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ANTITRUST

Expert Analysis

Settlements Challenged As Antitrust Violations

By **Elai Katz**

The U.S. Court of Appeals for the Eighth Circuit ruled that an Arkansas statute implementing the nation-wide tobacco settlement agreement was immune from antitrust scrutiny under the state action doctrine. The U.S. Department of Justice expressed concerns about a proposed class action settlement of a copyright dispute arising out of plans to create a comprehensive digital book library by the leading Internet search engine.

Other recent antitrust developments of note included a state court decision following federal precedent and ruling that the settlement of a pharmaceutical patent dispute involving a payment to potential generic rivals did not unreasonably restrain trade because it did not exceed the scope of the patent.

State Action Immunity

A small, Canadian-based cigarette manufacturer claimed that an Arkansas statute—enacted as a result of the 1998 Master Settlement Agreement (MSA) between 50 states and major cigarette manufacturers—restrained trade in violation of §1 of the Sherman Act by requiring the plaintiff and other non-settling manufacturers to make substantial payments to the state if they increase their market shares. The plaintiff brought suit against the state to enjoin enforcement of the statute and asserted that the law forces smaller manufacturers that did not participate in or subsequently join the MSA to raise their prices so as not to increase their share of the market by taking away sales from higher priced cigarette makers.

A district court dismissed the antitrust claims and the Eighth Circuit affirmed. The appellate court ruled that the state is shielded from antitrust liability under the state action immunity doctrine. Quoting from the Supreme Court's decision in *Hoover v. Ronwin*, 466 U.S. 558 (1984), the court noted that "when a state legislature adopts legislation, its actions constitute those of the state" and are by definition "exempt from the operation of the antitrust laws." The Eighth Circuit rejected the plaintiff's contention that it must apply the test set forth in *California Retail Liquor Dealers Ass'n v. Midcal Aluminum Inc.,* 445 U.S. 97 (1980), and did not require a showing that the challenged restraint was clearly articulated and affirmatively expressed as state policy and that the state actively supervised the implementation of the policy.

The appellate court also stated that the statute did not irreconcilably conflict with the Sherman Act because it did not place "irresistible pressure" on the plaintiff to violate antitrust law and therefore the statute was not preempted in accordance with the Supreme Court's decision in *Rice v. Norman Williams Co.*, 458 U.S. 654 (1982).

> The Eighth Circuit said powerful disincentives to lower prices do not constitute "irresistible pressure" to violate the Sherman Act.

The Eighth Circuit disagreed with contrary decisions involving the MSA by the U.S. Courts of Appeals for the Second and Third Circuits and stated that powerful disincentives to lower prices do not constitute "irresistible pressure" to violate the Sherman Act. Instead, the appellate court indicated that it was following opinions by the U.S. Courts of Appeals for the Sixth and Ninth Circuits, concluding that the MSA-related statutes did not "mandate or authorize" illegal conduct "in all cases."

***Grand River Enterprises Six Nations, Ltd. v. Beebe,* 2009-2 CCH Trade Cases ¶76,694**

Copyright Suit Settlement

The Department of Justice provided comments on the proposed class settlement of a copyright infringement action brought by authors and publishers contesting a leading Internet search engine's plans to create a comprehensive digital library by scanning and making accessible on the Internet millions of in-print and out-of-print books. The department's statement asserted that some provisions of the proposed settlement may violate the antitrust laws and suggested changes for the parties' consideration as they work to modify the settlement agreement.

With respect to antitrust issues raised by the proposed settlement, the department expressed concern that the settlement would foreclose other digital distributors from competing in the provision of a comprehensive digital library because the settlement arguably grants the search engine exclusive rights for the digital distribution of "orphan works"—out-of-print works by unknown rights-holders.

The department added that the proposed settlement seems to constrain price competition among authors and publishers in several ways, including by agreeing upon a single royalty rate payable to publishers who would otherwise compete in the sale of hard-copy and digital books to distributors, including the search engine.

In addition, the department noted that the settlement contains restrictions on retail discounting by the search engine and gives publishers the ability to control future pricing of orphan works, with which the publishers' books may compete.

Statement of Interest of the United States of America Regarding Proposed Class Settlement, *The Authors Guild Inc. v. Google Inc.,* No. 05 Civ. 8136 (S.D.N.Y. Sept. 18, 2009), also available at www.usdoj.gov/atr

Reverse Payment Settlements

California consumers of ciprofloxacin hydrochloride (Cipro) antibiotic medication brought suit alleging that the manufacturer of the branded drug settled patent infringement suits by paying potential generic rivals to stay

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off the market in violation of the Cartwright Act, California's antitrust law.

A California state trial court granted summary judgment to the defendants and stated that the agreement fell within the exclusionary scope of the patent and did not restrict more competition than allowed under the statutory monopoly granted by the issuance of a patent. The court noted that California courts often look to federal antitrust precedent for guidance and cited several federal appellate decisions, including one addressing the very same settlement agreement, that rejected claims that reverse payment settlements violated the Sherman Act.

***Cipro Cases I & II*, 2009-2 CCH Trade Cases ¶76,717 (Cal. Superior Court, San Diego County)**

Joint Marketing

The Department of Justice issued a business review letter stating that it will not challenge a proposal by seven independent regional "less-than-truckload" freight transportation carriers to collaborate on rate making and submit joint bids as part of a nationwide joint venture.

The department noted that, according to the carriers, each serves a distinct geographic region, they account for less than 20 percent of the market and the proposed collaboration would create transactional efficiencies and allow the carriers to better compete with national firms.

The carriers also stated that their agreement limits the ability of members to expand beyond their region to ensure that each member advances the interests of the joint venture rather than competing against it.

***The Reliance Network*, Business Review Letter (Sept. 8, 2009), available at www.usdoj.gov/atr**

Joint Purchasing

In another business review letter, the Department of Justice announced that it will not challenge plans by operators of the three major hospitals in the Savannah, Georgia, area to jointly and exclusively purchase certain medical and surgical supplies. The department stated that the proposal meets the requirements of the health care guidelines' safety zone as the cost of all products purchased through the arrangement would not exceed 20 percent of the hospitals' total revenues and the purchases would account for less than 35 percent of regional vendors' sales of the relevant supplies.

***Memorial Health Inc. and St. Joseph's/Candler Health System*, Business Review Letter (Sept. 4, 2009), available at www.usdoj.gov/atr**

Non-Competition Covenants

A management consulting firm claimed that a former employee who went to work for a competitor breached restrictive covenants in his employment agreement. The agreement prohibited the former employee from working for a direct competitor, disclosing confidential information and contacting former clients for six months following the termination of his employment. The agreement also included a tolling clause providing that the six-month period would be tolled during any period in which the employee is in breach of the covenants.

Following a bench trial, the district court entered an order prohibiting the former employee from violating the covenants for six additional months and awarded more than $1.6 million in damages for lost profits from a new project the former employee successfully solicited from a former client.

The U.S. Court of Appeals for the Eleventh Circuit affirmed the injunction and reversed the award of damages. The appellate court stated that the restrictive covenants were enforceable under Florida law and that, generally speaking damages could be recovered, but that in this case the employer failed to establish that the former employee's solicitation of a client caused the asserted loss of profits, as the employer did not show that, absent the employee's breach, it would have obtained the project.

***Proudfoot Consulting Co. v. Gordon*, 2009-2 CCH Trade Cases ¶76,696**

The appellate court stated that the FCC's rule capping the permitted market share at 30 percent of all subscribers was arbitrary and capricious because it did not sufficiently consider the impact of competition from direct broadcast satellite television providers.

Telecommunications

The U.S. Court of Appeals for the District of Columbia Circuit vacated Federal Communications Commission (FCC) regulations limiting the market share that a single cable television operator may serve. The appellate court stated that the FCC's rule capping the permitted market share at 30 percent of all subscribers was arbitrary and capricious because it did not sufficiently consider the impact of competition from direct broadcast satellite television providers and that the FCC failed to show that permitting a cable operator to serve a higher share of the subscriber market would reduce competition or diversity in programming.

The court observed that the rule was meant to prevent "bottleneck monopoly power" and ensure that no cable operator could, by refusing to carry a programming network, cause it to fail and impede the flow of video programming to the consumer. The court then noted that the increased market shares of satellite and fiber optic video providers diminished cable operators' ability to exercise power over programming networks.

***Comcast Corp. v. FCC,* No. 08-1114, 2009 WL 2633763 (Aug. 28, 2009)**

Acquisitions

The Supreme Court of Israel ruled that the country's leading telecommunications services provider should not be permitted to acquire majority control of the only domestic satellite television services provider because the transaction was reasonably likely to significantly harm competition in violation of Israel's restrictive trade practices law.

The Israel Antitrust Authority had issued an order preventing the telecommunications provider from exercising options that would have increased its equity stake in the satellite television firm from just under 50 percent to over 58 percent. The antitrust tribunal, a court with exclusive jurisdiction over non-criminal antitrust matters, reversed the authority's decision, approving the acquisition with conditions.

The Supreme Court noted that the telecommunications provider was a potential competitor in the multi-channel television network infrastructure market because it had the ability, incentives and had made assertions about its plans to develop an advanced Internet protocol television (IPTV) network using its existing telecommunications infrastructure in competition with cable and satellite networks. The court stated that the elimination or reduction of potential horizontal competition was recognized as a theory of harm under Israeli antitrust law.

The court rejected the antitrust tribunal's determination that the relatively small increase in ownership, from just under 50 percent to over 58 percent, did not lead to significant additional harm to competition and observed that anticompetitive transactions should not be permitted merely because competition in the relevant market is already impaired. The court emphasized the importance of crossing the 50 percent threshold in general and in this case in particular where the buyer would secure a majority of the board of directors.

***Eurocom D.B.S. Ltd. v. Bezeq The Israel Telecommunication Corp., Ltd.,* Civil Appeal Nos. 2082/09 and 2414/09 (Aug. 20, 2009)**

Comment: The two developments reported immediately above show how regulators and courts in different jurisdictions have endeavored to examine the competitive impact of fast-paced changes in video programming delivery technology.