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ANTITRUST

Expert Analysis

Grocery Wholesalers' Asset Swap Scrutinized

By **Elai Katz**

The U.S. Court of Appeals for the Eighth Circuit ruled that determining whether an asset swap agreement between grocery wholesalers should be judged under the rule of reason or as a per se market allocation agreement required fact-finding by a jury. The U.S. Court of Appeals for the Second Circuit decided that an alleged breach of contracts to supply generic drug companies with an unbranded version of a drug did not state a monopolization claim under a duty to deal theory.

Other antitrust developments of note included the Second Circuit's determination that the federal statute defining the extraterritorial reach of U.S. antitrust law goes to the merits of the claim rather than the jurisdictional power of the court and a district court's dismissal of antitrust claims by a horse trainer who was banned from a racetrack.

Asset Swap

D&G, Inc., a family-owned Iowa grocery store, brought a suit alleging that the two largest domestic grocery wholesalers allocated territories in violation of antitrust law through an agreement to exchange business operations. According to the complaint, C&S Wholesale—the leading New England wholesaler—acquired SuperValu's New England operations while SuperValu—the leading Midwest wholesaler—effectively acquired its main Midwestern competitor from C&S and the two agreed not to compete with one another, at least with respect to former customers.

ELAI KATZ *is a partner of Cahill Gordon & Reindel.* J. JAMIE GOTTLIEB, *an associate at the firm, assisted in the preparation of this article.*

Grocery wholesalers purchase thousands of products directly from manufacturers and suppliers and distribute them to retailers. Small retailers use full-line grocery wholesalers, including C&S and SuperValu, to stock their stores with the thousands of products American customers expect to find in their local grocery store.

D&G alleged that even though the written terms of the non-compete provisions in the wholesalers' agreement were limited to former customers, in fact SuperValu and C&S did not compete for the business of each other's new and existing customers as well. In addition, both wholesalers closed the distribution centers they acquired and market shares increased substantially in New England and the Midwest, according to D&G. In support of its assertions, D&G pointed to emails by C&S executives stating that the deal depended on SuperValu not competing with C&S in New England.

Reversing the district court, the Eighth Circuit ruled that neither D&G nor the wholesalers were entitled to summary judgment on the question of whether the challenged agreement should be evaluated under the rule of reason or as a per se violation. *In re Wholesale Grocery Products Antitrust Litigation*, 752 F.3d 728 (8th Cir. 2014). The court could not determine as a matter of law that the agreement was a per se violation because the plain terms of the non-compete provisions do not amount to a pure, horizontal division of customers or territories.

On the other hand, the appellate panel explained, the wholesalers were not entitled to a determination that their agreement must be judged under the rule of reason because the grocery store could present evidence that might persuade a jury that the wholesalers' real agreement was a "naked" division of customers along geographic lines, a per se antitrust violation. The court noted that such evidence could include emails indicating that "the basis of the deal" was that SuperValu would depart from New England and data supporting the claim that the wholesalers stopped competing over all customers, not only former customers.

The appellate court clarified that it was not expressing a view on whether the wholesalers committed any antitrust violation because the jury, as the finder of fact, must first determine the nature of the agreement. The Eighth Circuit added that the district court should present the jury with specific factual interrogatories that would enable the court to decide if per se or rule of reason analysis applies.

Although this case may have presented an unusual situation, where it was not clear to the appellate court if the formal agreement was a subterfuge, it is rare for courts that struggle with the appropriate mode of antitrust analysis to effectively send the question to the jury. Generally speaking, these kinds of agreements—that is, non-compete agreements accompanying the sale of a business—are judged under the rule of reason, unless the underlying transaction is a sham. And genuine transactions that increase market concentration, as was alleged was the cause of harm in this case, are usually evaluated under §7 of the Clayton Act which prohibits acquisitions that are likely to substantially lessen competition.

Putting aside the specific context of this case, many lawful, pro-competitive transactions, when one company sells its regional business assets to a rival, can be mischaracterized as a division of markets. But courts often focus on the economics and legitimacy of the overall transaction before condemning related non-competes.

Duty to Deal

Shire, the pharmaceutical company, holds patents covering Adderall, a drug used to treat attention-deficit/hyperactivity disorder. In 2002, two of Shire's competitors, Teva Pharmaceuticals and Impax Laboratories, sought FDA approval to produce a generic equivalent. Shire brought suit against both companies for patent infringement, and the parties settled in 2006. Under the settlement, Teva and Impax agreed to stay out of the market for three years, and in return, Shire agreed to grant them licenses to make and sell generic Adderall starting in 2009. The agreement also provided that if by 2009 the FDA had not yet given its approval for Teva and Impax to manufacture a generic, Shire would supply them with Adderall for resale under their own labels. The FDA did not give its approval prior to the end of the three-year period of exclusivity and so Teva and Impax began purchasing unbranded Adderall from Shire for resale.

Several months after their entry into the market, Teva and Impax complained that Shire was only partially filling their orders. Wholesalers who purchased the unbranded drug from Teva and Impax brought suit against Shire alleging that the contracts gave rise to a "duty to deal," that the shortfall unlawfully raised prices violating the anti-monopolization provision of the Sherman Act by breaching contracts to supply two of their competitors with an unbranded version of Adderall. Notably, Shire, Teva, and Impax settled among themselves litigation arising from the contract disputes, and neither Teva nor Impax was a party to the suit brought by the wholesale dealers.

The district court dismissed the complaint for failure to state a claim and the Second Circuit affirmed. *In re Adderall XR Antitrust Litigation*, 754 F.3d 128 (2d Cir. 2014). The Second Circuit noted that the settlements between Shire, Teva, and Impax resembled "reverse payment" settlements, wherein patent holders agree to make a payment to potential competitors who have threatened to enter the market and challenge the patent holders' right to the patent, thereby delaying the point at which the competitor enters the market. In 2013 the Supreme Court issued its decision in *FTC v. Actavis,* 133 S. Ct. 2223 (2013), finding that the potential anticompetitive effects of reverse payment settlements are not immune from antitrust scrutiny merely because they may "fall within the scope of the exclusionary potential of the patent" at issue and concluding that such agreements should be analyzed under the rule of reason.

The Eighth Circuit in the Grocery Wholesalers case clarified that the jury, as the finder of fact, must first determine the nature of the agreement.

Plaintiffs stated that they were not challenging the agreements themselves, instead arguing that once Shire had agreed to "relinquish its monopoly control over [Adderall] vis-à-vis Teva and Impax" by entering into the patent litigation settlements, it had a "duty to deal." The Second Circuit noted that "the sole exception to the broad right of a firm to refuse to deal with its competitors comes into play only when a monopolist seeks to terminate a prior (voluntary) course of dealing with a competitor."

While the Supreme Court's decision in *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 472 U.S. 585 (1985) "stands for the proposition that a business with market power may be subject to a duty to deal with a smaller competitor," the Second Circuit noted that, following more recent Supreme Court decisions, the case "lies at or near the outer boundary of [section] 2 liability." In addition, the court noted that *Aspen Skiing* did not govern, as plaintiffs failed to allege facts that would bring the case at bar within its parameters. For instance, plaintiffs not only failed to allege that Shire terminated any prior course of dealing, but the agreements at issue were "explicitly unprofitable" for Shire, as by entering into them Shire "created competition in the market." The court emphasized that "plaintiffs' allegations amount to the self-defeating claim that Shire monopolized the market by ceding its monopoly." The court further noted that the "mere existence of a contractual duty to supply goods does not by itself give rise to an antitrust duty to deal."

Extraterritorial Reach

In another Second Circuit decision, the appellate court concluded that the requirements of the Foreign Trade Antitrust Improvements Act (FTAIA), a law that defines the extraterritorial reach of U.S. antitrust law, are "substantive and nonjurisdictional," going to the merits of the claim rather than the adjudicative power of the court. *Lotes v. Hon Hai Precision*, 753 F.3d 395 (2d Cir. 2014). In addition, the decision clarified that in the Second Circuit, foreign anticompetitive conduct has the requisite "direct, substantial, and reasonably foreseeable effect" on U.S. commerce needed to give rise to an antitrust claim where there is a "reasonably proximate causal nexus" between the alleged foreign conduct and the harm to U.S. commerce.

The dispute concerned the development of the latest industry standard for Universal Serial Bus (USB) connectors. Lotes, a Taiwanese designer and manufacturer of electronic components, including USB connectors, alleged that Foxconn and other manufacturers of USB connectors attempted to gain control of a new technological standard for USB connectors (USB 3.0) and to monopolize the USB connector industry in violation of Sections 1 and 2 of the Sherman Act. Lotes claimed that the defendants violated commitments they made to a USB-standard setting organization to offer licenses on reasonable and nondiscriminatory (RAND) terms by filing patent infringement suits in China against two Chinese subsidiaries of Lotes.

The defendants moved to dismiss the claim, and the district court dismissed for lack of subject matter jurisdiction under the FTAIA. The FTAIA brings wholly foreign conduct within the statute's scope where (1) the foreign conduct has a "direct, substantial, and reasonably foreseeable effect" on U.S. domestic commerce, and (2) that effect "gives rise to a claim under" the Sherman Act. The district court further ruled that Lotes' Sherman Act claims were barred under the domestic effects test of the FTAIA because Lotes failed to plausibly allege that defendants' conduct had a "direct…effect" on U.S. domestic or import commerce.

The Second Circuit first addressed whether the FTAIA requirements are jurisdictional or substantive in nature and concluded that the requirements of the FTAIA "go to the merits of an antitrust claim rather than to subject matter jurisdiction," thereby overruling its previous decision in *Filetech v. France Telecom,* 157 F.3d 922 (2d Cir. 1998).

The appellate court then addressed whether Lotes plausibly alleged that the defendants' conduct had a "direct…effect" on U.S. domestic or import commerce. The court determined that the district court erred by misinterpreting the statute, disapproving of the lower court's reliance on the U.S. Court of Appeals for the Ninth Circuit's decision in *United States v. LSL Biotechnologies*, 379 F.3d 672, 680 (9th Cir. 2004), which found that "an effect is 'direct' if it follows as an immediate consequence of the defendant's activity." The Second Circuit instead adopted the U.S. Court of Appeals for the Seventh Circuit's approach in *Minn-Chem v. Agrium,* 683 F.3d 845, 857 (7th Cir. 2012), which interprets the term "direct" to require "a reasonably proximate causal nexus."

Although it declined to decide the question of whether the "direct…effect" test was met, the appellate court criticized the lower court for putting "near-dispositive weight on the fact that USB 3.0 connectors are manufactured and assembled into finished computer products 'in China' before being sold" in the United States, noting that "[t]here is nothing inherent in the nature of outsourcing or international supply chains that necessarily prevents the transmission of anticompetitive harms or renders any and all domestic effects impermissibly remote and indirect."

The court found that Lotes' Sherman Act claims were barred in any event—under the second prong of the FTAIA standard—because any "domestic effect caused by the defendants' foreign anticompetitive conduct did not 'give[ ] rise to' Lotes's claims." The Second Circuit noted the trend in other circuits to conclude that "the domestic effect must proximately cause the plaintiff's injury" and adopted the same standard. Although Lotes alleged that the defendants' conduct drove up prices of electronics incorporating USB 3.0 connectors in the United States, the court noted that "those higher prices did not cause Lotes's injury of being excluded from the market for USB 3.0 connectors." The court emphasized that Lotes' injury "flowed directly from the defendants' exclusionary foreign conduct." Because Congress did not intend for the FTAIA's exception to bring "independently caused foreign injury" within the reach of the Sherman Act, the court found that Lotes could not seek redress under that law.

> The Second Circuit concluded that the requirements of the Foreign Trade Antitrust Improvements Act, a law that defines the extraterritorial reach of U.S. antitrust law, are "substantive and nonjurisdictional," going to the merits of the claim rather than the adjudicative power of the court.

The appellate court therefore affirmed the lower court's ruling that the FTAIA barred Lotes' claims on the ground that any domestic effect of defendants' foreign anticompetitive conduct did not "give[ ] rise to" Lotes' Sherman Act claims.

A party contesting the extraterritoriality of an antitrust claim in the Second Circuit must now make a motion to dismiss for failure to state a claim (Federal Rule of Civil Procedure 12(b)(6)), rather than make a motion to dismiss for lack of jurisdiction (12(b)(1)). This affects when the issue may be raised, as challenges to subject matter jurisdiction can be brought at any time but motions for failure to state a claim cannot, as well as how the court will handle the disputed facts, as on a motion to dismiss, factual allegations contained in the complaint are accepted as true. Further, in requiring a proximate causal nexus between the alleged foreign conduct and the effect on U.S. commerce, the Second Circuit characterized its approach as "less stringent" than the Ninth Circuit's interpretation in *LSL Biotechnologies*, where the Ninth Circuit found that the effect is direct if it "follows as an immediate consequence."

Expulsion from Racetrack

A federal district court in Pennsylvania dismissed an antitrust claim brought against a racetrack by a licensed horse trainer who was banned from a racetrack after being accused of sexually assaulting two women there. As a result of the ban, the trainer lost his stall space at the track and his clients turned to other trainers. The trainer, previously the leading horse trainer at the track, alleged that his ejection from the track was part of a conspiracy by his competitors to restrain trade by interfering with his ability to participate in the horse racing industry.

Evaluating plaintiff's Sherman Act §1 claim, the court in *Juan Carlos Guerrero v. Bensalem Racing Association,* No. 13-7420, 2014 WL 2547520 (E.D. Pa.), first concluded that the trainer failed to allege an adequate antitrust injury because he had merely alleged individual harm, rather than the requisite harm to competition. The court also found that the complaint failed to allege an unreasonable restraint of competition, noting that it "fail[ed] to identify the relevant market entirely," instead simply referring generally to the "horse racing industry." Without identifying a particular market, the trainer could not allege the requisite harm to the relevant market, or market power. Finally, the court concluded that the trainer did not adequately allege the existence of a conspiracy because he failed to allege that defendants engaged in concerted conduct, as the race track "unilaterally decided to eject" him.