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ANTITRUST

Expert Analysis

Department of Justice Challenges Energy Swap Arrangement

By
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The U.S. Department of Justice brought an enforcement action against a New York City electricity supplier for entering into a financial derivative contract alleged to have the effect of acquiring its principal rival's electricity generation capacity. The department and European competition enforcers determined that an arrangement combining the second and third largest Internet search engines could create a viable competitive alternative to the leading search engine and was not likely to reduce competition.

Other recent antitrust developments of note included a decision by a district court dismissing claims that the "reverse payment" settlement of a patent dispute between branded and generic drug companies unlawfully restrained trade and the Justice Department's decision not to challenge a proposed online subscription news service that would combine various publishers' content.

Derivative Contracts

The Department of Justice announced the settlement of charges that the largest provider of electricity in New York City entered into an unlawful agreement in restraint of trade by arranging for a complex derivative contract or swap that essentially transferred the capacity of its largest competitor and enabled the electricity provider to withhold substantial output from the market.

The department asserted that because transmission constraints limit the amount of energy that can be imported to New York City, the city's installed electricity generation capacity constitutes a relevant geographic and product market. According to the department, three firms control most of the city's generating capacity and are subject to price caps. Prices are set through periodic auctions, and the last bid needed to meet demand establishes the market price for all capacity sold at a given auction.

The Department of Justice complaint alleged that the electricity provider had "bid its cap" or the maximum amount permitted from 2003 to 2005 when almost all local capacity was needed to meet demand, but excess capacity was anticipated following the entry of additional supply in 2006 which could have undermined the profitable "bid the cap" strategy. The complaint alleged that the provider then considered acquiring its rival, but instead acquired an indirect financial interest in the rival's capacity.

The derivative contract was entered into with a financial services company and provided that if the market price exceeded a predetermined amount, the provider would receive the additional revenue from 1,800 megawatts of electricity and if the market prices were below that amount, the provider would pay the difference. The financial intermediary entered into an offsetting agreement with the rival supplier of electricity, the most likely counterparty for such a hedge.

The Department of Justice stated in a business review letter that it will not challenge the creation of an online subscription news aggregation service.

The department stated that the swap agreement effectively eliminated the provider's incentive to compete for sales. After entering into the agreement, according to the complaint, the provider bid its cap at auctions even though a significant portion of its capacity went unsold and the market price did not decline despite the addition of new capacity in New York City.

The settlement requires disgorgement of profits, which the Department of Justice stated it had not previously sought as a remedy. The department noted that private parties might not be able to bring suits to seek compensation for their injuries because of the filed rate doctrine, which provides that, generally speaking, treble damages cannot be recovered in an action arising from rates approved by a government agency.

United States v. KeySpan Corp., Civil Action No. 10-cv-1415 (WHP) (SDNY Feb. 23, 2010), CCH Trade Reg. Rep. ¶45,110 No. 5068, ¶50,975, also available at www.usdoj.gov/atr

Comment: Even in the absence of a direct agreement between competitors, arrangements that have the effect of restraining output or increasing prices may be challenged as antitrust violations in certain cases.

Search Engine Agreement

The Department of Justice and the European Commission announced the closing of their investigations into a proposed agreement combining the Internet search and paid search advertising technology and operations of Microsoft Corporation and Yahoo! Inc. for 10 years. Both agencies stated that the arrangement would not likely reduce competition but rather create a stronger competitive alternative to Google, the dominant firm in these markets. The agencies noted that increasing scale is significant to enhanced performance because a larger set of queries and search data will enable Microsoft to serve more relevant search results and paid search listings as well as innovate more quickly.

Statement of the Department of Justice Antitrust Division on its Decision to Close Its Investigation of the Internet Search and Paid Search Advertising Agreement Between Microsoft Corporation and Yahoo! Inc., CCH Trade Reg. Rep. ¶50,249 (Feb. 18, 2010), available at www.usdoj.gov/atr and *Mergers: Commission clears Microsoft's proposed acquisition of the Yahoo! search business*, IP/10/167 (Feb. 18, 2010), available at ec.europa.eu/competition

Online News Service

The Department of Justice stated in a business review letter that it will not challenge the creation of an online subscription news aggregation service. The service intends to enter into bilateral, vertical, non-exclusive content licensing arrangements with

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numerous, competing Internet publishers. Participating publishers may distribute their content on their own Web sites and through other services in addition to the newly formed service.

Publishers may also choose which items can be viewed for free and which can only be viewed by paying subscribers to the service. However, publishers would be barred from distributing outside the service for free any part of their own content that was contributed to the service on a fee basis. The department stated that the service has the potential to benefit consumers by providing access to a broad network of related content and reduce distribution costs.

MyWire Inc., Business Review Letter 10-1, CCH Trade Reg. Rep. ¶44,110 (Feb. 24, 2010), available at www.usdoj.gov/atr

Patent Dispute Settlements

The Federal Trade Commission (FTC) and private plaintiffs alleged that the maker of a brand name gel used for testosterone replacement therapy and generic drug companies violated the antitrust laws by agreeing to delay the introduction of generic alternatives into the market in exchange for payments from the branded drug maker as part of a settlement of a patent infringement suit. Some of the private plaintiffs also alleged that the branded drug maker unlawfully filed anticompetitive infringement actions.

A district court dismissed the "reverse payment" claims and stated that in the U.S. Court of Appeals for the Eleventh Circuit, "neither the rule of reason nor the per se analysis is appropriate" when determining whether a patent settlement constitutes an unlawful restraint of trade, citing *Valley Drug Co. v. Geneva Pharmaceuticals Inc.*, 344 F.3d 1294 (11th Cir. 2003) and *Schering-Plough Corp. v. FTC*, 402 F.3d 1056 (11th Cir. 2005). The court added that agreements that do not exceed the scope of the patent do not violate the Sherman Act and that subsequent invalidation of the patent does not change the analysis. In addition, the fact that the patent dispute was resolved with a "reverse" payment to the alleged infringer does not impact the analysis.

The district court, however, did not dismiss claims that the infringement actions brought against the generic drug companies constituted "sham litigation." The court noted that the lawsuits fell within an exception to the immunity afforded to petitioning activity as the complaint alleged that the infringement actions brought against the generic drug companies were objectively baseless because the patent contained a significant error regarding the composition of the gel that could not have been infringed by the generic gel.

In re AndroGel Antitrust Litigation, 2010-1 CCH Trade Cases ¶76,914, 2010 WL 668291 (N.D. Ga.)

Comment: Notwithstanding the courts' mostly unfavorable reaction to reverse payment claims, pending legislation would make such settlement agreements presumptively unlawful. FTC Chairman Jon Leibowitz recently praised the inclusion of provisions addressing reverse payment (or "pay-for-delay") agreements in President Barack Obama's health care proposal.

Voting Machines

The Department of Justice and the attorneys general of nine states announced the settlement of charges that the completed combination of the two largest providers of voting equipment systems (integrated software, hardware and services used to electronically record, tabulate and transmit votes) would substantially lessen competition in violation of §7 of the Clayton Act. The settlement requires the divestiture of the acquired voting equipment systems business and waiver of contractual terms that would otherwise prevent customers from selecting the buyer in divestiture for the provision of voting systems.

> Even in the absence of a direct agreement between competitors, arrangements that have the effect of restraining output or increasing prices may be challenged as antitrust violations in certain cases.

The department and states had alleged that the acquisition, which was not reportable under the Hart-Scott-Rodino (HSR) Act's premerger notification program, reduced incentives to innovate and combined the two closest competitors in the provision of voting equipment systems, which constituted a separate relevant product market. The complaint stated that a small but significant increase in the price of voting equipment systems would not cause customers to substitute away from electronic voting equipment to mechanical lever and punch card voting machines.

United States v. Election Systems & Software Inc., No. 1:10-cv-00380 (D.D.C. March 8, 2010), available at www.usdoj.gov/atr.

Battery Separators

A Federal Trade Commission Administrative Law Judge (ALJ) ruled that a completed 2008 acquisition of a rival by a battery separator manufacturer was unlawful and ordered a full divestiture of the acquired firm, including two manufacturing facilities. The ALJ stated in an initial decision that the combination was likely to substantially lessen competition in four relevant markets involving battery separators—materials placed between positively and negatively charged plates in batteries to prevent short circuits while permitting ionic current to flow through the separators. The judge noted that in two of the four markets the merger led to a monopoly.

In addition, the ALJ decided that a 2001 agreement between the buyer and another rival unlawfully prevented the rival from entering the market and violated §5 of the FTC Act.

Polypore International Inc., Docket No. 9327, 2010 WL 866178 (March 1, 2010), available at www.ftc.gov

Comment: The two enforcement actions reported immediately above reflect the agencies' continued interest in challenging completed, non-reportable mergers.

Exclusive Dealing

The FTC announced the settlement of charges that the leading manufacturer of photochromic treatments—materials that darken eyeglass lenses when exposed to sunlight and clear up in the shade—illegally maintained its monopoly by entering into exclusive dealing arrangements with lens casters, the manufacturers of eyeglass lenses.

The commission's complaint alleged that the firm refused to deal with lens casters that carried rivals' photochromic lenses and provided discounts to retailers and wholesalers only if they purchased all or almost all their needs from the leading firm. The FTC determined that the firm's policies foreclosed rivals from access to lens casters accounting for over 85 percent of photochromic lens sales and deterred potential competitors from entering the market.

Transitions Optical Inc., File No. 091-0062 (March 3, 2010), available at www.ftc.gov

Relevant Market Definition

The U.S. Court of Appeals for the Fifth Circuit affirmed dismissal of a complaint by residents of a San Antonio apartment building (or "multiple dwelling unit") that an exclusive arrangement with a provider of telecommunications services violated antitrust laws.

The court stated that a single building could not plausibly be considered a relevant geographic market as tenants had the opportunity to inquire into the cost and quality of available telephone, cable television and Internet services before signing leases. In addition, telecommunications firms compete for exclusive contracts with landlords, and landlords compete for tenants on the costs of services, among other things. The court also observed that typical leases are short enough that most tenants would be locked into exclusive telecommunications services for relatively brief periods.

Wampler v. Southwestern Bell Telephone Co., 2010-1 CCH Trade Cases ¶76,911, 2010 WL 597245

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