

Antitrust Developments in 2013: The Year in Review

MR. STOCK: Good morning, everybody. Thank you all for coming. My name is Eric Stock; I am the Chair of the Antitrust Section of the New York State Bar Association. I have had the privilege of serving in that role since last January and if all goes as expected, I will be ceding that role to Barbara Hart, the program Chair, today at about noon today.

As one of my final acts as Chair it is my privilege to open our 2014 Annual Meeting and introduce Barbara, who will give us a rundown on all the great programs that we have lined up today.

I want to thank Barbara for putting together a really fabulous program. As you can tell from the materials, we are going to have panels and discussions today that cover some of the most interesting and timely antitrust topics that are around and I want to thank you all for coming here.

I want to thank our speakers both on this panel and our upcoming panels for coming and traveling here and especially everyone who made it here at the early hour for the first Antitrust Law Section program, which I know is going to be really good; so with that said, I want to pass it on to Barbara to introduce the program. Thank you.

MS. HART: Good morning. Welcome to Alaska; the good news is we can see Russia from here.

Anyway, thank you, Eric. Eric has been an amazing leader for the Section this past year and has helped me in so many ways to understand the important role that he's played and helped it go so smoothly. So, to suggest that I am program Chair and I should somehow take credit for the fabulous panelists would be to understate the fact that each one of these panels has really been self-directed and by a group of fabulous practitioners who were all just so on it. And I just essentially kicked them off a little bit and they ran with it, and then to acknowledge Eric's incredible role in giving me guidance along the way on how to get this done.

We are going to start this morning with Elai and Art and Scott and this is a wonderful tradition that I harken back to my early days being at these meetings where Bill Lifland would stand up and recap the days, the year's antitrust important decisions and Bill Lifland is, of course, one of the people that many of us with some decades into this area of practice look back on fondly as a gentle leadership, a role model, and substantive guy who just was a gentlemen in all respects and it's so nice to see Elai stepping into this role to give us the recap.

We will then move on to a really important issue of the day, social media and competitive policy, and Wendy has put together a tremendous group of panelists and I think this is one of those vortexes where the privacy issues, competition issues, and cutting edge technology are causing a lot of developing issues that our panelists, both in-house and outside counsel, are going to address.

Stacey Mahoney is going to head up a trial program that I think we really strove to push towards the nuts and bolts of why you win and lose, what are good jury instructions. Again, we have seasoned trial attorneys on that panel and Stacey is just wonderful. I am sure that is going to be great and high energy.

Mary Marks is going to lead a panel in regard to mergers and how to navigate the regulatory landscape, which is always multidimensional, and then Hollis Salzman is going to discuss antitrust class actions and class certification issues and has a bunch of very opinionated, wonderful panelists that I am sure will put on a lively discussion through that panel.

So it's just been seamless, it's been wonderful working with everybody. Having a group of high caliber people around you is really the way to go because everybody has just run with the ball and without anything further, thank you Elai, I look forward to your remarks.

MR. KATZ: Thank you very much, Barbara, and I really do look forward to the entire program today. Thank you to everyone for showing up early on this cold morning.

Today as Barbara said, we are going to be talking about developments in the past year but before we get into that let me introduce our distinguished panelists.

First on my far left and your far right is Art Burke, who is a partner at Davis Polk both in the New York office and in the Menlo Park, Northern California office. He has a broad antitrust practice: He does mergers, he does class action litigations, investigations; he has represented a wide variety of clients including Comcast and others that you are well familiar with in high tech, software, finances, and other industries.

I should say he was recently named an MVP, the competition MVP of the year by *Law 360*. Congratulations on that! And he clerked for Judge Douglas Ginsberg of the D.C. Circuit who, as you know, is one of our leading antitrust jurists of our day.

Next to my immediate left is Professor Scott Hemphill, who is a professor of antitrust law and intel-

lectual property law at Columbia Law School. He was the chief of the Antitrust Bureau of the New York Attorney General's Office. We have several people I see here in this room who have been in that very important role (and are in that very important role, I should say). He's written extensively about the balance between innovation and competition and more recently he's written on parallel exclusion.

Scott is both a lawyer and an economist: He got his JD at Harvard and Ph.D. at Stanford. He clerked for Judge Posner in the Seventh Circuit and also for Justice Scalia.

So without further ado, let's start with the program. I want to say that we, as Barbara noted, before we used to do this years ago where Bill Lifland, he was one of my mentors, really tried to go through everything that really mattered. We are not going to try to do that. Times have changed, there is a lot of information that all of you can get about antitrust news. What we are going to try to do instead is pick our favorite highlights of the year and we are going to go through those and chat about them in a little bit.

First, let's start with a Supreme Court; as always we have several important antitrust cases decided by the Supreme Court this year. The first one we are going to discuss is *FTC v. Actavis*. The Supreme Court addressed a practice that has divided the courts and generated a considerable debate in the antitrust community for quite a while, about a decade, in the sense the practice we are talking about is an arcane kind of arrangement and it really only happens in a corner of the world, a very important corner of the world but you know, pharmaceutical companies face generic competition and end up settling patent disputes. There is a lot of money here but it really only arises in that corner, at least in the arrangement that was at issue in this case.

In the challenged settlement, the alleged infringer, who was the generic drug maker, receives payments from the brand name drug company who is the patentee and delays entering the market. It has the catch phrases that are used for these kinds of arrangements either "reverse payment" or "pay for delay" and often that tells you what side of the fence people are on.

So the court ruled that reverse payments or pay for delay settlements of pharmaceutical patent disputes can violate the antitrust laws notwithstanding the existence of a patent.

What the court didn't do is they didn't do what the FTC urged them to do and rule - reverse these payments -presumptively unlawful; instead, the court said they should be analyzed under the rule of reason.

What the Court rejected was the approach that a number of circuits had adopted, which said that these kinds of settlements are lawful as long as the restrictions are within the scope of the patent.

So, a little bit about the facts before I pass it along for a more thoughtful discussion. In 2003 Solvay Pharmaceuticals got a patent for a brand name testosterone drug called AndroGel. Later in the same year, Actavis and two other generic drug companies sought approval from the FDA to market generic versions of the drug AndroGel. And in doing so under the statute they certified that the patent was invalid and their drug had been infringed on. Solvay then initiated the patent infringement suit against the generics. This is what almost always happens and then in 2006 all the parties settled. This used to almost always happen.

Under the terms of the settlement Actavis and the other generic manufacturers agreed to delay marketing the drugs for around nine years but that's prior to the expiration of Solvay's patent that was being challenged, and Solvay agreed to pay each of these generic manufacturers millions of dollars.

The FTC brought a suit. It was dismissed by the lower court, the Eleventh Circuit, then affirmed and they stated, as I mentioned before, that a reverse payment settlement is immune from antitrust attack so long as its anticompetitive effects fall within the scope of the exclusionary potential of the patent.

The Eleventh Circuit emphasized that public policy favors settlements and also that the patent holders have a lawful right to exclude others from the market.

This case went up to the Supreme Court and in a five-to-three opinion, Justice Breyer writing the decision, the Supreme Court reversed. It held the reverse payments can sometimes violate the antitrust laws and should be evaluated under the rule of reason.

Scott, you've written a lot about this and you've spoken about this, including the decision itself and the one prior to this; were you satisfied with this decision?

DR. HEMPHILL: Broadly speaking, yes. I think this is a big victory for the Federal Trade Commission and a victory for consumers.

Let me talk a little bit about why this is an important decision outside the pharmaceutical industry. It's important, first, for what it says about antitrust's intersection with intellectual property.

Second, for a different intersection between antitrust and traditional forms of regulation. And third for what it tells us about the rule of reason.

First, with respect to patent. These pay-for-delay cases in the lower courts had acquired an odor of patent triumphalism. Some lower courts, as Elai notes, had adopted a "scope of the patent" test. In retrospect, it's clear that these courts had gone pretty far out on a limb. Even the economists who supported defendants' perspective in these cases were unwilling to embrace the test that had been successful in the lower courts—that no matter how

weak the patent, no matter how long the delay in competition, no matter how large the payment, everything was fine from an antitrust standpoint, so long as the entry date wasn't even later than patent expiration.

The Court's rejection of this test fits within a larger narrative that we've seen from the Supreme Court about patent cases. The Federal Circuit today has taken the role once associated with the Ninth Circuit, as an appeals court targeted by the Supreme Court for frequent reversal. And a theme running through a lot of these cases is that the lower court has gone too far in the powers granted to a patent holder. We are now seeing from the Supreme Court a cutting back on that kind of patent triumphalism. I see *Actavis* is another move in that direction.

Second, the intersection with traditional regulation. This month is the tenth anniversary of *Verizon v. Trinko*, one of our leading cases at the intersection of antitrust and regulated industries. It's quite frequently cited outside its telecommunications context for the proposition that in regulated industries, antitrust ought to take a back seat. I think *Actavis* shows why that view of the intersection is inaccurate or at least incomplete.

The incompleteness is clear from *Trinko* itself, which says that "antitrust analysis must sensitively recognize and reflect the distinctive economic legal setting of the regulated industry to which it applies." That quotation is from *Town of Concord*, a first Circuit opinion by then Judge Breyer, who joined the majority in *Trinko* and who wrote the opinion in *Actavis*.

Now, that's pretty open-ended as perhaps you would expect from the quotation, which although it's an open-ended opinion by Justice Scalia is in turn quoting an appellate opinion called "Town of Concord" by then-Judge Breyer who went along in *Trinko*, joined the majority and who wrote the opinion in *Actavis*.

I think the point here is that it all depends. In some situations, the regulator is on the job implementing a competition function, as we saw in *Trinko* itself. In others, the regulator is not involved in doing antitrust work. We see this in pharma, where the FDA has a purely ministerial role, and goes out of its way not to get involved in competition questions. In these industries, antitrust has a larger role.

Third, with respect to the rule of reason, the Court's opinion insists that the rule of reason should be used, and explicitly rejected a particular test that had been proposed by the FTC.

Here, it's important to recognize that the rule of reason is not a single thing, it's a range of different tests. There are shortcuts. Here, the Court made clear that anti-competitive effect can be inferred from payment. If market power is needed at all, that too can be inferred from the fact of a large payment.

For those who have a deep interest in this continuum—per se to quick look to rule of reason—it's worth taking a look at the last paragraph or two of *Actavis*. There, the Court, in explaining how district courts have flexibility to work out what the rule of reason means, cites a few pages from the Areeda-Hovenkamp treatise. Those pages describe the different ways in which a district court can shorten the full rule of reason procedure. The Court is clearly leaving a lot of space for district courts to figure out how to work this out going forward.

MR. BURKE: It's very intimidating to follow after Scott on this subject since his articles were cited in the Supreme Court decision to support the majority's views, I think very effectively.

A few quick comments. This victory is a real vindication for the FTC; they suffered a lot of reversals and losses in the lower courts over a very long period of time, including the Second Circuit here on the *Tamoxifen* case, and in many other Courts of Appeal as well. Different leaders might have given up the ghost on this subject but the FTC continued to pursue this and doggedly over a decade and it was ultimately vindicated.

Obviously the FTC had advocated for even more stringent tests to be adopted by the Supreme Court. They had sought a quick look analysis, which would almost presumptively condemn these kinds of settlements, and the Supreme Court didn't go that far, but I think even though the FTC didn't get complete victory I think most observers would agree that this is very much more victory than the loss of the FTC and the fundamental reasoning that was embraced by the Court. So that is one point.

Second point, this is not the beginning of the end of this subject but it's sort of the end of the beginning because now we have a whole new set of issues to address. You know, the tests that largely have been adopted were almost a per se legality in most cases or a close per se illegality in a few but now we have a rule of reason test and what that is going to mean in practice is a very challenging thing to predict.

The thing that is really important to remember about this particular marketplace is that margins on branded drugs are very, very high. The cost of actually making the drug is very, very low; the vast majority of the expenses are minimal, making incremental pills that cost almost nothing yet generate a huge margin.

The minute that generic enters that business that margin collapses; sales prices drop by 80 percent or more, so if you are a branded company facing multiple patent challenges it makes a lot of sense for you rationally to consider settling some of those patent challenges even in cases where you are actually right.

Situations where you think you got well north of a 50 percent chance of prevailing in IP litigation if you're esti-

mating a 25 percent chance of loss but the consequence of that is an absolute obliteration of your margins, it doesn't seem to me to be surprising or necessarily inappropriate for you to settle.

How are courts going to address that situation? Scenarios where the so-called reverse payment may appear very large may, in fact, be larger than what the generic itself might be able to generate in profits. I think those kinds of issues are still open.

There are some hints in the court's opinion about how those issues might be addressed but it's going to be fascinating to watch the space going forward.

MR. KATZ: Before we move on to something else I do want to go back to something you had mentioned, Scott, about the difference between regulation and antitrust and I feel this falls in a different kind of place. Sometimes we have regulations set by a regulator, the FCC is a prime example, busy regulating industry well or not well, we can disagree on that; what I think makes this to some extent special is that you have a statute that tried to come up with some method to encourage competition and it pushed the generics towards suing early, then gave certain exclusive rights to those who sued early and should we think differently about a regulated space that is regulated just by the operation of the statute as opposed to someone who is busy watching what's going on?

DR. HEMPHILL: This is an interesting question in settings where you have an industry-specific statute that seems to take a view about the balance between innovation and competition. In those settings, there's surely an argument that antitrust should be dialed up or dialed down depending on what that specific statute says. I have done some writing that makes just this argument. *Actavis* could be taken as a decision in that vein.

MR. KATZ: Let's turn to mergers. There were some interesting mergers this year and I should note there is an excellent program later today about mergers, it promises to be a very fascinating panel; I am looking forward to it but we are going to focus on the few major merger challenges that we have to talk about, so first I want to talk about *American Airlines* and *US Airways*. Coincidentally I have to mention the three of us happened to start talking about this very case on an airplane. We happened to be on the same flight and the DOJ filed their complaint on the very same day so we are going to try to continue here and hopefully you will find it interesting too.

So the complaint the DOJ had filed alleged that the merger would create the world's largest airline, it would reduce the number of major legacy airlines from four to three but in addition to typical allegations that this would lessen competition in city pair routes, the complaint also asserted that after the merger that the airline would be—the combined airline would be less likely to offer dis-

counts for connecting flights with one-stop flights competing with other airlines nonstop flights.

The government also claimed that this merged airline would have nearly 70 percent of the landing slots at Reagan National Airport in D.C. so the complaint was filed in August. By November, about two weeks before trial was set to begin, the parties reached a settlement and the settlement required American and US Air to sell takeoff and landing slots and dates in related facilities all around the country but most importantly at LaGuardia Airport here in New York and national airport, Reagan National Airport in D.C.

So, Art, before we talk about the settlement, which I just described, what did you think of the complaint and how would you compare it to prior airline?

MR. BURKE: I think you highlighted the issue Elai in your introduction I think historically the focus in these kinds of cases is competition for nonstop flights, that the assumption was that for most people a direct flight is definitely not a substitute for one stop or connecting flight but in this case the DOJ took a different tact and argued that connecting flights could be substitutes and could compete with nonstop flights and they pointed to US Airways advantage program.

This was a program where US Airways very affirmatively attempted to compete for certain customers by offering competitive fares for one-stop connecting flights in competition with direct flights. What the DOJ determined was that for most legacy carriers connecting flights were priced almost exactly the same as direct flights. What rational person would ever pay \$1,000 for a connecting flight when that person could get to the same place on a direct flight for \$1,000?

In contrast US Airways acted sort of as a maverick in this market and did compete in some unusual ways and that was different and what that did was put a lot more markets in play than would have traditionally been in play. There were obviously overlaps for certain direct routes but when you add in the overlaps between direct routes and connecting flights that actually added hundreds of additional routes to the mix that had not historically been in the mix for airline mergers.

MR. KATZ: Let's turn to the settlement. What happened, as I began to describe earlier, what happened just a few weeks before trial was set to begin that the parties settled?

MR. BURKE: I will take a quick crack at it and Scott should amplify. I think the settlement looks much more traditional. The resolution of this case, as you noted, involved an investiture of certain landing slots predominantly and most significantly in LaGuardia and Reagan National and it didn't really address this broader competitive issue. So there is a little bit of a disconnect between

the complaint that the DOJ filed and the remedies that they obtained, which remedies resemble much more of those traditional airline mergers.

This a little bit of an anomaly, you know. Press reports, and who knows how the reliable they are, say that the attorneys and parties were surprised that when the DOJ sued them in this case, that they felt jumped and they were willing to talk about settlement and investments and were surprised that the case went so quickly to litigation.

So, it's an interesting issue here, you know, only time will tell. Maybe somebody can ask Bill Baer after the dinner tonight on what happened here but why couldn't the DOJ have gotten these remedies earlier in the process without having to commence the lawsuit and all the machinery of litigation having been geared up? So that's sort of my perspective on it.

DR. HEMPHILL: I certainly want to echo the sense of disconnect between the DOJ's theory of the case here and the remedy that they agreed to. The complaint emphasized one-stop competition, but the remedy is all about building up the low-cost carriers. Don't get me wrong—I see the point of shifting slots and gates to low-cost carriers. In principle, that might be a more potent form of competition than USAir had provided. So the question is whether this will result in more competitive pressure on the legacy carriers, compared to before the transaction. The government says yes, this settlement is even better than the injunction they could have gotten had they won the case.

Now, if DOJ is right about that, is it suspicious that USAir and American would accept such a deal? I think it might not be suspicious. After all, some of this new competition might be at the expense of Delta and United. So the parties might well agree to a settlement that is, in part, at the expense of rivals. That said, the stock price of Delta and United both rose on the deal, suggesting that the market sees this arrangement as competition reducing.

Now, in defense of the settlement, DOJ has offered an analogy to the earlier United-Continental transaction, which helped make Southwest a real competitor, in part thanks to some transfers at Newark. This is an odd example, though, again comparing this to the complaint, because the complaint argues with some regret that the United-Continental deal was a mistake.

I am an academic, so let me just say it directly: This is a subject that is crying out for further study. It's hard to imagine a stronger candidate for a merger retrospective, a couple years down the line. We have a high-profile merger in a data-intensive industry where the settlement is explicitly premised on a different theory from the claimed loss. A serious look should be taken to see whether the

mismatch, the bet that DOJ has taken, pays off. We should set the wheels in motion for something like that now.

MR. BURKE: It's a very interesting point and not to get too sidetracked on this but I was recently talking with a DOJ official about retrospectives and he took the position that the DOJ lacks the authority to engage in retrospectives because they bring cases, that's all they do.

The FTC has a broader mandate. Under the FTC act, it can study markets, it can do studies and it can issue subpoenas to find out what is going on in the industry but the DOJ can't do so. Maybe that's correct, but if they can't do it maybe they should let the FTC do it.

DR. HEMPHILL: I agree—the FTC could do it, a state could do it, or the presiding judge in the Tunney Act proceeding could order it.

MR. KATZ: We have a lot more to cover. I want to talk about another merger and this a merger that ultimately was not challenged and this is Office Depot and Office Max. So the FTC closed its investigation of this proposed combination, of the second and third largest office supply superstores. Similarly to the airline merger that we had just been discussing, this isn't the first time that the agency has taken a look at this particular industry.

Sixteen years ago, or now it's a little more than that, the FTC had blocked successfully in court and affirmed on appeal Office Depot's proposed merger with Staples. So what changed over these past 16 years that would lead to such a different result?

MR. BURKE: It's going back to Staples. At the time it was surprising to many people because people said look, you can buy paperclips and post-it notes anywhere, how can you have a monopoly on that market but what was shown very compellingly by the FTC was that in fact buying those things at office superstores was very different. Those stores focused on competition with each other, they worried about each other's pricing and it was very compelling evidence that in their internal documents, in their internal pricing policies, that they priced their paperclips and post-it notes differently depending on how many other office superstores there were in the area.

So the FTC was successful in pursuing a kind of novel theory at the time that you can have that kind of localized competition. It was a really one of the first unilateral effects cases, I would say, where a court really adopted that kind of approach.

Well, what happened was that the markets changed and the FTC acknowledged that and there were two big changes that they noted. First, there was greater competition from brick-and-mortar traditional stores, a lot of firms like Wal-Mart and Target and others have gotten into this market and are very vigorous competitors and the companies' documents and their pricing policy reflected that.

Then also obviously the growth of online commerce has been very significant in those 16 or 17 years since the case was decided. Many businesses are able to acquire these kinds of products as well as individuals on internet places like Amazon, et cetera.

So the marketplace has changed, the FTC acknowledged that. I think they were careful to note there is not a magic wand to say there's internet competition, that there may be markets where the growth of the internet does change the dynamic and over time does change the market definition.

There may be other markets, however, where the online channel still is not a real substitute for traditional brick-and-mortar, so I don't think that you should assume this case means that when you're defending a merger you can always sort of point to the internet and say it's a much bigger market, don't just look to brick-and-mortar stores, but this certainly does give some ammunition to parties who want to do that.

DR. HEMPHILL: I think I agree with all of that. What we're seeing is that past performance is no guarantee of what is going to happen in the future. In airlines, consolidation has changed the terrain. Here, the issue is technological change, so that a merger that might have been unthinkable a decade ago seems unobjectionable today.

MR. BURKE: It's a cautionary tale for everybody in a sense that there's a tendency to say well, how did the DOJ or FTC or the state AG address this merger the prior five times, when a similar merger occurred? Both of these cases are illustrations that markets do change and evolve.

MR. KATZ: I think on the one hand the merging parties would like the government to look at how the market has changed, on the other hand it's predictability is so important that it's sometimes nice to say well, the last 18 mergers in this business went this way and therefore the one you are proposing now is not going to go the following way, so I think that there's a balance between everybody's desire for predictability and what is also clearly necessary, which is understanding the changes, and sometimes I think the government is slow to change the way it looks at some industries and I think it's an industry-by-industry kind of analysis.

Let's turn our way from mergers; if we have time again maybe we will come back for some more.

On a topic that is something that is near and dear to many of us here in New York, it's been several years since the height of the financial crisis but to this day we are seeing this past year and a couple years before some major investigations, class actions involving financial institutions, we have LIBOR matters, the regulatory investigations, the settlements, regulatory settlements, private class actions.

In *LIBOR* just to try to describe very, very briefly there are allegations that the banks conspired to misreport their estimated cost of borrowing when they made daily submissions to the British Banking Association, which collects this information.

LIBOR stands for London Interbank Overnight Rate; it's a widely used benchmark interest rate and it's calculated based on the panel banks reporting of their estimated cost of borrowing in London at 11 a.m., particular various kinds of funds.

So the fines here are in the billions; there was a long decision by Judge Buchwald here in the Southern District that dismissed the antitrust claims so that case is clearly ongoing.

In addition to LIBOR, though we have class actions investigations involving other financial markets, we have foreign exchange trading, we have CDS credit default swaps, that's a different kind of theory but we have North Sea Oil prices and another benchmark; so Art, is there some common theme here to these or is there some reason they are all coming up around now?

MR. BURKE: It's an interesting question. There have always been antitrust litigations in the financial services industry. If we go back to the 90s and early 2000s there were litigations involving IPO spreads, the flipping cases. Many of those cases were actually dismissed based upon security law preemption arguments.

But we've had a new wave and clearly there is something going on here. Now I think if you looked at the allegations in many of the complaints, the claims are that the misconduct arose in part because of the financial crisis. That is certainly what the allegations are in *LIBOR*, that the banks, because they were concerned that LIBOR essentially was self-reported rates, that the banks claim they can borrow certain instruments, certain currencies at certain different time periods. The concern or allegation is that during the financial crisis that borrowing price went way up and the bank actually had to disclose that. It would send a bad signal to the marketplace that the bank was very fragile, so there was a uniform suppression of true LIBOR rates to hide that fragility. I think many of these other cases also have links to the financial crisis.

One of the things that I think is driving these things are leniency programs, not necessarily just in the U.S. but also in Europe and elsewhere; many of these banks have already confessed to doing bad things in other circumstances and they are under some obligation to turn themselves in under their existing non-prosecution agreements or other settlements as well as being afraid that if they are not the person in the door someone else is going to beat them to it.

So I do think there has been sort of a rolling level of institutions turning themselves in to the government for potential misconduct and that obviously has spurred the

investigations which, in turn, has spurred the civil litigations that followed after that.

DR. HEMPHILL: This is a fascinating area. There's a big picture question that courts will have to wrestle with, which is how far does antitrust extend? What kinds of suspension of competition count under antitrust and when we do see the suspension of competition at all?

It's worth taking a look at the district court's ruling in the *LIBOR* case. The judge took the view that the *LIBOR* setting process isn't itself "competitive." It's just a made-up number that each of the banks throws into a big hat, and you take the average of some of the numbers in the hat. That not being a competitive process to begin, why are we talking about antitrust at all?

Now, the plaintiffs respond that this process looks like some older cases, where there was manipulation of a component of price or an input of price. The case that comes to mind is *Knevelboard*. It's a cheese case, where a bunch of cheese makers got together and fixed the price on bulk cheese, which mattered as an input to the price for milk. The *LIBOR* district judge was aware of *Knevelboard*, but responded that in that case, they were actually supposed to be competing as to cheese; in *LIBOR*, they were not. Now, there is not a clear answer at the appellate level about whether the cheese case is a good analogy; stay tuned.

These questions will also be relevant for one of the other cases that was mentioned, the foreign exchange case, where the *WM/Reuters* rate is alleged to have been manipulated. Let's take for granted for the moment that there is manipulation—that some traders did something bad. But still we have to ask whether they did something that was *antitrust* bad. Now, here it's a bit different from *LIBOR*, because the rate is set not by throwing a bunch of made-up numbers into a hat, but instead by taking the average of some actual trades. Here, one key question will be, what competition is being reduced?

MR. BURKE: Just hearing Scott talk about this, it actually makes me think about your comments earlier about *Trinko* and regulated industries. I think this may also be an area where courts feel some reluctance to apply antitrust in a sort of a traditional fashion because this is such a highly regulated space where you've got Securities Exchange Commission, the CFTC. Many of the cases that have been brought have not been brought by the Antitrust Division but they have been brought by the criminal fraud section of the DOJ. There are a lot of other things going on and there is sort of a sense maybe somehow that if something wrong happened here it may be wrong but it may not really be antitrust wrong.

One other point I will make is that these are all cases that were in the very early stages and we only have one significant decision, Judge Buchwald's, that obviously

will ultimately be subject to appeal and so we really don't know where these cases are going to ultimately go.

One thing that I think is important to remember is that many of these cases involve allegations of essentially ad hoc trader manipulation, a trader who was talking with his friends and they wanted to push a benchmark in one direction or another so as to be able to make a better bet based upon that.

I think that is going to be very interesting to see how those claims are ultimately addressed when it comes to class certification if these cases get to that point. It's going to be very challenging and obviously I am biased having been more on the defense side but it will be very challenging I think to see how you can certify a class when the manipulations are day-to-day changing and directionally changing so some defendants or some plaintiffs may actually benefit from a manipulation depending on whether they are long or short in a certain position.

That is going to be an area that gets a lot of attention. We are probably a few years away, of course. Maybe that is something we can address next year or the year after that.

MR. KATZ: Let's talk about another a big industry here in the city: publishing. After a bench trial, Judge Cote in the Southern District found that Apple had played a central role in an illegal price fixing scheme with five book publishers to raise the price of e-books and to limit retail price competition. All five of the publishers had settled before trial.

I am going to try to give a few key facts. I will miss important facts no doubt, but hopefully I will get some of the important ones.

In 2009 about 90 percent of e-books were sold by Amazon and Amazon charged \$9.99 for many of the new releases and best sellers. Publishers weren't happy with this. Apple had wanted to enter the e-book retail market and they wanted to tie that together with the launch of their iPad.

Now, this was in 2010 they were going to launch their iPad so Apple had proposed for the publishers to move to an agency model where the publishers would set the retail price and then Apple would sell the e-book as an agent, they would just take a percentage commission for each transaction.

In the proposal the prices would be higher and in addition in the proposal from Apple in separate agreements with each of the publishers there was a most favored nation-like clause that effectively required the publishers to make sure that no other e-book retailers, which of course included Amazon, would sell their e-books at a lower price than the price that was sold by Apple as that agent for the publishers. And the publishers agreed to this.

There are colorful allegations of meetings by publishers but to focus on what Apple did, Judge Cote, I will quote what she said, “that the agreements did not promote competition but destroyed it, that they removed the ability of retailers to set the prices of their e-books and compete with each other on price, they relieved Apple of the need to compete on price and allowed the publishers to raise prices for their e-books.”

The decision discusses both *per se*, rule of reason but I think the government looked at this as a *per se* price fixing case and my question to you Scott is that right, should we think of this as a price fixing case?

DR. HEMPHILL: The question, as Judge Cote understood it, was whether Apple made a conscious commitment to a common scheme to do some harm. The underlying theory here is that the publishers hated a \$9.99 price point, and they were also worried about disintermediation by Amazon, as Amazon developed into an alternative to the traditional publishers.

This is probably the right moment to say, by way of disclosure (or advertisement!), that my wife is a novelist. She publishes with a different part of Amazon, not the e-book part but a part of Amazon that acts as a traditional publisher. *Buying In* is the name of her novel; it’s available in hardcover and Kindle.

MR. KATZ: I can tell you it’s a great book; I read it, and it talks about mergers.

DR. HEMPHILL: I spent some time at the trial last summer. One of the things that was really striking was the extent to which the late Steve Jobs was the star witness. The scheme was described by Jobs as an “aikido” move—a redirection of force. It was clear that Jobs understood the overall scheme. He told his biographer, “So we told the publishers, ‘we’ll go to the agency model, where you set the price, and we get our 30 percent, and yes, the customers pay a little more, but that’s what you want anyway.’ So they went to Amazon and said, ‘You’re going to sign an agency contract or we’re not going to give you the books.’” That is the government’s theory and it’s right there in the biography.

I plan, next time I teach this case, to show a short video, from right after the launch of the iPad, where Jobs is speaking with Walt Mossberg, the prominent tech reporter. During the launch presentation, Jobs discussed selling a book at a price quite a bit higher than what Amazon was then charging. Mossberg can’t understand how this is going to work, and asks Jobs about it. Jobs just smiles and says, “That won’t be case.... The prices will be the same.”

So it’s clear that Jobs understood this overall scheme and that Apple benefited from that, and I think that’s described very powerfully in Judge Cote’s opinion. The opinion is at pains to repeatedly credit some witnesses’ testimony, and discredit and disbelieve the testimony of

various Apple witnesses. Those kinds of very detailed findings will be challenging to attack.

Now, to come around at length to your question, *per se* liability for Apple leaves me a little bit uneasy. It’s one thing to say, the publishers got together in a fancy restaurant to talk about the threat from Amazon. But Apple wasn’t in that room. So you have to be a little uneasy when you have a vertical player who sort of gets wrapped up in it all, even if they knew what was going on, and conclude that we are just going to find a violation without doing any further analysis.

That raises a question. If there is a *per se* violation for some conspirators, is it necessarily a *per se* violation for all of them? I think we have some precedent that the answer is yes. Judge Wood’s opinion in *Toys R Us* suggests as much, but she may have been uneasy about that, and had lots of alternative holdings to make clear that the arrangement was in fact anticompetitive.

That raises the question of liability under the rule of reason. There is not a fact pattern that is exactly like the e-books case, so you can’t just take a case off the shelf and say, this is exactly like that. The closest case may be *United States v. General Motors*, a Supreme Court case where Chevrolet dealers all got together with one another and with GM to try to get rid of some other dealers. These other dealers were apparently selling cars at a discount but not taking on the obligation of servicing them. There is an analogy here to showrooming by retailers, who have to compete with online retailers.

In *General Motors*, the Supreme Court had no problem saying that the combination was a *per se* violation. I personally think that is wrongly decided. I think there was a procompetitive argument here, the basic free-rider argument, and that the horizontal combination of the dealers should not have been enough for *per se* liability. If *General Motors* were decided today, I think it’s clear that it would not be decided on a *per se* basis.

So there is an argument for considering this case under the rule of reason instead. Even so, Judge Cote squarely held in the alternative that there was an anticompetitive effect from the price rise, and no compelling justification.

MR. KATZ: Let’s turn to something else—we are starting to run out of time—but I do want to very briefly mention another Supreme Court decision, this one has to do with merchant agreements between retailers, in this case a restaurant and American Express. These agreements required that all disputes would be resolved by arbitration but it said that there would be a waiver of the right to arbitration on a class basis.

The Second Circuit said this class action waiver is not enforceable, that any one individual couldn’t prosecute this claim by themselves, you had to hire experts,

et cetera and it would make it so nobody could bring cases. The Supreme Court reversed the Second Circuit. It's called *American Express v. Italian Colors Restaurant* and the court said they have to rigorously enforce arbitration agreements according to their terms. Art, should we take this as an antitrust decision, should we care about the antitrust laws or is this just really arbitration?

MR. BURKE: I mean it's highly relevant to antitrust. Basically, wherever there are consumer class actions this is going to be an issue. If the court does hold to many people's surprise that arbitration provisions in merchant agreements apply, the individual consumer wanting to bring a class action later may be likely prohibited from doing so.

So I think it has potentially significant implications. One you would need to follow is in cartel cases. How significant are these provisions because even if a consumer, one consumer, has an arbitration provision with an alleged cartel member A, it's probably not going to have that arbitration provision with cartel member B, C, D, and E. There is joint and several liability among several cartel co-conspirators. So the arbitration provision will not necessarily block the claim in its entirety but will shave off a portion of the claim. I think the courts are struggling with that issue and we will see how that plays out over time.

MR. KATZ: This claim was only against American Express.

MR. BURKE: When you've got a claim against a single defendant it should be game over for plaintiffs.

MR. KATZ: There are some other very important interesting developments in class actions cases but we are going to skip along to something else.

This next topic is not a case or really an enforcement action but it's a business model that is being examined and we are talking about patent assertion entities (PAEs). They are called—for those who don't know what that means—we often call them patent trolls. We are not going to use that word again it is apparently offensive. I am not going to attempt to define what that means but generally speaking what we are talking about are firms that buy patents from existing owners of patents and then they assert those patents and bring infringement suits or they insist upon licensing fees, but they are not in the business, they don't do research and they don't practice the patents, so these PAEs they have attracted the attention of politicians and intellectual property lawyers and now the FTC. There was a workshop over a year ago and presently there is a study ongoing by the FTC of Patent Assertion Entities, so Scott you think a lot and write about IP and antitrust and is this an area that we should be concerned about, is the FTC right to spend their time and energy on this and maybe not some merger?

DR. HEMPHILL: There is plenty of space to do both! As a starting point, we can take our cue from the President's patent shout-out in this year's State of the Union address. He said, "let's pass a patent reform bill that allows our businesses to stay focused on innovation, not costly, needless litigation." That said, as Lisa Larrimore Oullette pointed out to me, he also mentioned patents in 2011, again in his State of the Union Address. There, he said, "America still has the largest, most prosperous economy in the world.... No country has more successful companies, or grants more patents to inventors and entrepreneurs." You almost get the sense that patents were great in 2011, but now we've realized that maybe they're not so great in 2014.

With respect to PAEs, I think we could spend a whole session on this. There are three broad issues here that I want to touch on briefly.

The first and maybe most standard is the PAE as defendant, either in an antitrust or a deception case. These are PAEs that are sometimes described as "bottom feeders," firms that are asserting patents without a careful investigation beforehand and being misleading about what patents they have or are asserting or are relevant. Or misleading would-be licensees about the settlements they've reached with other targets.

I think the classic example right now is MPHJ Technology Investments. As some of you know, the New York AG's office just reached a settlement with them. Vermont has done work in this area too. The FTC had drafted a complaint against them, but the firm preemptively sued the FTC and its commissioners individually, asserting that the FTC's actions in pursuing the firm are unconstitutional.

The story here, judging from the New York settlement and the FTC draft complaint, is that the firm claims patent protection in the use of scanners on networks that have e-mail. It sent a succession of form letters to small businesses, asking for \$1,000 per employee and threatening litigation. They claimed that they'd reached settlements with lots of other targets. In fact, judging from the draft complaint, just 17 firms fell for this. To be clear, enforcers are pursuing this not primarily as an antitrust theory, but as a kind of fraud and deception.

The second category features the PAE not as a defendant but as an antitrust plaintiff. For example, a PAE called Cascades Computer Innovation tried to get a bunch of big companies to take a license. Those companies relied on a company called RPX to negotiate jointly for licenses as to all of them. The district judge recently denied dismissal. I was in a conference recently where RPX described itself as "pooling the buying power of its members." This was after the antitrust complaint was filed. If you are counseling RPX or somebody like them, you might advise them to rethink their public presentation of the business model.

The third category is the alleged abuse of standard essential patents. Now, this issue is not limited to PAEs. Clearly, operating companies, which make things in addition to having patents, could be implicated in this question too. The worry here is that through the standard-setting process, firms adopt the standard, and they do so on the understanding that the license will be reasonable and nondiscriminatory, and then once everybody is hooked, the licensor increases the price or tries to enjoin an infringing user of the technology. This is an issue that potentially sounds in section 2, although there are challenges in bringing cases like that.

MR. BURKE: Just a few comments on this, this is a big problem if you talk to general counsels and I am sure many of you do, especially technology companies, but not solely technology companies anymore. This kind of litigation is accounting for a greater and greater portion of their litigation budget.

It is increasing at a rate that is very fast. I mean even as compared to two or three years ago GCs are saying they are seeing proliferation of this kind of litigation so it is a very serious problem. Again maybe I am biased. I don't see this being a reward to innovators, you know, the people who are behind these kinds of organizations say that look, we are just trying to get, you know, the fair royalties for the people that invented these kinds of products but the facts are these patents have long since been sold and the actual innovators behind the technology are not associated in any way with the claims that are being asserted.

So it's hard to see how this kind of litigation is spurring on innovation when this kind of litigation didn't even exist on its current scale until the last few years. How was this innovation actually necessary 20 years ago for somebody to invent the fax machine or the internet?

I am certainly skeptical that this is a socially beneficial kind of litigation. The problem here is to find a way under the antitrust laws to challenge the conduct because honestly it is largely legal. These are valid patents or at least when they are valid they can be asserted.

So while there are certain examples like the case that we were just discussing in New York, where people are misleading the licensees in paying royalties, that doesn't really get at the fundamental problem because the bigger players are careful not to do that.

If you are one of the very large Patent Assertion Entities you've got thousands of patents, many of them are valid, you can use them very effectively in a way that's completely legal.

So now that leads us to the final question which goes to the State of Union Address. Is there a way to solve for this in legislation? I think it's hard for me to see this issue

getting resolved by the courts and there are a lot of types of legislation that are under consideration here.

The challenge here is though defining what you are trying to—it's very easy to sort of like what you say about pornography, you know it when you see it, but actually legislating against this is very challenging, defining what a patent troll is. You say it's an entity that doesn't actually produce anything. Well, then that also would sweep in universities who have lots of IP portfolios but don't actually produce widgets and we certainly don't necessarily want to sweep universities into the same bucket as we sweep these Patent Assertion Entities, and also you know, Patent Assertion Entities can circumvent that by having a small operating business associated with them and there are many, many other challenges when it comes to drafting the legislation.

So this is an important area where we really do get a chance for bipartisan reform on both sides of the aisle and people realize this is a problem but actually the legislative process is going to be very challenging.

MR. KATZ: We are coming near to the end of our session, I hope you don't mind if I steal just a little bit from the break because we had a little bit of stall in the beginning of our session. I do want to offer up the chance for some questions from the audience if there are any and if there are maybe you guys might want to bring up things that we haven't discussed.

Yes?

AUDIENCE MEMBER: There was a recent decision involving reverse payments by a lower court, which had held that reverse payments have to actually be money. I was wondering what Scott's views are and whether a reverse payment can be any consideration or just money.

DR. HEMPHILL: You're thinking of the *Lamictal* opinion. So one of the issues in reverse payment cases going forward is, what counts as a payment? What counts as compensation? One issue in *Lamictal* is a "no-authorized generic" provision. When a generic enters the market, a branded firm can launch its own generic version of the product—a so-called "authorized generic"—which greatly reduces the competing generic's profits. Or the branded firm could license another firm to do the same thing, to similar effect.

So, as part of a sweetheart settlement deal, the brand could agree not to launch an authorized generic—that's the "no-authorized generic" provision. In other words, the branded firm could agree to sacrifice some of its profits to benefit the generic firm. The effect is to smuggle some compensation to the generic firm.

Now, the *Lamictal* district court rejects this perspective entirely. It takes the view that a payment must take the form of cash. After all, the Supreme Court's *Actavis*

opinion was about cash. Now, you might disagree with me about whether a no-authorized generic provision ought to give rise to antitrust liability, and yet still reject the court's view that it has to be cash. On the district court's view, if I pay you in land or gold it doesn't count. The court must be wrong that it has to be cash, merely because *Actavis* talked about cash.

I think the Third Circuit is likely to conclude that no—AG provisions ought to be thought of the same way. There are other interesting examples of compensation that we are going to have to think about as well. For example, in the *Lamictal* case, actually the settlement was about not one drug but two, involving the same patent. The settlement has different entry dates for each drug. The drug that didn't face any additional generic competition got an early date. The drug that would face lots of additional compensation got a late date. That kind of arrangement can provide compensation too.

AUDIENCE MEMBER: There were two, one was a 50 million dollar drug the other was a 2 billion dollar.

DR. HEMPHILL: Correct, that's right. That's right. So the generic got a good deal on the little drug.

AUDIENCE MEMBER: There is a case in Delaware that counsel may not use the term patent troll in front of the jury. I don't think it's been litigated against a lot of trolls. This is very clear business model in which they send letters and make false statements in the letters and

try to get unknowing people or people who can't afford any patent counsel. I am talking about pure patent troll is something people should be aware of.

MR. BURKE: The problem is though that there are some companies that are very large that are not relying on those tactics; they've got good counsel, they know how to turn right corners, but the patents or the effects especially are perhaps in a sense even worse.

MR. KATZ: I want to thank everyone, Scott, Art and the rest of the audience for listening and we certainly enjoyed it, I hope you did too.

Please stay on for the rest of the day, which has some very, very exciting interesting programs. Thank you.

MS. HART: I have failed to do a little bit of house-keeping oversight and I want to thank Art, Scott, and Elai for what they did and we have such a great audience too, with humor and intelligence, so the questions are going to be a very important part of the day and we do want to reserve time as we go along.

We are going to have a short break. Please be sure to fill out your midday attendance form and then your end of day attendance form. I am sure that in part you are here for CLE credit and please do endeavor to go online to do the evaluations. Those are important to inform the Section about which speakers really succeed with the audience. Thank you so much and now we have a brief break.