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ANTITRUST

Expert Analysis

Essential Facilities and Natural Gas Pipelines

By **Elai Katz**

The U.S. Court of Appeals for the Tenth Circuit affirmed dismissal of antitrust claims asserting concerted denial of access to an essential facility in the natural gas market in western Colorado. The appellate court found that the plaintiff, a venture seeking to enter the gas production market, failed to present sufficient evidence of harm to competition in a properly defined relevant market. Confirming the persistent significance of relevant market analysis in antitrust cases, a district court's acceptance of a narrow relevant market proposed by the U.S. Department of Justice ensured the government's successful challenge to Aetna's proposed acquisition of rival health insurer Humana.

Essential Facilities

Under the hundred-year-old essential facilities doctrine, one who controls a key infrastructure, network or other "bottleneck" may violate antitrust law by denying competitors access to the "essential facility," such as the only bridge across a river. A long line of cases has required monopolists that hold an essential facility to provide access to rivals on reasonable terms. The essential facilities doctrine is closely related to the law on refusing to deal with rivals. In some circumstances, a monopolist may violate the Sherman Act by refusing to deal with rivals when, aside from the benefit of excluding competitors, it would be profitable and prudent to continue to do business with them.

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The seminal case, *United States v. Terminal Railroad Association*, 224 U.S. 383 (1912), involved the aggregation by financier Jay Gould of all three Mississippi river crossings in St. Louis and all rail facilities on either side of the river in the late 1800s. These assets were indispensable for carrying any freight or passengers by rail across the river, providing Gould with a chokehold. Gould was able to impose significant surcharges on rival railroads, with the only alternative being a railroad crossing in Memphis, Tenn., nearly 300 miles away. The Supreme Court declined to force divestiture of some of the crossings and facilities acquired by Gould, accepting the argument that single control provided efficiencies in railroad operations. Instead, the court compelled access to the crossing by permitting other railroads to participate in ownership of the association at comparable terms to Gould's ownership rights or, in the alternative, rival railroads that did not want to participate in ownership would be charged a comparable usage fee.

But the vigor of the essential facilities and refusal to deal doctrines has been eroded over the years in the face of significant scholarly and judicial criticism. The Supreme Court declared in *Verizon Communications*

ELAI KATZ *is a partner at Cahill Gordon & Reindel.*

v. Law Offices of Curtis V. Trinko, 540 U.S. 398, 408-11 (2004), that "as a general matter, the Sherman Act does not restrict the long recognized right of a trader of manufacturer … freely to exercise his own independent discretion as to parties with whom he will deal." The *Trinko* court went on observe that the Supreme Court had never recognized the essential facilities doctrine "crafted by some lower courts" and found "no need either to recognize it or repudiate it." Some scholars have criticized the lack of consistent criteria for application of the essential facilities doctrine and raised concerns about the administrative difficulties of setting a reasonable rate for access. See, e.g., Abbott B. Lipsky Jr. and J. Gregory Sidak, "Essential Facilities," 51 Stan. L. Rev. 1187 (1999) and Philip E. Areeda, "Essential Facilities: An Epithet in Need of Limiting Principles," 58 Antitrust L.J. 841 (1990).

Nonetheless, these doctrines survive and cases are brought from time to time, albeit with limited success. One such case involved the rights to produce natural gas in western Colorado, where Buccaneer Energy (USA) was formed in 2008 to enter the natural gas market. Buccaneer leased rights to produce gas and drill new wells, contingent on obtaining rights to transport the gas. Two incumbent natural gas producers, SG Interest and Gunnison Energy (collectively, the incumbents or defendants) controlled a local pipeline system that connected to a regional gas pipeline. Following several rounds of negotiation, by late 2008 Buccaneer failed to secure a transportation agreement, the country was in an economic crisis, and gas prices fell dramatically. Buccaneer never produced gas and its investors pulled out in late fall 2008.

In 2012, Buccaneer filed suit in federal court in Colorado alleging that the local pipeline system was "essential to effective competition for production rights and the sale of natural gas" in the area and that the incumbent gas producers refused to provide reasonable access to their jointly owned regional pipeline system. Buccaneer asserted that the incumbents engaged in a conspiracy in restraint of trade and a conspiracy to monopolize in violation of §1 and §2 of the Sherman Act.

The district court granted summary judgment to defendants even though there was sufficient evidence for a reasonable jury to find that defendants conspired to deny Buccaneer access to the local pipeline system and that they intentionally blocked Buccaneer from competing with them as gas producers in the local area. The district court reasoned that Buccaneer did not present "evidence showing that the defendants caused or were capable of causing injury to competition in a defined market, as opposed to simply harm to Buccaneer." The Tenth Circuit affirmed on that basis and did not reach the district court's alternative reasoning for granting summary judgment, lack of antitrust standing. *Buccaneer Energy (USA) v. Gunnison Energy*, No. 15-1396 (10th Cir. Feb. 3, 2017).

The Tenth Circuit began by addressing the appropriate antitrust standard, observing that a concerted refusal to deal may be judged under the rule of reason or as a per se violation, depending on the circumstances. The court noted that use of the group boycott label does not necessarily "justify application of the per se rule" because not all group boycotts are naked restraints of trade with "no purpose except stifling competition." Because Buccaneer advanced what appeared to be a rule of reason case, the appellate court held the plaintiff to that standard. The court also stated that the "quick-look" or abbreviated rule of reason method would not apply because the market effects of access denial were far from "obvious."

Turning to the status of the essential facilities doctrine after *Trinko*, the Tenth Circuit focused on the distinction between concerted and unilateral refusals to provide access to an essential facility, noting that *Trinko* should be limited to unilateral or single-firm conduct and that concerted conduct by two or more players generally present greater anticompetitive concerns.

The appellate court stated that Buccaneer failed to prove a key element of the essential facilities doctrine, "a competitor's inability to duplicate the facility." The panel found that while duplicating the gas pipeline system may have been difficult, Buccaneer failed to advance evidence proving its inability to do so.

Relevant Market Definition

The Tenth Circuit next turned to address the traditional elements of a

rule of reason case, which places the initial burden on the plaintiff to show that an agreement had a substantial adverse effect on competition. Buccaneer sought to show anticompetitive effects in two markets: the market for upstream production rights and the market for downstream gas sales.

The court noted that Buccaneer did not present direct evidence of actual anticompetitive effects in either proposed market. Indeed, gas output through the pipeline at issue increased shortly after Buccaneer's exclusion in 2008. As such, the Tenth Circuit explained that Buccaneer had to attempt to establish likely indirect harm to competition by demonstrating that defendants possessed market power in properly defined relevant markets, relying, among other precedents, on *Novell v. Microsoft*, 731 F.3d 1064 (10th Cir. 2013) (Gorsuch, J.).

The panel found that Buccaneer failed to clearly define the product or geographic markets for production rights, which might or might not include new or existing leases and other interests and rights. Moreover, Buccaneer did not present evidence of defendants' market shares or the number and strength of other rivals in the proposed markets, which could have demonstrated defendants' possession of market power.

Nor did Buccaneer satisfy its burden to define the geographic dimension of the downstream natural gas sales market. The court rejected Buccaneer's attempt to segment the market into a "constrained Rocky Mountain Pipeline" market when demand peaks in winter months and an "unconstrained Rocky Mountain Pipeline" for the rest of the year. In any event, the court found that defendants could not have maintained any durable market power because they were captive to the local natural gas provider, which would likely balk at price increases.

Health Insurance

The definitions of the relevant market and possession of market power have proven to be enduring, essential and often decisive elements in many antitrust cases. Failure to properly define a market and demonstrate the existence of market power frequently proves fatal to an antitrust claim. And in many cases, particularly in mergers, the plaintiff has a good chance of winning if it can persuade the judge that its proposed relevant market is correct.

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In the Department of Justice's suit to block Aetna's proposed acquisition of rival health insurer Humana, the district court found, after a 13-day bench trial, that Medicare Advantage is a relevant product market separate from the original Medicare market. The insurers had argued one was a substitute for the other because as seniors turn 65, they choose between original Medicare (Medicare benefits offered directly by the government) and Medicare Advantage (Medicare benefits offered by private insurers) and are free to switch between the two on an annual basis. The court noted that Medicare Advantage had different price points and benefits than original Medicare and that data showed few consumers switched between Medicare Advantage and original Medicare. Accordingly, the court concluded, a Medicare Advantage provider could raise its prices without fear of losing a significant number of customers to Medicare. *United States v. Aetna,* 16-cv-1494 (D.D.C. Jan. 23, 2017).

Once the court accepted Medicare Advantage as a separate relevant market, the government could show high market concentration in hundreds of counties and in 70 counties where Aetna and Humana were the only two providers, a merger to monopoly. Having established such a "structural" case and obtained the benefit of a presumption of substantial lessening of competition, the government was well on its way to victory.

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