animal toys, which include a code for access to a website, upon the purchase of unrelated toys. The toy maker moved to dismiss the complaint and argued that the complaining stores improperly defined an overly narrow relevant market—delineated as "tangible toys whose purchase is required to gain access to a website that includes games"—to exaggerate Webkinz' market power. The court stated that the market definition did not warrant dismissal at the pleading stage and observed that it did not appear "unduly farfetched."

In re Webkinz Antitrust Litigation, 2010-2 CCH Trade Cases ¶77,208 (N.D. Cal.)

Rail Joint Acquisition

The Department of Justice required the divestiture of a manufacturing plant to permit the combination of L.B. Foster Company and Portec Rail Products Inc., two firms that manufacture and distribute products and services for the rail industry. The department asserted that the proposed acquisition would have combined two of the leading participants in the already concentrated markets for two kinds of rail joints—steel bars used to connect the ends of pieces of rail.

The proposed settlement required the sale of the manufacturing plant to a pre-approved buyer, Koppers Inc., that the department had determined would integrate the divested plant to create a viable business and remedy the department's competitive concerns. The department noted that railroad customers would have confidence in the buyer-in-divestiture's ability to make quality joints because of its relationships and reputation in the railroad supply business.

United States v. L.B. Foster Co., No. 1:10-cv-02115, CCH Trade Reg. Rep. ¶45,110 No. 5154, ¶50,985 (D.D.C. Dec. 14, 2010), also available at www.usdoj.gov/atr

Comment: The Department of Justice has generally permitted challenged transactions to close without requiring advance identification of a specific buyer for the assets that must be divested. Traditionally, the FTC has been more likely to require such an up-front buyer than the department, but in the case reported immediately above, the department was concerned that a buyer lacking sufficient expertise and a proven track record would not be able to gain customers' trust quickly enough to replace the loss of competition resulting from the acquisition.

Internet Search

The European Commission opened an investigation based on complaints that Google, the leading Internet search engine, abused its dominant position by disfavoring rival search firms, including price comparison sites, and giving preferential treatment to its own services. The commission stated that it intends to investigate whether the leading search engine lowered the ranking of unpaid or "natural" search results of competing service providers, among other allegedly unlawful conduct. The commission acknowledged that the opening of the investigation followed complaints by rival search providers and that the initiation of the investigation does not imply that the commission has proof of any violations.

The Department of Justice required the divestiture of a manufacturing plant to permit the combination of two firms that manufacture and distribute products and services for the rail industry.

The investigation will examine several additional allegedly abusive practices, including lower ranking for rivals' sponsored links (or paid search results), exclusive advertisement placement requirements, and restrictions on customers taking their data to competing platforms.

Press Release: *Antitrust: Commission probes allegations of antitrust violations by Google*, IP/10/1624 (Nov. 30, 2010) available at ec.europa.eu/competition

Discovery of Foreign Material

The U.S. Court of Appeals for the Ninth Circuit ruled that law firms must submit documents originating from outside the United States to a federal grand jury investigating possible antitrust violations. The law firms obtained the documents from their foreign clients as part of discovery in a civil suit.

The district court granted the law firms' request to quash the grand jury subpoenas, and the Ninth Circuit reversed, stating that grand jury subpoenas take precedence over a civil protective order. The appellate panel observed that by "chance of litigation, the documents have been moved from outside the grasp of the grand jury to within its grasp."

In re Grand Jury Subpoena, No. 10-15758, 2010 WL 4948545 (Dec. 7, 2010)

ATM Fees

Customers of banks brought an antitrust suit claiming that large commercial banks conspired to fix the "interchange fee" banks paid to one another when one bank's customer uses another bank's automatic teller machine (ATM) to withdraw cash routed over the largest ATM network. The complaint alleged that the defendant banks unlawfully set the interchange fee through their participation on the ATM network's board. The customers claimed that the banks pass along some portion of the artificially inflated interchange fees.

The district court granted the banks' motion for summary judgment to dismiss the plaintiffs' claims for damages on the grounds that they are indirect purchasers of the allegedly fixed services and as such are prohibited from suing to recover damages for antitrust violations under the 1977 *Illinois Brick* decision, 431 U.S. 720. The court rejected the plaintiffs' argument that there was no realistic possibility that banks—the direct payers of ATM interchange fees—would sue to challenge price-fixing, explaining that many bank members of the ATM network paid more in interchange fees than they received and had a strong financial incentive to bring such a suit.

In re ATM Fee Antitrust Litigation, 2010-2 CCH Trade Cases ¶77,173 (N.D. Cal. Sept. 16, 2010), reconsideration denied, 2010 WL 4918971 (Nov. 29, 2010)

Securities

A district court ruled that former holders of common stock in a public corporation did not have standing to bring claims alleging that private equity firms engaged in bid rigging in leveraged buyout auctions in violation of §1 of the Sherman Act. The court stated that the complaining shareholders had first sold their shares to the majority shareholder, which held 80 percent of the public corporation at the time, and that only subsequently did the defendant private equity firm acquire the shares at a lower price than the complaint alleged could have been obtained in an auction free of anticompetitive restraints.

The court rejected the plaintiffs' argument that the two steps constituted a single transaction and determined that plaintiffs were indirect purchasers barred from bringing federal claims under *Illinois Brick*, as the majority shareholder could seek to recover the entire amount of any overcharge.

Dahl v. Bain Capital Partners, LLC, Civ. No. 07-12388-EFH, 2011 WL 108905 (D. Mass. Jan. 13, 2011)