WHAT'S NEW AND HORIZONTAL?

HORIZONTAL RESTRAINT DEVELOPMENTS 2005-06

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The Department of Justice and Federal Trade Commission released their *Competitor Collaboration Guidelines* (2000) over five years ago to inject some clarity into the law of joint ventures and other horizontal restraints. Since then, Westlaw discloses not a single judicial decision in which the *Guidelines* have even been cited, and no one would describe the law in this area as particularly clear. Developments over the past year have done little to decrease, and may even have increased, the uncertainty. But the tunnel may have a light. A Supreme Court decision is coming and, if the Court avoids the *Empagran* route of making things even more obscure, we may get some welcome clarity to at least some aspects of the law. In the meantime, the past year has given us a lot to think about. So let's start.

DAGHER

The big news was the grant of *certiorari* in *Dagher*. The Supreme Court heard arguments on January 10th on whether joint price setting by the members of a lawful joint venture could reasonably be subject to the per se rule. *Texaco, Inc. v. Dagher*, 125 S. Ct. 2957 (2005), *granting cert*. to 369 F.3d 1108 (9th Cir. 2004). There will be a decision by the end of June. And a ruling before the ABA Spring Meeting is a real possibility.

Dagher involved a joint venture to market gasoline in the Western U.S. formed by Texaco and Shell. The legality of that joint venture itself, dubbed Equilon, was conceded. For the initial eight months of the operation of the joint venture, there was a price differential of roughly 2¢ per

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gallon between the brands. After that initial eight-month period, Equilon decided that the prices should be equalized even though the gasoline would continue to be sold under the separate brand names. It was this decision that was challenged as per se price fixing. The plaintiffs relied on *Citizen Publishing Co. v. United States*, 394 U.S. 131 (1969). *Citizen Publishing* had held illegal per se a price fixing agreement between joint venture partners in the context of a joint *production* venture that had provided for *separate marketing* by the partners in competition against each other—rather different from Equilon, which involved joint marketing from the outset. Nevertheless, a divided Ninth Circuit agreed that per se condemnation was appropriate.

Expect a reversal from the Supreme Court, and do not be surprised if it is unanimous. The oral argument exposed the critical flaw in the argument for application of the per se rule—namely, that Texaco and Shell were not competitors in the marketing of gasoline in the Western U.S. before the decision to set a uniform price was made. Whatever competition had existed between them in the marketing of gasoline in the Western U.S. had been eliminated by the joint venture, which was conceded to be lawful. The challenged agreement, therefore, was not an agreement among competitors to fix prices. Once the joint venture was established, Texaco and Shell, through Equilon, had to set some price or prices for the joint venture's products. Whether those prices were the same or entirely different was irrelevant. The vice that the per se rule prohibits is the *agreement* among competitors to set prices. If price setting is lawful—for example, as here, because the firms are not competitors in relevant respects—the agreement does not become unlawful because the prices are uniform.

CREDIT CARD INTERCHANGE CASES

The decision in *Dagher* may have interesting effects on a number of cases now proceeding through the lower courts, such as *Brennan v. Concord EFS, Inc.*, 369 F. Supp. 2d 1127 (N.D. Cal. 2005), which concerns the joint setting of certain ATM interchange fees for transactions mediated by the STAR network. Plaintiffs alleged that the defendant banks who control the STAR network committed a per se violation of Section 1 by agreeing to fix the amount of the interchange fees; several defendants moved to dismiss on the ground that STAR is a procompetitive joint venture subject only to rule of reason analysis. *Brennan*, 369 F. Supp. 2d at 1128. Citing the Ninth Circuit's decision in *Dagher,* the court rejected defendants' argument on the grounds that the question of whether fixing the amount of the interchange fee is a naked restraint or one necessary to the existence of the STAR joint venture was a factual question that could not properly be resolved on a motion to dismiss. *Id.* at 1133. Judge Walker's decision included an extensive discussion of related case law, providing a good sense of what is at stake in deciding the extent to which a joint venture is or is not a "mantra to escape *per se* analysis." *Id.* at 1132.

Joint price setting is also at issue in numerous class and individual actions concerning another type of interchange fees that have been consolidated for pre-trial purposes in the Eastern District of New York (MDL 1720). *In re Payment Card Interchange Fee and Merchant Discount Antitrust Litigation*, 398 F. Supp. 2d 1356 (J.P.M.L. 2005).[1] Among other claims, the plaintiffs in these cases allege that the setting of interchange fees—the major component of the merchant discount rate paid by merchants for each retail transaction where a Visa or MasterCard is used—by Visa and MasterCard and their member banks amounts to illegal price fixing either per se or under the rule of reason. The contention is that jointly-set interchange is not necessary to effectuate transactions, and that competition would be served if rates were negotiated individually. *See, e.g.,* Complaint ¶ ¶ 92, 121, 138, *Photos Etc. Corp. v. Visa USA, Inc.,* No. 3:05-CV-01007-WWE (D. Conn., filed June 22, 2005).

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[1] The authors represent American Express in these cases, as well as in the *Ross* case, discussed below.

The MDL 1720 plaintiffs are pursuing these allegations notwithstanding a prior 11th Circuit decision upholding interchange, albeit based on a record from an earlier time period. *See National Bancard Corp. (Nabanco) v. Visa U.S.A., Inc.*, 779 F.2d 592 (11th Cir. 1986). Plaintiffs' analysis appears to be based in substantial part on a ruling, later mooted by the *Wal-Mart* case settlement, in *Reyn's Pasta Bella, LLC v. Visa U.S.A., Inc.*, 259 F. Supp. 2d 992 (N.D. Cal. 2003). *Reyn's* held that credit card association interchange was not subject to per se condemnation but could be challenged under the rule of reason. The court there distinguished *Nabanco* on the ground that, while individual rate negotiations with merchants were permitted (at least in the abstract) at the time of *Nabanco*, that was no longer true; current association practice precludes individual negotiations. *Reyn's*, 259 F. Supp. 2d at 999. The decision in *Dagher* may have a substantial impact on the consolidated cases as they proceed.[2]

STILL MORE CREDIT CARD LITIGATION

Yet another pair of cases in the credit card industry involves an allegation that the major credit card issuers, acting through their legal counsel, conspired to insert arbitration clauses in consumer cardholder agreements. *Ross v. Bank of America*, 05 Civ. 7116 (S.D.N.Y., filed Aug. 11,

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[2] Various other allegations regarding the collective policies of the MasterCard association and its member banks are at issue in another case proceeding in the Eastern District of New York, *Paycom Billing Services, Inc. v. MasterCard Int'l, Inc.*, 2005-1 Trade Cas. (CCH) ¶ 74,751, 2005 WL 711658 (E.D.N.Y. 2005) (Trager, J.). The court granted defendant MasterCard's motion to dismiss plaintiff's claim (among others) that MasterCard's policy of having merchants bear the entire cost of allegedly fraudulent transactions where the merchant cannot produce a signed sales receipt (as is the case with all internet transactions) violates Section 1 both because it constitutes price fixing and because it constitutes an agreement not to compete regarding risk allocation for internet transactions. *Id*. at *3. Noting that "courts have generally found that where inter-brand competition exists, an agreement to limit *intra*-brand competition does not harm competition," that "MasterCard's policies only restrict competition within its own brand," and "this restriction may inhibit MasterCard's ability to compete in the market for internet merchant services," the court found that the policy was not illegal under the rule of reason, properly applicable to MasterCard as a joint venture. *Id*. at *3-4.

2005); *Ross v. American Express,* 04 Civ. 5723 (S.D.N.Y., filed July 22, 2004). Assuming there was evidence that such a conspiracy existed, the complaints raise a host of questions:

- Is an agreement among competitors to include arbitration clauses illegal per se or subject to the rule of reason? Plaintiffs say per se, citing *Paramount Famous Lasky Corp. v. United States*, 282 U.S. 30 (1930). But Second Circuit authority of more recent vintage holds otherwise. *Drayer v. Krasner,* 572 F.2d 348, 355 (2d Cir. 1978). If an agreement of this type existed, it would clearly reduce costs, and competition among card issuers would cause the cost savings to be passed along to consumers. Is more required for the rule of reason to apply?
- Assuming the rule of reason applies, what would be the harm to competition from an agreement to insert arbitration clauses? And in what market?
- Can a private plaintiff sue? If so, what is the injury? The Supreme Court has made clear, in *Mitsubishi* and elsewhere, that having to arbitrate rather than litigate is not "injury" under the law.
- Who decides? Is the arbitration conspiracy claim itself arbitrable? Or does a jury decide the issue in the context of deciding whether an agreement to arbitrate was "made" under section 4 of the Federal Arbitration Act? *See Ross v. American Express Co.*, 2005 WL 2364969 (S.D.N.Y. Sept. 27, 2005) (ordering jury trial under section 4).

Decisions at least at the district court level should be coming out within the next year. Stay tuned.

<u>ACTUARY CASE</u>

Information sharing about risk avoidance measures was at issue in the Department of Justice Complaint and Consent Decree in *United States v. Professional Consultants Insurance Co., Inc.* (D.D.C. 2005) (amended final judgment entered Nov. 26, 2005). The Justice Department alleged that PCIC, a captive insurance company that provides professional liability insurance to its member actuary firms, participated with its members and other non-member actuaries in improper information sharing relating to the use of contractual limitations of liability ("LOLs") in engagement agreements with pension funds and other employee benefit plans. The complaint characterized these

LOL clauses as a “significant basis of the firms’ competition for clients and potential clients.” Complaint ¶ 11.

Significantly, no explicit agreement to include LOLs in engagements was alleged. The complaint instead identified various instances in which PCIC members or officials discussed the implementation of LOL clauses among themselves and with non-PCIC competitors, including at “profession-wide” meetings, Complaint ¶¶ 15-17, and alleged that this information sharing restrained “significant competition” among firms, *id.* ¶ 18.

What is notable about this complaint is that there is no allegation of a per se offense, no allegation that the members of PCIC had market power in any market, and no specific allegation of any anticompetitive effect. On its face, the complaint identifies only general and mostly historical information of the kind that would ordinarily be considered competitively harmless. There is no explanation of how communications taking place sporadically “since at least 1999” about a topic (i.e., techniques to reduce the risk of malpractice claims) of widespread public discussion (not only among actuaries but every other professional group) uniquely contributed to the widespread adoption of LOL provisions—which the complaint implies had not happened by even as late as September 2003 notwithstanding that the information exchange began long before then. And from a joint venture standpoint, it is at least arguably reasonable for an insurance firm—PCIC—to recommend to those it insures commonly-used ways to reduce the risk of malpractice claims. If taken at face value, this complaint would appear to be at odds with general enforcement trends.

The consent decree settling the case ends it with something of a whimper—simply restricting the manner in which PCIC can get and use LOL information, with minimal “fencing in” provisions.

NAR CASE

The DOJ also filed suit against the National Association of Realtors (NAR), based on that organization’s recently-enacted policy governing its members’ use of multiple listing data in connection with internet-based real estate brokerage services. NAR establishes policies for real estate brokers, and for the multiple listing service (MLS) joint ventures in which those brokers participate in order to share client listings. In its original complaint, which was filed on September 8, the Antitrust Division alleged that real estate brokers using Internet-based business models to provide searchable real estate listings to their customers at a lower cost posed a competitive threat to brokers who searched the listing themselves in order to identify and share relevant listings with their customers, since the Internet-based brokers were able to offer discounted commissions to sellers or commission rebates to buyers. *United States v. Nat'l Ass'n of Realtors*, No. 05C-5140 (N.D. Ill.) (complaint filed September 8, 2005). In response to concerns raised by some of its multiple listing service (MLS) members about Internet-based competition, NAR adopted a policy forbidding any broker who participates in an MLS to convey a listing to a customer over the Internet without the permission of the listing broker and gave the listing broker the ability to withhold permission selectively. Complaint ¶ 31. The policy also forbids Internet-based brokers from referring their customers for a fee. Complaint ¶ 34.

After the government informed NAR that it intended to file suit, NAR announced a modified policy, which continued to forbid any participating broker from conveying a listing to a customer via the Internet without the permission of the listing broker (under so-called "opt-out provisions"), albeit no longer on a selective basis, while specifically exempting NAR's own official website from the need to seek such permission. The modified policy also denies MLS membership and access to listings to brokers offering referral services for a fee.

Unimpressed with these and other modifications, the DOJ filed an amended complaint challenging both the original and the modified policy on October 4, 2005. *See, e.g.* Amended Complaint ¶¶ 39, 40. According to the Amended Complaint, both the original and modified opt-out provisions "provide brokers an effective tool to individually or collectively punish aggressive competition by any Internet-based broker." Amended Complaint ¶ 42.

<u>FTC CASES: 3 TENORS/TEXAS DOCTORS</u>

Over at the FTC, in one of the most-discussed opinions of the past year, the D.C. Circuit upheld the FTC's finding in the "Three Tenors" case that a distributor's agreement with its codistributor to temporarily suspend advertising and discounting of performers' previous concert albums as part of their joint efforts to promote a subsequent recording violated section 5 of the FTC Act. *Polygram Holding, Inc. v. Federal Trade Commission*, 416 F.3d 29 (D.C. Cir. 2005). In addition to blessing the analytical framework deployed by the FTC in the case, *id*. at 36, the D.C. Circuit confirmed that the analysis of the case under the FTC Act is the same as it would be under Section 1. *Id*. at 32. The court characterized the applicable analysis as part of a steady, long-term move within the Supreme Court's Section 1 jurisprudence away from reliance upon fixed categories such as per se and rule of reason, or even "quick look," and toward an analytical continuum "in which the extent of the inquiry is tailored to the suspect conduct in each particular case." *Id.* at 34. The high-level debate over whether recourse to a potentially more efficient but ever-evolving analytical continuum provides economic actors with better incentives to compete than would the use of at least somewhat fixed categories will and should continue, as Section 1 jurisprudence absorbs advances in economic learning. In the meantime, the *Polygram* decision definitely makes clear that additional caution is warranted when collaborating competitors impose restrictions on existing products as part of introducing a new one. *Id*. at 38.

The FTC also had the opportunity during the past year to "provide some guidance to the health care community on the appropriate boundary between pro-competitive and anti-competitive activities" in the context of collective price setting by physician groups. *North Texas Specialty Physicians*, Dkt. No. 9312 (F.T.C. Nov. 29, 2005). In a lengthy and detailed unanimous opinion in which it reviewed *de novo* the facts adduced during a full administrative trial, the Commission deployed what it referred to as its "more flexible *Polygram* framework" and found that, taken as a whole, the activities of the independent physician organization in connection with negotiating reimbursements for its members from insurance companies and health plans amounted to horizontal price fixing unrelated to any procompetitive efficiencies. *Id.* at 3, 41.

The Commission opinion, the swan song of retiring Commissioner Thomas Leary, first identified an agreement among participating physicians, despite the lack of evidence of direct communication among them: "In this case, it is enough that participating physicians individually authorized NTSP to take certain actions on their behalf, knowing that others were doing the same thing. Indirect communications of this kind are sometimes referred to as 'hub-and-spoke' conspiracies." *Id.* at 17. The Commission next analyzed each of the challenged restraints, which included (1) annual polls regarding minimum reimbursement rates; (2) a participation agreement which, despite the inclusion of opt-out provisions, in effect rendered NTSP the sole bargaining agent of its member physicians; and (3) instances in which NTSP advised its members to refuse to contract with payors except on collective terms. *Id*. at 18-24. Commissioner Leary's discussion of each of these restraints, as well as the corresponding proffered justifications, merits careful reading even by practitioners outside the health care field as a guide to the circumstances under which individual pricing authority properly may be delegated to a common agent—and those under which it may not.

TWOMBLY AND PLEADING STAGE PLUS FACTORS

Private litigation also resulted in a number of decisions evaluating the sufficiency of allegations concerning parallel behavior outside the context of formal collaborations between competitors. In *Twombly v. Bell Atlantic Corp.*, 425 F.3d 99 (2d Cir. 2005), the Second Circuit vacated the district court's decision granting defendants' motion to dismiss, holding that while a plaintiff need not plead "plus factors" in order to state a Section 1 claim based on parallel conduct, the factual predicate pleaded must include conspiracy among the realm of plausible possibilities. *Id.* at 111. In other words, at the motion to dismiss stage (in explicit contrast to the standard of proof at summary judgment), allegations of consciously parallel conduct, without more, are sufficient to state a claim. The court said that "to rule that allegations of parallel anticompetitive conduct fail to support a plausible conspiracy claim, a court would have to conclude that there is no set of facts that would permit a plaintiff to demonstrate that the particular parallelism asserted was the product of collusion rather than coincidence." *Id.* at 114. The appellate court found that the consumer plaintiffs had stated a Section 1 claim by alleging, among other things, that Bell Atlantic and other defendant incumbent local exchange carriers (ILECs) had not attempted to compete meaningfully in each others' adjacent territories despite having acknowledged the inherent profitability of doing so, and that they had kept competitive local exchange carriers (CLECs) out of their territories through a variety of means, including "continuing to bill customers who had switched to the CLECs' services, denying the CLECs access to essential network equipment and facilities, and providing erroneous and confusing bills to the CLECs for their services." *Id*. at 118.

The *Twombly* decision, while perhaps consistent with the notion of "notice pleading" as what the Federal Rules require, creates a real policy concern. Parallel conduct is ubiquitous in the economy. To say, as the Second Circuit now has, that nothing (or not much) more is required to state a claim may allow significant mischief. Plaintiffs may be able to file wholly meritless cases but nonetheless extract significant settlement dollars as defendants seek to avoid years of costly discovery and uncertainty. As this plays out going forward, it would not be unreasonable to expect to see the courts cut back on *Twombly* and require at least something more at the pleading stage. Time will tell.

The district court relied in part on more traditional "plus factor" allegations in permitting plaintiffs' price fixing claims to survive a motion to dismiss in *In re Carbon Black Antitrust Litigation*, 2005-1 Trade Cas. (CCH) ¶ 74,695, 2005 WL 102966 (D. Mass. 2005), holding: "The plaintiffs have provided sufficient circumstantial evidence to put the defendant on notice of their claims and to permit me to find that there is a plausible set of facts under which they could prove their case." *Id*. at *8. The court found that, drawing inferences in favor of the plaintiffs, allegations including coordination of price increases via a third-party conduit and at trade association meetings, plant closings to limit supply, and market conditions facilitating maintenance of the alleged agreement were plausible and, if true, could form the basis of a valid section one claim. *Id.* at *8. The decisions in *Carbon Black*, and to an even greater extent *Twombly*, illustrate a reluctance to test plausible plaintiffs' allegations against even the most sophisticated defendants' arguments that the facts alleged could just as easily be true in the absence of any conspiracy.

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