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Expert Analysis

New Merger Guidelines Downplay Need to Define Markets

By **Elai Katz**

The Department of Justice and Federal Trade Commission (FTC) circulated revised guidelines describing the antitrust agencies' current, less rigid analytical approach in reviewing horizontal mergers. Two district courts addressed market definition in merger cases. One court rejected New York City's challenge of a completed combination of health insurance plans because the city failed to adequately define the relevant market, and another court decided that the department's identification of a relevant geographic market in a complaint contesting a dairy processor merger sufficed to survive a pleading motion.

Other recent antitrust developments of note included a decision by the U.S. Court of Appeals for the Ninth Circuit that a product design improvement by a dominant firm, without more, did not constitute unlawful monopolization and a ruling by the U.S. Supreme Court that defendants could not be forced to defend price-fixing claims in class action arbitration when the arbitration clause was silent on the matter.

Merger Guidelines

The FTC and the Department of Justice released for public comment new horizontal merger guidelines, which will replace the current guidelines issued in 1992 (revised slightly in 1997). The proposed guidelines contain substantial changes and are intended to increase transparency in the merger review process for practitioners and the business community by outlining the federal antitrust agencies' current enforcement policies and principal analytical techniques. The proposed guidelines observe that, under §7 of the Clayton Act, the central question remains whether a merger may substantially lessen competition or tend to create a monopoly.

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Among the significant changes in the proposed guidelines is the agencies' assertion that defining the relevant market is not a necessary starting point or an end in itself. Instead, the guidelines provide that market definition is a useful tool to the extent it "illuminates" the combination's likely competitive effects. This revision represents a substantial shift from the 1992 guidelines, which stated that "the Agency will first define the relevant product market," to a more flexible approach—using various tools and evidence not in any fixed order—to predict the likely competitive effects of mergers. The guidelines acknowledge that "evaluation of competitive alternatives available to customers is always necessary at some point in the analysis."

The proposed guidelines emphasize the significance of unilateral effects analysis, that is, the elimination of competition between merging firms, even if the combination does not change the behavior of other firms in the market. Of particular concern are mergers in differentiated (non-homogeneous) product industries between companies whose products are very close substitutes. Such mergers might provide an incentive to raise the price of one merging party's product because a sufficient portion of sales lost due to higher (post-merger) prices would be diverted to the product sold by the other party to the merger.

The guidelines endorse an economic test to measure a proposed merger's upward pricing pressure (UPP), an indicator of the likelihood that a merger will lead to price increases based on the value of sales diverted from one of the merging firms to the other. This unilateral price effects analysis need not, according to the new guidelines, rely on market definition, market shares, or concentration calculations. Furthermore, the guidelines advise that the agencies consider possible adverse competitive effects on a targeted subset of customers susceptible to price discrimination even if the merged firm is not likely to be able to profitably raise prices for other customers.

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

To catch up with the agencies' practice as it has evolved over the years, the new guidelines increase the technical market concentration thresholds indicating that further review would be warranted. A market will be considered highly concentrated if its Herfindahl-Hirschman Index (HHI, calculated by summing the squares of the individual firms' market shares) is above 2,500, instead of 1,800 under the old guidelines.

Markets with an HHI measurement below 1,500 will generally be classified as unconcentrated, instead of 1,000. In addition, a merger will have to lead to an increase in HHI of more than 200 (instead of 100) to be presumed likely to enhance market power. The new guidelines note that these thresholds should not be taken as a "rigid screen" but as one way to identify mergers that need to be examined more carefully.

The proposed guidelines also provide new sections addressing innovation markets, partial acquisitions, the impact of powerful buyers of the products of a merged firm, and mergers involving competing buyers.

The merger guidelines are merely descriptive of the agencies' policies and methods and do not carry the force of law, but they are meant to assist the courts in adjudicating merger challenges, and parts of the 1992 guidelines have been cited with approval in many opinions.

Horizontal Merger Guidelines for Public Comment (released on April 20, 2010; public comments must be submitted by June 4, 2010) available at www.ftc.gov

Comment: As a leading practitioner observed, the new guidelines' move toward greater flexibility and away from a step-by-step technique may be less appealing to generalist judges tasked with resolving complex merger challenges. In any event, the courts may not hasten to embrace the guidelines' relegation of market definition analysis to the role of a potentially "useful tool" in light of a long line of cases going back to the Supreme Court's admonition in *United States v. E.I. DuPont de Nemours & Co.*, 353 U.S. 586, 593 (1957), that "determination of a relevant market is the necessary predicate" to a merger challenge under §7 of the Clayton Act.

Acquisitions—Health Plans

The City of New York sought to unwind the 2006 merger of two health insurance providers, which had been reviewed without challenge by the U.S. Department of Justice and New York State regulators. The district court granted the defendants' motion for summary judgment because the city's alleged relevant product market—"the low-cost municipal health benefits market"—was deficient as a matter of law. The court noted that the city defined the market solely with regards to its own preferences and requirements as a buyer of health insurance and that the merged firms were the only sellers in the proposed market.

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The court rejected the city's request to amend the complaint to add as an alternate avenue of proof the UPP test (described in the merger guidelines discussion above), among other things. The court stated that the proposed amendment was too late and observed that no federal cases have adopted the UPP test in lieu of traditional relevant market analysis.

City of New York v. Group Health Inc., No. 06 Civ. 13122 (RJS) (SDNY May 11, 2010)

Acquisition—Defining Market

As reported in a recent column, the Department of Justice and three states filed an action challenging the 2009 acquisition of a Wisconsin dairy processor by a rival. The defendant moved to dismiss the complaint on the grounds that the government did not sufficiently plead a relevant geographic market for fluid milk.

The district court denied the motion and stated that even though the complaint was "not well structured," there was no precedential basis for imposing the type of highly specific pleading standard advocated by the defendants for defining a relevant geographic market in a merger case. The court observed that the government's geographic market— limited to Wisconsin, Michigan's Upper Peninsula and northeastern Illinois—was plausible as fluid milk has limited shelf life and is costly to transport.

The court agreed with the defendants' observation that the relevant geographic market is not necessarily limited to the region where the merging parties competed but rather the area where customers look to buy the product. But the court found that, despite inartful phrasing, the department's complaint identified an area where the merged firm could impose supra-competitive prices. The court added that the department's geographic market analysis was premised on the 1992 merger guidelines, which the court noted were relevant but not binding.

United States v. Dean Foods Co., No. 10-CV-59, 2010 WL 1417926, 2010-1 CCH Trade Cases ¶76,952 (E.D. Wisc. April 7, 2010)

Comment: Portions of the anti-trust agencies' revised merger guidelines may manifest a view that the burden of pleading and proving a relevant market impedes the enforcers' ability to challenge mergers, yet in the case reported immediately above, the government's case was not derailed despite shortcomings in the pleadings supporting the proposed relevant market.

Product Design

Hospitals and other health care providers brought suit alleging antitrust violations by the leading manufacturer of pulse oximetry sensors and monitors, which measure and display oxygen levels in patients' blood. The hospitals claimed that the manufacturer developed a new pulse oximetry technology as the patent on its original technology was about to expire and that by introducing a new, patented technology that was incompatible with generic sensors, the manufacturer unlawfully maintained its monopoly over the pulse oximetry sensor market in violation of §2 of the Sherman Act.

A district court granted the defending manufacturer's motion for summary judgment and the Ninth Circuit affirmed. The appellate court observed that a design change that improves a product does not constitute unlawful monopolization without more. The panel added that courts are skeptical of claims that a monopolist's product design changes harmed competition.

The Ninth Circuit declined the complaining hospitals' invitation to balance the benefits of product improvement against its anticompetitive effects, stating that as long as the design change is an "improvement" it would not offend the antitrust laws on its own.

The court noted that there was no evidence that the defendant abused its power to force consumers to adopt it new technology and that its market-share discounts and sole source arrangements did not prevent customers from buying less expensive generic alternatives.

Allied Orthopedic Appliances Inc. v. Tyco Health Care Group LP, 592 F.3d 991, 2010-1 CCH Trade Cases ¶76,932

Arbitration Clauses

The U.S. Supreme Court ruled that an arbitration panel erred by imposing class arbitration on international shipping companies facing price-fixing claims, as the agreement requiring arbitration of disputes did not expressly provide for class actions. The 5-3 decision (Justice Sotomayor did not participate) noted that class treatment changed the nature of arbitration such that it could not be inferred from the agreement to arbitrate under the Federal Arbitration Act.

Stolt-Nielsen S.A. v. AnimalFeeds International Corp., No. 08-1198, 2010 WL 1655826, 2010-1 CCH Trade Cases ¶76,982 (April 27, 2010)

Patent Settlements

The U.S. Court of Appeals for the Second Circuit affirmed summary judgment granted to brand name and generic drug manufacturers alleged to have violated §1 of the Sherman Act when they settled a patent dispute by agreeing to delay the entry of generic versions of an antibiotic in exchange for substantial payments.

The appellate panel stated that it was bound to affirm the decision because under Second Circuit precedent, such "reverse payment" or "pay-for-delay" agreements were lawful as long as competition was restrained only within the scope of the patent, assuming there was no fraud or sham. *In re Tamoxifen Citrate Antitrust Litigation*, 466 F.3d 187 (2d Cir. 2006).

However, the panel suggested that the case be considered for en banc reexamination by the full appellate court. The court reasoned that en banc review might be appropriate because the Department of Justice recently repudiated the *Tamoxifen* standard, there was evidence that reverse payment settlements had increased recently and the *Tamoxifen* court misconstrued the statutory scheme, believing incorrectly that later generic patent challengers were eligible for the 180-day exclusivity intended to reward early generic entry.

In re Ciprofloxacin Hydrochloride Antitrust Litigation, *Arkansas Carpenters Health & Welfare Fund v. Bayer AG*, Nos. 05-2851, 05-2852, 2010 WL 1710683, 2010-1 CCH Trade Cases ¶76,989 (April 29, 2010)

Comment: FTC Chairman Jon Leibowitz stated that the invitation to seek a rehearing en banc in the opinion reported immediately above shows that courts are "rethinking their approach to pay-for-delay settlement" and that the commission will continue to contest them in the courts and in Congress. (April 29, 2010 statement available at www.ftc.gov)

Scope of the Patent Test

The FTC and private plaintiffs alleged that branded and generic drug companies unlawfully entered into reverse payment settlement agreements to resolve patent disputes involving drugs for the treatment of sleep disorders. The district court rejected the plaintiffs' contention that such reverse payment settlements should be condemned as per se antitrust violations but denied the defendants' motion to dismiss under the "scope of the patent" framework. The court determined that the complaint sufficiently alleged that the settlement agreements granted greater rights than those conferred by the patent, including the creation of a bottleneck precluding entry by other generics and the prohibition of sales of other drug products not protected by the patent, as well as allegations of sham, fraud, and the existence of a larger conspiracy.

King Drug Co. of Florence v. Cephalon Inc., 2010 WL 1221793, 2010-1 CCH Trade Cases ¶76,950 (E.D. Pa. March 29, 2010)