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ANTITRUST

Expert Analysis

Latest Airline Merger Challenged in Court

By
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The Department of Justice brought an action to block the proposed merger of American Airlines and US Airways, surprising some observers of the airline industry, which has seen significant mergers approved with limited route divestitures in the last decade. The U.S. Court of Appeals for the Eleventh Circuit rejected monopolization claims in a market limited to black hot rolled coil steel because the market definition failed to properly consider supply substitution by producers of other kinds of steel.

Other antitrust developments of note included the New York Attorney General's requirement that an online food-delivery service forgo exclusive arrangements with Manhattan restaurants before it could merge with a rival, the dismissal of conspiracy claims against three private equity funds because the evidence against them did not exclude the possibility of independent action and a ruling that refusal to include cloned horses in a registry violated antitrust law.

Airline Merger

The U.S. Department of Justice and several states filed a suit to halt the proposed merger of American Airlines and US Airways, alleging that the combination would substantially eliminate competition for commercial air travel in many local markets and lead to higher prices and less service. The department stated that if the merger is permitted to proceed it would form the world's largest airline and would result in four airlines controlling 80 percent of domestic commercial air traffic.

The department asserted that US Airways offers significant discounts for connecting (one-stop) flights that compete with rival airlines' nonstop service and that the merger would eliminate US Airways' structural incentive to continue to offer these discounts by adding major hubs and more popular non-stop routes to the airline's network. The complaint also quoted US Airways executives' past statements that the airlines were able to pass along fare increases to customers "because of consolidation." The complaint went on to posit that the merger would make it easier for the remaining airlines to cooperate, rather than compete.

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In addition to listing hundreds of city pairs where both American and US Airways compete by offering connecting or direct service, the complaint alleged that the combined firm would control 69 percent of the takeoff and landing slots at Reagan National Airport. The district court in Washington, D.C., set a trial date of Nov. 25, 2013.

The government's analysis arguably deviated from prior airline merger reviews, where the principal focus of the inquiry was on overlapping non-stop service between particular city pairs and where combining complementary networks was deemed to enhance efficiency. As US Airways and American pointed out in their answers, mergers reviewed and approved by the department in recent years created the two largest airlines, Delta and United. But while past administrative decisions provide vital guidance to counselors and the business community, unlike court decisions, they (especially settlements or decisions not to bring a challenge) do not have binding precedential value. In addition, in a consolidating industry, later proposed mergers may face heightened scrutiny because the market has become more concentrated.

United States v. US Airways and AMR, 13-cv-01236-CKK (amended complaint filed Sept. 5, 2013)

Cross-Elasticity of Supply

The Eleventh Circuit rejected a claim that Nucor, a leading steel manufacturer, conspired to monopolize the black hot rolled coil steel market because plaintiff's definition of the relevant product market was "too restrictive" given the high cross-elasticity of supply in that market, affirming the lower court's grant of summary judgment in favor of Nucor.

In 1999, Gulf States Steel, one of Nucor's main competitors in the southeastern region of the United States, filed for bankruptcy, and as part of the bankruptcy proceedings, Gulf States Steel's assets were put up for sale. GSRG, a newly-formed entity hoping to enter the black hot rolled coil steel market, contracted with the bankruptcy trustee to purchase Gulf States Steel's steel-producing assets unless a higher bid was submitted, whereupon a public auction would be held. Nucor then formed a new entity with another company to acquire the assets. At a public auction, GSRG's bid was rejected because it didn't conform with the auction's rules, and Nucor's bid was accepted. GSRG then brought suit against Nucor and others, alleging, inter alia, that they conspired to monopolize the black hot rolled coil steel market in violation of Section 2 of the Sherman Act.

The appellate court noted that to establish a violation under Section 2, a plaintiff must properly define the relevant market. GSRG asserted that the relevant market was the market for black hot rolled coil steel. The Eleventh Circuit rejected this definition as too limited and went on to specify why cross-elasticity of supply is critical to defining the relevant market in this case.

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Steel can have a variety of forms, depending on the treatment process that it undergoes. When black sheet steel is rolled into a coil, making it easier to store and transport, the result is known as black hot rolled coil steel. When black hot rolled coiled steel is submerged in acid and then coated in oil, it is known as pickled and oiled steel.

The court noted that GSRG's contention that, from the perspective of purchasers, pickled and oiled steel "is not the equivalent" of black hot rolled coil steel "misses the point" as product markets are not defined solely on the basis of consumer demand, but rather must take into consideration the elasticity of supply in appropriate cases.

The court found that GSRG's proposed product market of black hot rolled coil steel was "too restrictive" given that "[p]ickled and oiled steel is essentially black hot rolled coil steel that a manufacturer bathes in acid and coats with oil" and that a producer of pickled and oiled steel could "without much or any cost" switch to producing black hot rolled coiled steel. Therefore, if a monopolist raised its prices, "pickled and oiled steel manufacturers could (and likely would) enter the fray in order to enrich themselves," which would "increase the supply, and lower the price, of black hot rolled coil steel." Therefore, the appellate court found that GSRG's "failure to account for cross-elasticity of supply" was "fatal" to its attempted monopolization claim.

Gulf States Reorganization v. Nucor, No. 11-14983, 721 F.3d 1281 (11th Cir. 2013)

Private Equity Buyouts

A district court in Massachusetts ruled on summary judgment motions in a class action alleging that 10 private equity firms conspired to allocate the leveraged buyout market and allowed federal antitrust claims to proceed against seven of the defendants. Plaintiffs, shareholders of companies that were taken private, alleged that defendants allocated the leveraged buyout (LBO) market in order to pay less than fair value for target companies, with particular emphasis at this stage of the case on "proprietary" deals. In a proprietary deal in the LBO market, the target company negotiates an agreement of sale with a buyer (or a consortium of buyers). After the agreement is publicly announced but prior to the closing of the deal, the target company is typically granted time to try to find a better offer, called a "go-shop" period.

In a previous ruling, reported in the March 22, 2013, column, the court had narrowed the scope of the alleged conspiracy, finding that plaintiffs had sufficiently shown the existence of a genuine issue of fact as to the existence of an overarching conspiracy among the defendants to "refrain from 'jumping' each other's announced proprietary deals." The court left open the issue of whether there was sufficient evidence to connect each defendant to the conspiracy, and the 10 defendants brought renewed individual motions for summary judgment.

Viewing the evidence in the light most favorable to plaintiffs, the court pointed to "three fundamental pieces of evidence" in connection with two proprietary transactions which it found suggested that "the act of 'standing down' or not 'jumping' announced proprietary deals" was part of a "continuous agreement" and "a code of conduct agreed to by" eight of the defendants. Such evidence included an email from an executive at one defendant stating that another firm "has agreed not to jump our deal since no one in private equity ever jumps an announced deal," as well as the observation of an executive at another defendant that "club etiquette prevails."

The court further emphasized the "fact that no Defendant ever 'jumped' an announced proprietary deal during the 'go-shop' period" of the two transactions. The court therefore found that the evidence tended to exclude the possibility that most of the defendants "were acting independently when choosing not to 'jump' announced proprietary deals."

With regard to two of the defendants, Apollo and Providence, the district court found that the evidence did not "support a connection to the overarching conspiracy" or tend to exclude the possibility of independent action. Quoting from an internal communication between two executives at Apollo wherein one executive stated "[w]e're not in that boy's club yet and let's not agree to stand down too quickly and meekly," the court stated that it indicated that Apollo "viewed itself as an outsider to any potential conspiracy." The court further noted that plaintiffs' allegations with regard to Providence were primarily based on a contention that Providence made no effort to "jump" transactions outside its investment focus and that there was no evidence that Providence was involved in the transactions that "serve[d] as the basis" for the other defendants' connection to the overarching conspiracy.

The court subsequently decided to dismiss claims against another defendant, Thomas H. Lee Partners, because its "hesitance" to "bust up" another firm's late-stage deal was as consistent with an independent fear of retaliation as it was with an agreement not to "jump" announced proprietary deals.

Dahl v. Bain Capital Partners, 2013-2 CCH Trade Cases ¶¶78,460, 78,502, No. 07-12388-EFH (D. Mass. July 16, 2013 & Aug. 29, 2013).

A jury in a Texas federal court unanimously found that defendant American Quarter Horse Association, a non-profit association that is the "preeminent Quarter Horse breed registry," violated the Sherman Act and Texas state antitrust law by refusing to allow cloned horses in its registry.

Online Food Delivery Merger

New York's Attorney General reached a settlement to address concerns about the competitive impact of the combination of New York City's leading online food-ordering service, Seamless, and its rival GrubHub. To allay concerns that exclusive arrangements with restaurants would impede the growth of competing online delivery services, the merging parties agreed to waive the exclusivity provisions in their agreements with Manhattan restaurants and to refrain from entering into any new exclusivity arrangements for 18 months.

The relief obtained in this merger enforcement action endeavors to address the perceived exclusionary effects of a merger with conduct remedies rather than more traditional structural remedies.

Office of the Attorney General of the State of New York, Investigation of the Proposed Combination of Seamless North America, LLC and GrubHub, Inc., Assurance No. 13-388 (Aug. 5, 2013)

Cloned Horses

A jury in a Texas federal court unanimously found that defendant American Quarter Horse Association (AQHA), a non-profit association that is the "preeminent Quarter Horse breed registry," violated the Sherman Act and Texas state antitrust law by refusing to allow cloned horses in its registry. Plaintiffs breed horses that are genetic clones of one parent through a process called somatic cell nuclear transfer. In this process, the nucleus of a cell from an AQHA registered Quarter Horse is implanted into a mare. Thus, all of plaintiffs' cloned horses are exact genetic copies of horses already registered with the AQHA. Under the AQHA's rules, neither cloned horses nor their offspring were eligible for registration. Plaintiffs argued that registration was necessary for them to compete in the market for "elite" Quarter Horses, noting that Quarter Horses lose significant value without AQHA registration as they cannot participate in many high stakes competitions and have less value as a breeding animal.

Evaluating plaintiffs' restraint of trade claims at the summary judgment stage, a federal district court judge found sufficient evidence to proceed to trial. The court rejected the AQHA's argument that it could not have conspired with itself, noting that the "concerted action inquiry is functional" and looks to whether there is a conspiracy "between separate economic actors pursuing separate economic interests" such that the market is deprived "of independent centers of decisionmaking." The court noted that the committee that made registration recommendations to the AQHA's board was made up of breeders who "had an incentive to decrease competition by excluding elite clones." On the other hand, because the AQHA benefits from registering more horses, the AQHA acting on its own would not necessarily benefit economically from excluding cloned horses from its registry.

Turning to plaintiffs' monopolization claims under Section 2, the court observed that the claim "turn[ed] on whether the AQHA maintained its monopoly power by refusing to register clones." The court stated that the evidence could support a finding that the AQHA's rules control whether "a horse is valuable or relatively worthless" and that "because the AQHA defines the market, it maintains [monopoly] power by refusing proposals to redraw market boundaries" and allowed plaintiffs' claims for monopolization of the elite Quarter Horse market to proceed. The court further stated that the AQHA's argument that its rules excluding clones from the market were not anticompetitive "because registration rules are necessary for competition" would "best be dealt with at trial."

The jury unanimously found that the AQHA violated Section 1 and Section 2 of the Sherman Act but awarded no damages. Subsequently, the court ordered AQHA to register cloned horses.

Abraham & Veneklasen Joint Venture v. American Quarter Horse Association, No. 2:12-cv-103-J (N.D. Tx. July 30, 2013 & Aug. 22, 2013)