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The Broad Reach Of Antitrust: An Overview

The Editor interviews ***Richard Hernandez****, Partner, McCarter & English, LLP.*

Editor: Please tell us about your practice.

Hernandez: My antitrust counseling and litigation practice covers a broad spectrum of substantive areas: price-fixing, group boycotts, refusals to deal, tying, exclusive dealing, monopolization, reverse payments, licensing of intellectual property, dealer terminations and franchising. I also counsel clients on a variety of production distribution matters, including distributor agreements, resale price maintenance, customer and territorial restraints, and other vertical restraints. I assist clients in formulating and implementing antitrust-compliant joint ventures and competitor collaborations. My practice includes antitrust compliance programs, trade association conduct, representation in government investigations of anticompetitive conduct, including those initiated by the Federal Trade Commission, the Department of Justice and various state attorneys general. I also represent clients in all aspects of the Hart-Scott-Rodino pre-merger notification process, including complying with government-issued Second Requests and securing antitrust regulatory approvals for a variety of transactions.

Editor: Please describe the facts in the case of *Comcast v. Behrend*. What overall effects will the Supreme Court's decision in this case have?

Hernandez: Comcast cable television subscribers in the Philadelphia area sued Comcast, alleging that the company violated federal antitrust laws by engaging in "clustering" – a strategy of concentrating operations within a particular region. The plaintiffs asserted four theories of liability, but the district court certified the class as to only one of them – that Comcast acquired a significant share of the Philadelphia area, which deterred competitors (known as "overbuilders") from entering the greater Philadelphia cable market, thereby resulting in less competition and supra-competitive prices. But the plaintiff's damages model was based on all four theories. So, Comcast appealed the district court's class certification decision, arguing that the plaintiffs could not prove damages. The Third Circuit Court of Appeals affirmed, but the Supreme Court reversed, ruling that since three out of four theories of liability upon which the damages calculation was based didn't survive, damages could not be calculated across the entire class and the class could therefore not be certified.

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The *Comcast* ruling heightens the requirements for plaintiffs seeking class certification and will have significant implications for antitrust class actions in particular, and for class actions in general. The decision creates a new weapon for defendants to collaterally attack class certification. The Court's new standard for evaluating class certification appears to require plaintiffs to plead their damages claims such that they are able to establish the damages on a class-wide basis.

The decision invites the argument by defendants that, "[q]uestions of individual damage calculations will inevitably overwhelm questions common to the class." *Comcast* also appears to require plaintiffs to plead a damages theory that is consistent with their liability theory, particularly with respect to the alleged anticompetitive effects of the violation.

Editor: The case of *FTC v. Actavis* dealt with pharmaceutical reverse-payment cases. What were the holdings in this case? Does it provide a guidepost for future reverse-payment cases?

Hernandez: *FTC v. Actavis* garnered a significant amount of attention, in part because the circuit split aptly demonstrated the divergent views on the proper treatment of reverse payments. The Eleventh Circuit decision in *Actavis* followed the scope-of-the-patent test, under which a reverse-payment settlement agreement was generally entitled to immunity from an antitrust challenge so long as the anticompetitive effects fell within the scope of the patent's exclusionary potential. As a practical matter, this approach provided near-total immunity from antitrust attack without any regard for the underlying patent's validity or any potential infringement. A primary holding from the Supreme Court's *Actavis* decision was that the existence of a valid patent to which anticompetitive effects could be attributed does not, in itself, immunize a reverse-payment agreement from an antitrust challenge.

In *Actavis*, the FTC argued for a presumption that reverse payments are unlawful with a "quick look" review of that presumption. The Court rejected that position, and instead adopted the standard rule of reason analysis. Thus, the lower courts are charged with the task of analyzing the facts surrounding each reverse-payment settlement agreement that comes before them. The implications of *Actavis* on future reverse-payment agreements are not yet clear because the Court provided little guidance to trial courts that must now apply the full-fledged rule of reason analysis to reverse-payment settlements.

Editor: What have been the outcomes of recent cases regarding resale price maintenance and vertical restraints on competition?

Hernandez: I will start by talking about resale price maintenance. On June 28, 2007,

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the United States Supreme Court in *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, 551 U.S. 877 (2007), expressly overruled the nearly 100-year-old "*Dr. Miles*" per se prohibition against minimum resale price maintenance agreements and applied the "rule of reason" to such agreements. Before *Leegin*, the Supreme Court repeatedly held minimum resale price maintenance to be illegal *per se* under Section 1 of the Sherman Act.

The historical prohibition of resale price maintenance agreements resulted in the development of numerous workarounds designed to avoid the finding of an agreement pursuant to Section 1 of the Sherman Act, including Minimum Advertised Pricing Policies and unilateral *Colgate* policies. However, these programs are difficult, expensive and risky to implement and enforce. In *Leegin*, the Supreme Court criticized these workarounds as "creating legal distinctions that operate as traps for the unwary – more than supporting the interests of consumers – by requiring manufacturers to choose second-best options to achieve sound business objectives."

In *Leegin*, the Court found that minimum resale price maintenance agreements are not restraints "that would always or almost always tend to restrict competition and decrease output" so as to justify automatic condemnation under the per se rule. Acknowledging several decades of economic literature, the Court found that there are several procompetitive justifications for a manufacturer's use of resale price maintenance, including stimulation of interbrand competition among manufacturers by reducing intrabrand competition among retailers; that vertical price restraints, while tending to eliminate intrabrand competition, can "stimulate retailer services" that aid the manufacturer's position as against rival manufacturers. The Court reasoned that absent vertical price restraints, retail services that enhance interbrand competition might be underprovided because discounting retailers (such as Internet sellers) can "free ride" on retailers who furnish services that help create the demand.

The application of the rule of reason to minimum resale price maintenance agreements now allows courts to consider such procompetitive justifications when evaluating whether such an agreement is an unreasonable restraint of trade, as it does with other vertical restraints, unrelated to price. The Court, however, did caution that setting resale prices can have anticompetitive effects, such as facilitating a manufacturer or retailer cartel. The Court identified the following factors as among those relevant to the rule of reason inquiry: (i) the number of manufacturers using the practice; (ii) the source of the restraint; and (iii) the manufacturer's market power.

In theory, the *Leegin* decision gives manufacturers greater flexibility to influence the pricing of their resellers than in the past. But the ability to use the *Leegin* decision to defend an agreement between a manufacturer and a reseller as to the prices that the reseller will charge its customers has been severely circumscribed by a number of post-*Leegin* developments, including a lack of case law that actually applies the rule of reason standard to resale price maintenance agreements, muddled statements from the Department of Justice and Federal Trade Commission as to whether *Leegin* is a sound decision that the agencies will respect in their investigatory and enforcement activities, legislation repeatedly introduced in Congress to explicitly repeal *Leegin* and return to the per se rule, and the actions of state legislators and enforcement agencies that demonstrate that certain states will not follow the *Leegin* decision in applying their own state antitrust laws to resale price maintenance agreements. For example, Maryland has passed and implemented a *Leegin* repealer statute explicitly declaring that resale price maintenance agreements are per se illegal under Maryland law. California and New York have also brought enforcement actions against several manufacturers under their respective state law antitrust statutes alleging per se illegal resale price maintenance. In fact, at least seventeen states continue to treat resale price maintenance agreements as per se unlawful under their state antitrust laws.

Given the uncertainty of differing state and federal (and even international) laws, regulations and rulings regarding the treatment of resale price maintenance agreements between manufacturers and resellers, the most prudent course of action at this time is for manufacturers to continue to follow the pre-*Leegin* guidelines and workarounds for resale price maintenance agreements designed to avoid the finding of an agreement pursuant to Section 1 of the Sherman Act.

As for vertical restraints, an interesting recent case that centered on vertical restraints was *Brantley v. NBC Universal, Inc.*, 675 F.3d 1192 (9th Cir. 2012). The plaintiffs, a putative class of cable subscribers, alleged an unlawful vertical restraint on trade stemming from a tying arrangement. Specifically, the plaintiffs challenged the television programmers' bundled sale of channels to television distributors, and further, the distributors' bundled sale of channels to cable subscribers. According to the third amended complaint, both programmers and distributors conditioned the purchase of high-demand channels – the product that subscribers actually want – on the purchase of low-demand channels – an undesired product – rather than offering channels a la carte.

The plaintiffs did not allege a horizontal agreement, nor did they contend that the challenged tying practices were per se antitrust violations. As a result, the Ninth Circuit analyzed the vertical restraint under the rule of reason. The Court explained that vertical tying agreements have the potential to harm competition in the sense that they may "harm existing competitors," "create barriers to entry" into the relevant market, or force buyers to purchase the tied product rather than substitutes for the tied product. Importantly, the plaintiffs did not allege any of the these types of injuries to competition that typically result from tying arrangements. Rather, the plaintiffs focused on the fact that the programmers require the distributors to bundle their channels.

According to the third amended complaint, the programmers' mandate imposed on the distributors "harms consumers by limiting the manner in which distributors compete with one another in that distributors are unable to offer a la carte programming, which results in reducing consumer choice and increasing prices." The Ninth Circuit held that "these assertions [did] not sufficiently allege an injury to competition for purposes of stating a Section 1 claim because Section 1 does not proscribe all contracts that limit the freedom of the contracting parties, a statement that parties have entered into a contract that limits some freedom of action (in this case, by circumscribing the distributors' ability to offer smaller packages or channels on an unbundled basis) is not sufficient to allege an injury to competition. Businesses may choose the manner in which they do business absent an injury to competition."

This case reinforces the well-established principle that, with vertical relationships, many restraints are permissible pursuant to general freedom-of-contract standards. In this instance, the court expressly condoned a vertical agreement that mandated a tying arrangement for sale to consumers. Accordingly, this decision reflects the principle that tying arrangements, "[l]ike other vertical restraints, . . . may promote rather than injure competition."