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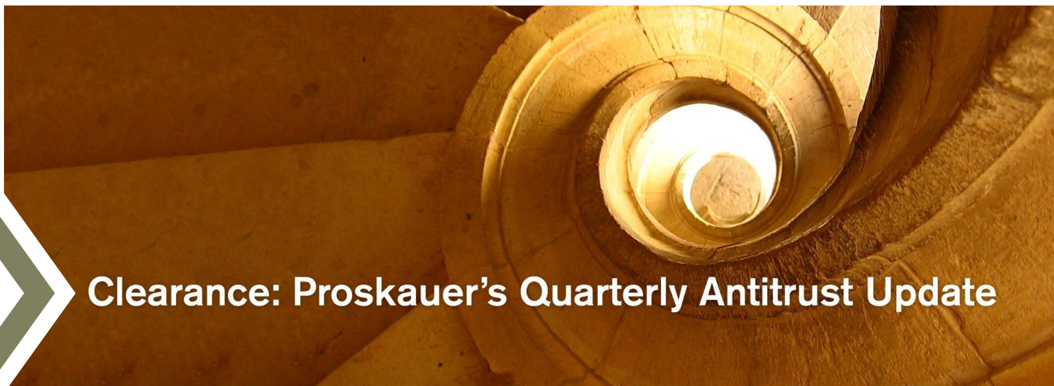

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FALL 2012

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Exchange Of Employee Wage Information: What Is Permitted Under The Antitrust Laws?

The exchange of wage-related information between two competitors may not be a *per se* violation of antitrust laws, according to a Federal court in Michigan. The decision, from the U.S. District Court for the Eastern District of Michigan, *Cason-Merenda v. Detroit Medical Center, et al*,[1] follows two cases filed by the Department of Justice (DOJ) in 2010 that alleged firms conspiring to fix the terms of employment *had* committed *per se* violations of § 1 of the Sherman Act.[2] The more recent case characterized the issue as a "very close question." An analysis of the decisions shed some light on how to avoid allowing employment related information exchanges cross the line into a violation of the Sherman Act under either the *per se* rule or the rule of reason.

The Cason-Merenda case

Cason-Merenda involved an alleged conspiracy to reduce the wages of registered nurses (RNs) at eight[3] Detroit-area hospitals. The class action suit[4] alleged that the hospitals violated § 1 by conspiring to hold down the wages of RNs and by exchanging compensation-related information in a manner that reduced competition in the wages paid to RNs. Specifically, the plaintiffs alleged three ways in which information had been shared among the defendant hospitals: (1) direct contacts to obtain compensation information, including future wage increases, between employees of the various hospitals

[1] *Cason-Merenda v. Detroit Medical Center*, 2012 WL 995293 (E.D. Mich. Mar. 22, 2012).

[2] *See United States v. Adobe Systems, Inc. et al*, 1:10-cv-1629 (D.D.C. Mar. 18, 2011); United States v. Lucasfilm Ltd., 2011 WL 2633850 (D.D.C. June 3, 2011). Section 1 of the Sherman Act states that "[e]very contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal . . . ."

[3] At the time the summary judgment opinion was issued, five defendants remained in the case.

[4] The class was made up of the allegedly harmed RNs.

who were involved in the process of determining RN compensation; (2) healthcare industry organizations, such as a healthcare recruiting association, and meetings that addressed nursing issues, including compensation; and (3) third-party surveys of RN compensation sponsored by the defendant hospitals with disaggregated wage information.

RECENT CLASS ACTION RULING STATES THAT ENTITIES ALLEGEDLY CONSPIRING TO FIX THE TERMS OF EMPLOYMENT EXPOSE THEMSELVES TO *BOTH* PRIVATE *AND* GOVERNMENT ENFORCEMENT UNDER *PER SE* AND RULE OF REASON THEORIES.

On March 22, 2012, the court issued a lengthy opinion on the parties' cross-motions for summary judgment,[5] with detailed analysis supporting its conclusion that the defendant hospitals were entitled to summary judgment on the plaintiff claim of a *per se* § 1 violation, *but not* on a rule of reason theory.

To prove a *per se* violation in the Sixth Circuit, a plaintiff must show "(1) two or more entities engaged in a conspiracy, combination or contract; (2) to effect a restraint or combination prohibited *per se* (wherein the anticompetitive effects within a relevant geographic and product market are implied); (3) that was the proximate cause of the plaintiff's antitrust injury."[6] The court noted that because the plaintiff RNs were not able to demonstrate *direct evidence* of an explicit agreement among the hospitals to fix RN wages, they were left to establish the alleged conspiracy through circumstantial evidence.

The defendants argued that the plaintiffs' failure to discover evidence that the hospitals had engaged in parallel conduct was fatal to their circumstantial case. The court, however, stated that parallel conduct was only one form of circumstantial evidence and plaintiffs were not mandated to allege or prove parallel behavior.[7] Rather, "circumstantial evidence of any sort will do, provided that it demonstrates business behavior which evidences a unity of purpose or common design and understanding …in an unlawful arrangement."[8] In addition, in order to make out a circumstantial *per se* case on a motion for summary judgment, plaintiffs' evidence needed to exclude the possibility of independent action.[9]

The court held that the evidence produced by the plaintiffs just barely failed to meet the *per se* standard. While the plaintiffs had "produced a great deal of evidence," it was not enough to preclude the inference of independent action by the hospitals.[10] The plaintiffs amassed "considerable evidence" that the hospitals did not pursue their independent self-interests in their "on-demand" exchanges of detailed current and future wage information and in their use of sponsored wage surveys that disclosed disaggregated wage information. The court noted that hospitals' exchange of current disaggregated wage information and the use of sponsored surveys violated the FTC's and DOJ's policy statement on the exchange of wage information in the healthcare industry.[11] The

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[5] *Cason-Merenda v. Detroit Medical Center*, supra.

[6] *Expert Masonry, Inc. v. Boone County, Ky.*, 440 F. 3d 336, 342 (6th Cir. 2005) (citations omitted).

[7] Cason-Merenda at *17-18.

[8] *Id.* at *19.

[9] *Id.* at *17, *citing Matsushita Electric Indus. Co. v. Zenith Radio Corp.*, 475 U.S.574, 588, 594 (1986).

[10] *Id.* at *19.

[11] DOJ/FTC, Statement of Antitrust Enforcement in Healthcare, Statement 6(A) at 63 (August 1996). The policy expressly addresses wage exchanges via surveys, explaining that the FTC and the DOJ "will not challenge, absent

hospitals also had a clear motive to conspire. By not competing for skilled labor, the supply of which is relatively scarce, wages were artificially depressed.[12]

Significantly, however, the evidence of uniform conduct by the hospitals in their wage-setting decisions, which one would expect in a conspiracy, was weak.[13] Indeed, the court found that "the evidence here simply features too wide a disparity among the Defendant hospitals' processes for determining RN compensation and the outcomes of these processes to support" a *per se* conspiracy in violation of § 1.[14]

On the other hand, the evidence was strong enough to survive summary judgment on a rule of reason theory. Under the rule of reason, the plaintiffs are required to allege and prove that they had suffered an "antitrust injury," that is harm caused by the anticompetitive aspect of the alleged violation.[15] Here, the RNs alleged a conspiracy to depress RN wages through information exchanges.[16] As noted, there was "considerable" evidence of "on-demand" wage information exchanges that was routinely passed up to the hospitals' executive leadership for use in making wage determinations. Given that record, the court found that a jury should be permitted resolve whether plaintiffs had proven "as a matter of fact and with a fair degree of certainty"[17] a "causal link" between an antitrust violation (an agreement to exchange wage information) and the relevant antitrust injury (sub-optimal wages).[18]

Thus, while the court granted the defendant hospitals' motions for summary judgment on plaintiffs' *per se* claim, it allowed plaintiffs' rule of reason claim to survive summary judgment and proceed to trial.[19] Following the March 22, 2012 decision, plaintiffs[20] and

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extraordinary circumstances, provider participation in written surveys of . . . wages, salaries, or benefits of health care personnel," so long as (i) the survey in question is "managed by a third-party," (ii) the "information provided by survey participants is based on data more than 3 months old," (iii) "there are at least five providers" participating in the survey, with no participant's data "represent[ing] more than 25 percent" of a given reported statistic, and (iv) the "information disseminated is sufficiently aggregated such that it would not allow recipients to identify the . . . compensation paid by any particular provider." *Id*.

[12] Cason-Merenda at *28-30, 34.

[13] *Id.* at *26-27, 30

[14] *Id.* at *32.

[15] *Id* at *32, citing *Brunswick Corp. v. Pueblo Bowl–O–Mat, Inc.*, 429 U.S. 477, 489 (1977); Atlantic Richfield Co. v. USA Petroleum Co., 495 U.S. 328, 341–45 (1990).

[16] Cason-Merenda at *33.

[17] *Id*. at *32, citing *Shreve Equipment, Inc. v. Clay Equipment Corp.,* 650 F.2d 101, 105 (6th Cir.1981)

[18] *Id.* at *37.

[19] *Id.* at *32-39.

[20] The plaintiff RNs' motion for reconsideration challenged the standard applied by the Court to evaluate the circumstantial evidence in support of plaintiffs' *per se* claim. *See* 2012 WL 1900604 at *2 (E.D. Mich. May 24, 2012). The Court rejected this argument, noting that Sixth Circuit precedent makes clear that a four factor test is intended to guide the Court's analysis of the evidentiary record, rather than dictating an outcome through a rigid hierarchy of government precepts. Id.

two defendants[21] filed motions for reconsideration. The court denied both motions on May 24, 2012, thus reaffirming its March 22, 2012 decision. [22]

The DOJ cases

In contrast, two cases filed by DOJ resulted in settlements where the defendants agreed to significant restrictions. In *Lucasfilm*, the DOJ asserted that a non-solicitation agreement between Lucasfilm and another studio was *per se* unlawful. There the parties had agreed (1) not to cold call each other's employees; (2) to notify each other when making an offer to each other's employees; and (3) not to counteroffer above the other's initial offer when the other company made an offer to one of their employees.[23] In the final judgment, the parties agreed that the defendant is "enjoin[ed] from entering into an agreement with any other person or company to in any way refrain from recruiting the other person or company's employees."[24]

IN ORDER TO AVOID A FINDING THAT AN AGREEMENT IS PER SE UNLAWFUL, ENTITIES THAT EXCHANGE WAGE-RELATED INFORMATION SHOULD DO SO WITH PARTICULAR CARE AND UNDER THE SUPERVISION OF ANTITRUST COUNSEL.

Similarly, in *Adobe Systems*, the DOJ suggested that while narrowly tailored restraints on hiring would typically be reviewed under the rule of reason, naked restraints – such as agreements not to cold call another company's employees – will be reviewed under the *per se* rule. In the proposed final judgment, the parties agreed to restrictions that are identical to those entered into in the *Lucasfilm* case – that each defendant is "enjoined from attempting to enter into, entering into, maintaining or enforcing any agreement with any other person to in any way refrain from, requesting that any person in any way refrain from, or pressuring any person in any way to refrain from soliciting, cold calling, recruiting, or otherwise competing for employees of the other person."[25]

Conclusion and Guidance

The recent *Cason-Merenda* case confirms that entities allegedly conspiring to fix the terms of employment expose themselves to private – not just government – enforcement. It also confirms that, in order to avoid a finding that an agreement is *per se* unlawful, entities that intend to exchange wage-related information need to do so with particular care. Compensation information (i) should not be current or concern future wage

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[21] Two of the defendant hospitals also filed a motion for reconsideration, which was also denied by the Court on two separate grounds. *See* 2012 WL 1900604 at *3 (E.D. Mich. May 24, 2012). First, the Court noted that one of defendant's motions for reconsideration was based on grounds not raised in the underlying summary judgment motion, and that a motion for reconsideration is not an appropriate mechanism for "arguing matters that could have been heard during the pendency of the previous motion." *Id.* Second, the Court disagreed with the other defendant's argument that the Court "found" facts bearing on the potential liability of each defendant, and noted that "[h]aving failed to pursue such an individualized challenge at the designated time for doing so, [defendant] cannot now seek to raise this issue at the present, advanced stage of this protracted litigation." *Id.* at *4,

[22] *See also Fleischman v. Albany Medical Center*, 728 F. Supp.2d 130, 158 (N.D.N.Y. 2010, the facts of which are similar to Cason-Merenda, and resulted in a settlement. In Fleischman, plaintiff RNs alleged that Albany Medical Center, along with other area hospitals, (1) entered a conspiracy to suppress RN wages in violation of § 1 of the Sherman Act; and (2) exchanged information regarding RN wages in furtherance of their conspiracy and with the effect of suppressing wages. After nearly four years of litigation, Albany Medical Center agreed to pay over $4.5 million to a class of RNs.

[23] *United States v. Lucasfilm, LLC,* 2011 WL 2636850 at *1 (D.D.C. June 3, 2011).

[24] *See Id.*

[25] *United States v. Adobe Systems*, 1:10-cv-01629 (March 18, 2011) (Final Judgment).

increases or decreases and (ii) should be sufficiently aggregated such that it would not allow recipients to identify the compensation paid by any particular provider. Compensation surveys should be managed by third parties and not be sponsored. Finally, "no solicitation" agreements should not be entered into unless they are "ancillary to a legitimate procompetitive venture and reasonably necessary to achieve the procompetitive benefits of the collaboration."[26]

THE SEVENTH CIRCUIT RULING POTENTIALLY EXPANDS THE FOREIGN REACH OF U.S. ANTITRUST LAWS AND GIVES THE DOJ AND FTC MORE LEVERAGE IN ITS NEGOTIATIONS WITH FOREIGN FIRMS LOOKING TO DO BUSINESS IN THE UNITED STATES.

Minn-Chem Maximizes Sherman Act's Reach

The long arm of American antitrust law can reach across oceans and penalize actions by foreign corporations, so long as those actions have a "reasonably proximate causal nexus" to effects in the United States. That is the finding of an en banc panel of the Seventh Circuit, reversing an earlier panel decision by the same court in *Minn-Chem, Inc. v. Agrium, Inc.*[27] The decision potentially expands the foreign reach of U.S. antitrust laws and gives the Justice Department and FTC more leverage in its negotiations with foreign firms looking to do business in the United States.

Rising from the (pot)Ashes

The case concerned an international cartel of potash producers, mainly in Canada, Russia, and the former Soviet republics.[28] Potash is the term for potassium rich mineral salts, mainly used in fertilizer and some consumer products.[29] It is a commodity of which there are few deposits in the United States. Consequently, U.S. fertilizer producers and other manufacturers import the vast majority of their potash needs, to the tune of millions of tons per year.[30] Approximately seven foreign companies account for more than 70 percent of the world's production.[31]

The plaintiffs were U.S. purchasers of potash who alleged that seven foreign companies conspired to restrict output and raise prices in other countries, notably China, Brazil, and India. The plaintiffs allege that once the companies secured higher prices outside the U.S., the cartel used the higher price as a "benchmark" to raise U.S. prices.[32] The complaint alleged the cartel was remarkably successful, raising the cost of potash 600

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[26] Adobe Systems Competitive Impact Statement, at 11 (conduct Not Prohibited). The DOJ has also suggested that no solicitation agreements may be appropriate within existing and future employment or severance agreements with a company's own employees, and where reasonably necessary for (i) mergers or acquisitions, consummated or unconsummated, investments, or divestitures, including due diligence related thereto; (ii) contracts with consultants or recipients of consulting services, auditors, outsourcing vendors, recruiting agencies or providers of temporary employees or contract workers; (iii) the settlement or compromise of legal disputes; (iv) contracts with resellers or OEMs; and (v) contracts with providers or recipients of services.

[27] 686 F.3d 845 (7th Cir. 2012) (en banc) *rev'g* Minn-Chem, Inc. v. Agrium, Inc., 657 F.3d 650 (7th Cir. 2011).

[28] *Id.* at 848.

[29] *Id.*

[30] *Id.* at 849.

[31] *Id.*

[32] *Id.*

percent over five years, despite there being no significant upsurge in demand or production costs.[33]

The complaint pointed out numerous statements and actions by the cartel that appeared to make a strong case for concerted, anticompetitive action,[34] and the district court allowed the case to move forward, denying the defendants' motion to dismiss.[35] A Seventh Circuit panel reversed, stating the Foreign Trade Antitrust Improvements Act of 1982 (FTAIA)[36] demanded dismissal because the conduct complained of was entirely foreign and did not fit into the FTAIA's "import commerce" exception.[37]

The Seventh Circuit agreed to rehear the case sitting *en banc*, and in a well-reasoned opinion written by Judge Wood, reinstated the District Court's ruling.

Crossing the Threshold

The FTAIA has long been a subject of concern in the courts as a particularly poorly drafted statute.[38] First, the courts had split as to whether the FTAIA was jurisdictional or elemental.[39] If the former, Courts would have no competence or ability to hear complaints lodged about foreign anticompetitive conduct at all, unless it could be proven at the outset that such conduct had a "direct, substantial, and reasonably foreseeable effect . . . on import commerce."[40] If the latter, the "direct effect" requirement is merely an element of the antitrust claim plaintiffs have to prove in order to prevail. The distinction matters because it makes it slightly easier for a plaintiff to keep an antitrust suit against foreign companies alive. Plaintiffs must prove jurisdiction affirmatively, meaning plaintiffs have

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[33] *Id.* In fact, the complaint alleged demand was relatively inelastic.

[34] *See Id.* (Pointing out the companies exchanged executives, met and subsequently raised prices, and coordinated reductions in output to keep prices stable).

[35] *See Id.* at 848 (noting the district court rejected defendants' motion to dismiss for failure to state a claim).

[36] Codified at 15 U.S.C. § 6a (2012). The statute provides, in relevant part, that the Sherman Act "shall not apply to conduct involving trade or commerce (other than import trade or import commerce) with foreign nations unless (1) such conduct has a direct, substantial, and reasonably foreseeable effect (A) on trade or commerce which is not trade or commerce with foreign nations, or on import trade or import commerce with foreign nations; or (B) on export trade or export commerce with foreign nations, of a person engaged in such trade or commerce in the United States; and (2) such effects give rise to a claim under the provisions of [the Sherman Act].

[37] *See Minn-Chem, Inc. v. Agrium, Inc*., 657 F.3d 650 (7th Cir. 2011). The court, interpreting the FTAIA through the lens of the Twombley/Iqbal "plausibility" pleading standard, *see* Ashcroft v. Iqbal, 556 U.S. 662, 678 (2009); Bell Atlantic Corp. v. Twombley, 550 U.S. 544, 555 (2007), originally found that the complaint "only generally allude[d] to a link between the cartelized prices in [China, India, and Brazil] and American potash prices" and concluded the pleading failed to meet the *Twombley* standard. 657 F.3d at 662-63.

[38] *See Animal Sciences Prods. v. China Minmetals Corp.*, 654 F.3d 462, 465 (3d Cir. 2011) (quoting past cases describing the statute as "inelegantly phrased" and using "rather convoluted language").

[39] *See United Phosphorous, Ltd. v. Angus Chem. Co*., 322 F.3d 942, 947-49 (7th Cir. 2003) (describing the debate between the circuits and between Supreme Court justices as to whether the FTAIA was a jurisdictional or elemental statute).

[40] 15 U.S.C. § 6a (1)(A). The statute provides, in relevant part, that the Sherman Act "shall not apply to conduct involving trade or commerce (other than import trade or import commerce) with foreign nations unless (1) such conduct has a direct, substantial, and reasonably foreseeable effect (A) on trade or commerce which is not trade or commerce with foreign nations, or on import trade or import commerce with foreign nations; or (B) on export trade or export commerce with foreign nations, of a person engaged in such trade or commerce in the United States; and (2) such effects give rise to a claim under the provisions of [the Sherman Act].

the burden of persuasion at the outset to prove the court is allowed to hear the case.[41] Furthermore, at any time the court's power to hear the case may be raised again by a judge or the defendants to dismiss the suit.[42] As an elemental statute, however, plaintiffs must only win the argument once, at the motion to dismiss stage. [43] Additionally, as an elemental statute, plaintiffs get the benefit of procedural rules requiring the court to accept the facts alleged in the complaint as true when arguing their case at the motion to dismiss stage.[44] In *Minn-Chem*, the Seventh Circuit, citing recent Supreme Court precedent, first reversed its previous decision in *United Phosphorous* and held the FTAIA is an elemental, not a jurisdictional, statute.[45]

From a potential plaintiff or defendant's position, the decision means the FTAIA does not provide a shortcut out of court for foreign firms accused of anticompetitive conduct that affects the United States. Coming from a court known for the quality of its antitrust decisions (Judges Easterbrook and Posner, two of the leading antitrust jurists in the country, sat on the *en banc* panel and joined Judge Wood's opinion), the Seventh Circuit's interpretation is likely to hold significant persuasive authority with the other U.S. circuits.

Direct Effect

However, deciding the FTAIA is not a jurisdictional statute did not end the inquiry. The true impact of *Minn-Chem* is likely the way the Seventh Circuit interpreted "direct, substantial, and reasonably foreseeable."[46] In adopting the Justice Department's suggested interpretation and breaking with the Ninth Circuit,[47] the *Minn-Chem* court solidified a circuit split, virtually guaranteeing plaintiffs seeking to sue foreign importers will file their cases in Chicago rather than San Francisco. The split also may force the Supreme Court to step in and resolve the issue at some point in the near future.[48]

The entire case hinged on the definition of "direct." The foreign companies in *Minn-Chem* argued that their allegedly anticompetitive behavior did not cause prices to rise in the United States as an "immediate consequence," the standard adopted by the Ninth Circuit.[49] Citing Congressional intent and the presence of the qualifying words "substantial" and "foreseeable" in the statute, the *Minn-Chem* court rejected the Ninth Circuit's definition and instead adopted the definition urged by the Justice Department: a

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[41] *See* Fed. R. Civ. P. 8(a)(1) (requiring a statement of the court's jurisdiction be part of all pleadings before a federal court).

[42] *Id.* at 853.

[43] *Id.*

[44] *Id.*

[45] *Minn-Chem*, 683 F.3d at 852.

[46] 15 U.S.C. § 6a (1)(A).

[47] *See United States v. LSL Biotechs*, 379 F.3d 672, 680 (9th Cir. 2004) (defining direct effect in the context of the FTAIA as "an immediate consequence of the defendant's activity).

[48] Indeed, shortly after the *en banc* judgment was filed, the potash defendants asked the court to stay the judgment pending a petition of certiorari to the Supreme Court.

[49] *See United States v. LSL Biotechs*, 379 F.3d 672, 680 (9th Cir. 2004).

"reasonably proximate causal nexus".[50] On such a definition, the entire complexion of *Minn-Chem* (and future foreign antitrust cases) changed.

Rather than demanding an "immediate consequence," the causal nexus test takes a much broader, contextual view of foreign anticompetitive behavior. It is debatable, at best, whether an increase in potash prices in China and India would immediately cause an increase in U.S. prices. However, the Seventh Circuit found it eminently reasonable that such an increase was the proximate causal nexus leading to increased costs in the U.S. import market, thus bringing the foreign defendants' behavior within reach of the Sherman Act.[51]

The court similarly dispensed with the foreseeable and substantial requirements by noting the millions of tons imported by U.S. purchases were substantial under any metric and, based on previous experience and the use of benchmarks in other industries (such as the London LIBOR rate for the banking industry), the effect on U.S. prices was reasonably foreseeable.[52]

Sherman's Long(er) Arm

Minn-Chem is a relatively clear case that can have far reaching consequences. The Complaint alleged numerous instances of anticompetitive conduct that would have most likely raised the ire of U.S. authorities had such conduct been engaged in domestically. However, in expanding the reach of the Sherman Act to conduct that, admittedly, was undertaken *entirely* overseas, *Minn-Chem* could potentially grant the Department of Justice and the FTC significantly more authority over foreign companies hoping to do any business with the United States.

Entirely foreign actions with only tangential links to the United States will still remain beyond the reach of the Sherman Act.[53] However, cartels operating globally that wish to engage in import commerce in the United States will have to carefully consider if their actions overseas could have a proximate causal nexus to effects in the United States; if the nexus exists, the cartel will have to consider the potential for U.S. antitrust liability based on such conduct.

Notably, the Seventh Circuit's decision does nothing to affect the Ninth Circuit's interpretation of the statute, meaning cases filed in the Ninth will continue to be subject to the "immediate consequence" requirement. There is no telling if or when the Ninth may reevaluate its stance, but veteran court watchers are not holding their breath.[54]

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[50] *Minn-Chem*, 683 F.3d at 856-57.

[51] *Id.* at 859-60 (citing examples of benchmarks causing global changes in price in multiple industries and finding those benchmarks analogous to that used by the potash cartel).

[52] *Id.* at 859.

[53] *See F. Hoffman-La Roche, Ltd. v. Empagran S.A.*, 542 U.S. 155, 159 (2004) (dismissing foreign purchasers' Sherman Act claim based on foreign conduct).

[54] On September 24, 2012, Global Competition Review reported that Uralkali, the world's largest potash producer, become the first company to settle the class action lawsuits, agreeing to pay $10 million and $2.75 million

The FTC Goes Retro to Win Down South

The Federal Trade Commission (FTC) scored a victory in the Eleventh Circuit this summer when the court upheld a divestiture order based on violations of the Clayton and FTC Acts.[55] As if the FTC winning an Eleventh Circuit decision was not rare enough,[56] the court relied on several cases[57] and methods thought by some antitrust practitioners to be merely quaint anachronisms.[58] The lessons are clear: documents can still provide a smoking gun for regulators; merging to create a monopoly is still very tough to justify; and post-merger remedies can be draconian. The case is *Polypore International, Inc. v FTC*.

THE LESSONS IN THE FTC'S RECENT ELEVENTH CIRCUIT VICTORY ARE CLEAR: BAD DOCUMENTS TRUMP ECONOMIC THEORY; IT IS VERY DIFFICULT TO JUSTIFY MERGING TO MONOPOLY; POST-MERGER REMEDIES CAN BE DRACONIAN; AND DIVESTITURE IS A POTENT AND REALISTIC THREAT.

Bringing Separators Together

If you own a car, you probably have something made by Polypore. Polypore makes battery separators. Without separators, a battery would short circuit or be unable to regulate the flow of electricity. In 2007, there were three companies that made battery separators for use in North America: Polypore, Microporous, and Entek. The FTC identified three major types of battery separators at issue: deep cycle, used in products like golf carts; motive, used primarily in industrial machinery; and starter-lighter-ignition, or SLI, used in car, truck, and other automotive starter batteries.[59] Polypore and Microporous split the deep cycle and motive markets,[60] while Polypore and Entek split the much larger SLI market.[61]

Smoking Guns

Starting in the early 2000s, Microporous geared up to enter the SLI market, causing Polypore to view Microporous as a "real threat."[62] Polypore responded by locking major

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respectively to end litigation brought by classes of direct and indirect purchasers. *See* http://www.globalcompetitionreview.com/news/article/32349/potash-litigation-delivers-first-settlement/

[55] *Polypore Int'l, Inc. v. FTC*, 686 F.3d 1208 (11th Cir. 2012).

[56] The Eleventh Circuit has been something of a house of horrors for the FTC in recent years. *See*, *e.g.*, *FTC v. Watson Pharma*., 677 F.3d 1298 (11th Cir. 2012) (affirming dismissal of an FTC enforcement action); *FTC v. Phoebe Putney Health Sys., Inc*., 663 F.3d 1369 (11th Cir. 2012) (same); *FTC v. Hosp. Bd. of Dirs. of Lee Cnty*., 38 F.3d 1184 (11th Cir. 1994).

[57] Polypore, 686 F.3d at 1213 (citing United States v. Phila. Nat'l Bank, 374 U.S. 321 (1963)); *Id.* at 1213-14 (citing *United States v. El Paso Natural Gas*, 376 U.S. 651); *Id.* at 1214, 1217 (citing *Brown Shoe Co. v. United States*, 370 U.S. 294 (1962)).

[58] *See* Robert H. Lande, *Resurrecting Incipiency: From* Von's Grocery *to Consumer Choice*, 68 Antitrust L.J. 875, 888 (2001) (noting courts "have usually ignored" the incipiency doctrine established by *Brown Shoe* and *Phil. Nat'l Bank*).

[59] Matter of Polypore Int'l, Inc., F.T.C 9327 at 2-3 (2010). A fourth category, uninterrupted power supply separators ("UPS"), was initially identified by the FTC Complaint, but the full Commission found UPS separators were not affected by the merger. *Id.* at *23.

[60] *Polypore*, 686 F.3d at 1211. Polypore had 90 percent of the motive market with Microporous making up the other 10 percent; the reverse was true in the deep cycle market. *Id.*

[61] *Id*. Polypore had 48 percent of the market and Entek had 52 percent. *Id.*

[62] *See Id.* at 1212.

customers into exclusive contracts and evaluating options to acquire Microporous.[63] Internal documents revealed just how real a threat Polypore believed Microporous to be.

For instance, one Polypore sales associate wrote to tell a colleague that Polypore should be prepared to push for premium prices where Microporous was not able to compete.[64] A Polypore board presentation outlined how far the company's earnings would fall if it did *not* acquire Microporous and how much prices and profits would rise *with* the acquisition.[65] Perhaps worst of all, the same Board presentation listed the ability to "implement price increase[s] to non-contract" customers as a benefit of the proposed merger.[66] Needless to say, such documents rendered it virtually impossible for Polypore to argue later that the acquisition was designed to help consumers.

In 2008, Polypore bought Microporous for $76 million.[67] The merger did not require notification under the Hart-Scott-Rodino Act,[68] so the merger went through without pre-clearance from the FTC.[69] Six months later, the FTC issued an administrative complaint, alleging that the acquisition substantially lessened competition in the three major battery separator markets.[70] An Administrative Law Judge (ALJ) found in the FTC's favor and ordered Polypore to divest itself of all the former Microporous assets, effectively turning back the clock to before the merger.[71] The full Commission affirmed the ALJ's decision.

You Can't Have it Both Ways

Polypore appealed the ruling to the Eleventh Circuit, arguing the Commission had relied on outdated case law, used the wrong market definition, and that the divestiture order was too broad.[72] A unanimous Eleventh Circuit panel agreed with the Commission, and affirmed.

The crux of the legal argument was whether the Commission correctly found that Microporous was Polypore's competitor in the SLI market.[73] Polypore tried to argue Microporous was merely a potential competitor, not an actual competitor. That's important, because if Microporous was merely a potential competitor, different legal presumptions should have applied. Polypore's documents proved otherwise.

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[63] *Id.* at 1212-13.

[64] Matter of Polypore, F.T.C 9327 at 28 (2010).

[65] *Id.* at 30.

[66] *Id.*

[67] Matter of Polypore, F.T.C 9327 at 2 (2010).

[68] *Id.* at 2 n.3.

[69] *Id.* at 1-2.

[70] *Polypore*, 686 F.3d at 1212-13. Two other charges were addressed in an administrative hearing, but neither was appealed to the 11th Circuit.

[71] *Id.* at 1213.

[72] *Id.*

[73] *See Id.*

Although the Eleventh Circuit did not go in to as much cringe-inducing detail[74] as the Commission, the court's opinion is clear. Among the choice quotations the judges used is this one: "The president of Daramic [Polypore's battery separator division] put Microporous at the top of his list of potential acquisitions *to eliminate price competition*."[75] Although there is no intent element under section 7 of the Clayton Act, there is little doubt quotations in ordinary course of business documents like that one hurt Polypore's case. Moreover, the FTC had evidence that Polypore actually *did* raise prices after the merger.[76]

In relying on two Supreme Court decisions from the 1960s (*Philadelphia National Bank*[77] and *El Paso Natural Gas*[78]), the Eleventh Circuit made a strong point: the modern economy still has to play by the established rules. *Philadelphia National Bank* was one of the first cases to lay out the "incipiency doctrine" where the Supreme Court held Congress intended the Clayton Act "to arrest anticompetitive tendencies in their incipiency."[79] The case (and the doctrine) means there is a presumption that a merger between two competitors in a market that is already highly concentrated will harm consumers. The presumption can be rebutted by introducing merger specific precompetitive efficiencies, but that can be uphill fight in a merger to a duopoly or monopoly, as was the case in *Polypore*.

In *El Paso Natural Gas*, the Supreme Court stopped a merger between El Paso and Pacific Northwest Pipeline Corp., a company El Paso viewed as a potential threat.[80] The Supreme Court analyzed the case under the incipiency doctrine even though Pacific Pipeline had not sold any natural gas in California (the relevant market) and therefore, according to El Paso, not an actual competitor.[81] The Supreme Court disagreed, noting that Pacific Pipeline had unsuccessfully bid for business against El Paso, had plans to enter the California market and would have had opportunities to enter if it had remained independent. "Unsuccessful bidders are no less competitors that the successful one," remarked the Court.[82] Such a merger was presumptively unlawful under *Philadelphia*

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[74] Prior to the acquisition, the FTC noted Polypore had created the "MP Plan" to combat Microporous' entry into the market. Matter of Polypore Int'l, Inc. F.T.C. 9327 at 28 (2010). Polypore executives discussed, in writing, the advantages and disadvantages of a merger, stating "Microporous may continue [its] plans for a second line resulting in either our loss of current customers or further reduction in our market pricing." *Id.* at 29. A vice president's statement that Microporous "represented a threat to [Polypore] for the future ... Their first [assembly] line cost us [redacted] year, in price concession and loss of business. The second line could cost us another [redacted]." *Id*. Polypore even gave its acquisition project the codename "Titan." *Id.* "Titan" is also the title of the bestselling biography of noted oil monopolist John D. Rockefeller.

[75] *Polypore*, 686 F.3d at 1212 (emphasis added) (internal quotation marks omitted). Internal company documents also noted that failing to acquire Microporous would cause Polypore to "lower prices by [redacted] beginning in 2008" in response to Microporous' competition. Matter of Polypore Int'l, Inc., F.T.C 9327 at 30 (2010).

[76] Matter of Polypore Int'l, Inc., F.T.C 9327 at 30-31 (2010).

[77] 374 U.S. 321 (1963).

[78] 376 U.S. 651 (1964).

[79] *Polypore*, 686 F.3d at 1213 (*quoting Phila. Nat'l Bank*, 374 U.S. at 362).

[80] *Id.* at 1214.

[81] *Id*.

[82] *United States v. El Paso Natural Gas*, 376 U.S. 651, 661 (1964).

National Bank because the California market was already highly concentrated and therefore the merger created a "tendency to monopoly."[83]

The Eleventh Circuit found Polypore's situation almost identical to the merger in *El Paso*. Even though Microporous had not yet sold a single SLI separator, the Eleventh Circuit found the potential threat Microporous posed was enough to make the two companies direct competitors. The court relied on evidence that Polypore's customers bargained for lower prices by threatening to buy from Microporous[84] and that prices rose after the merger.[85]

Some practitioners may have thought that *Philadelphia National Bank* and its progeny had fallen into disfavor in recent years as antiquated and reflecting outdated economics. Yet, the Eleventh Circuit's use of the incipiency doctrine here was a clear signal that those old cases are still "good law." The court's decision tells businesses and the FTC, that if a business wants to merge into a monopoly, it better have a very good story as to why that merger will help consumers. Since Polypore's documents said one of this merger's benefits was the ability to raise prices, this case may have been doomed at the outset.

Considering very few antitrust cases make it to trial, the question remains: why did Polypore fight? The answer may have been in the remedy. The court found the FTC had wide latitude to fashion an appropriate remedy and here the divestiture order was reasonable.[86] Classic antitrust doctrine states divestiture is nearly always the preferred remedy, since the goal is to "restore competition lost through the unlawful acquisition."[87]

For Polypore, that meant having to sell off the Microporous assets, and license intellectual property Polypore used at the acquired sites *after* the merger.[88] The Commission reasoned (and the court agreed) that it would be unfair to a potential buyer to be forced to remove any improvements Polypore made to the Microporous facilities.[89] As a result, Polypore lost its acquisition and, in the process, made its competitor more effective.

So What?

Polypore is at least a cautionary tale. It might also be the proverbial canary in the coal mine.

First, it reminds us that bad documents can still trump economic theory. It may have been possible for Polypore to make an efficiency case for the merger. We'll never know,

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[83] *Id.* at 661-62; *Polypore*, 686 F.3d at 1214.

[84] *Polypore*, 686 F.3d at 1215.

[85] *Id.*

[86] *Id.* at 1218.

[87] Matter of Polypore, F.T.C 9327 at 37 (2010) (citing, *inter alia*, *Ford Motor Co. v. United States*, 405 U.S. 562, 573 n.2 (1972)).

[88] *Id.* at 41.

[89] *Id.* at 42.

because it seems apparent that neither the Commission nor the Eleventh Circuit wanted to look past the dozens of company memos that talked about using the acquisition to raise prices.

Second, it means *Philadelphia National Bank* is still the law of the land. The Eleventh Circuit did something courts have been doing for years: it shifted the burden of proof to the merged company after the government established a probability of anticompetitive effects. Since the FTC challenged this merger *after* it happened, it had evidence that Polypore increased prices post-merger.[90] Between the pre-merger documents claiming Polypore could raise prices and the post-merger evidence of actual price increases, the court was left with little to decide.

Finally, divestiture is still a potent and realistic threat. It is fitting that the Polypore-Microporous merger closed on February 29, a day that usually doesn't exist. The FTC's order made the entire merger cease to exist and brought back the status quo ante, except now Polypore will presumably face a more efficient rival.

Whether *Polypore* is an anomaly or a harbinger remains to be seen. As we have previously written, the FTC is becoming more aggressive in evaluating mergers, even after they have been consummated. A revitalized incipiency doctrine would force businesses to be more cautious in analyzing mergers, and the specter of divestiture still hovers over every enforcement action. It may be retro, but *Polypore* tells us those old cases have some life in them.

7th Circuit Clarifies Standing to Challenge "Interlock" Violations

SEVENTH CIRCUIT RULES THAT IN ORDER TO SUE FOR AN INTERLOCK VIOLATION, A PLAINTIFF MUST SHOW SHE WAS HARMED BY THE DECREASE IN COMPETITION IT CAUSED.

Company shareholders do not suffer "antitrust injuries" because of an alleged violation of Section 8 of the Clayton Act,[91] prohibiting officers and directors from serving on the boards of competing corporations, according to a new Seventh Circuit decision in *Robert F. Booth Trust v. Crowley*.[92] The decision was authored by Chief Judge Frank H. Easterbrook, a widely respected antitrust jurist, and joined by Judge Richard A. Posner, another antitrust heavyweight.

Standing, or the ability to bring suit, is often an issue in private antitrust suits, particularly when the interlock prohibition is involved. Under a long line of Supreme Court precedent, a plaintiff has to suffer an "antitrust injury" to have standing to sue under the antitrust laws. Antitrust injury means "injury of the type the antitrust laws were intended to prevent and that flows from that which makes defendants' acts unlawful."[93] Stated more plainly, the plaintiff has to be hurt by the *decrease* in competition wrought by the antitrust

[90] Matter of Polypore, F.T.C 9327 at 30 (2010); *Polypore*, 686 F.3d at 1215.

[91] Codified as amended at 15 U.S.C. § 19. Individuals and corporations may not simultaneously serve as an officer or director of two corporations if the corporations are competitors such "the elimination of competition by agreement between them would constitute a violation of any of the antitrust laws." *Id*. at § 19(a)(1)(B).

[92] No. 10-3285, 2012 WL 2126314 (7th Cir. June 13, 2012).

[93] *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc*., 429 U.S. 477, 489 (1977).

violation, as opposed to an increase in competition. What constitutes such an injury was the central issue in *Booth*.

The dispute arose after two retail giants, Sears and K-Mart, merged in 2005.[94] The merged entity took on directors from both companies, including William C. Crowley and Ann N. Reese. Crowley was simultaneously a director of AutoNation, Inc. and AutoZone, Inc., while Reese was simultaneously a director of Jones Apparel Group, Inc.[95] The plaintiffs claimed that Crowley and Reese were in violation of Section 8 of the Clayton Act,[96] which prohibits interlocking directorships, because the merged company was in direct competition with AutoNation, AutoZone, and Jones Apparel in the automotive and apparel markets, respectively. Neither the Federal Trade Commission nor the Department of Justice had raised such a claim when the *Booth* suit was filed,[97] nor apparently during the investigation of the merger. Instead, two of the merged company's shareholders filed a derivative action[98] against the corporation based on the alleged antitrust violation.

In a strongly worded opinion, the Seventh Circuit threw the shareholders out of court.[99] Citing to *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*,[100] the Seventh Circuit found the shareholders, as investors in the merged company, could not suffer an antitrust injury because they would presumably *benefit* from the alleged violation.[101] Even if the violation caused harm to competition, Judge Easterbrook reasoned, it would have helped Sears by, presumably, allowing it to charge higher prices or lower output.[102] In so far as Sears was benefited, the plaintiffs, as shareholders of the company, would also benefit from the purported illegal conduct.

As Judge Easterbrook explained, *Brunswick* stands for the proposition that antitrust laws protect against a specific kind of injury. In the case of an interlock violation, the law is designed to prevent harm caused by interlocking directors presumably working to limit competition between the two companies for which they serve. For example, if Suzy Smith serves on the Board of two competing widget manufacturers, Smith would be in a position to facilitate price fixing and other anticompetitive practices by virtue of her position. Therefore, Smith cannot serve on both widget boards at the same time. To suffer an antitrust injury from an interlock violation, a plaintiff has to prove he was harmed

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[94] 2012 WL 2126314 at *1.

[95] *Id.*

[96] 15 U.S.C. § 19.

[97] *Booth*, 2012 WL 2126314 at *1.

[98] In a derivative action, shareholders sue the Board of Directors in the name of the corporation, typically alleging the Board has breached a duty owed to the corporation and its shareholders. In effect, a derivative action involves a company suing itself.

[99] *Id.* at *3 ("[T]his litigation is so feeble that it is best to end it immediately").

[100] 429 U.S. 477 (1977).

[101] *Id.* at *1-2.

[102] *Booth*, 2012 WL 2126314 at *1

by the decrease in competition caused by the interlock, e.g., a purchaser of the widget whose price was fixed.

In *Brunswick*, the plaintiff who initiated the suit was a competitor of the company that allegedly broke the antitrust laws.[103] The plaintiff argued that because the defendant acquired several failing bowling alleys to keep them open, the plaintiff lost profits it would have gained if the alleys had been forced to close.[104] The Court held that the defendant were entitle to judgment because the plaintiff did not suffer an antitrust injury. Specifically, the plaintiff had not suffered the type of harm the antitrust laws are designed to prevent -- harm from lessened competition. Instead, the plaintiff was harmed by an increase in competition, or, at least, maintenance of the status quo which was a competitive market.[105]

Comparing *Booth* to *Brunswick*, Judge Easterbrook drew some parallels. In *Brunswick*, the plaintiffs complained they were not allowed to benefit from decreased competition. In *Booth*, the suing shareholders alleged they were, in effect, being forced to benefit from decreased competition. Like the plaintiffs in *Brunswick*, Judge Easterbrook held that the *Booth* plaintiffs had not suffered an antitrust injury because the presumed harm to competition would benefit them as shareholders, even if it ostensibly harmed competition.[106]

The court was unequivocal in its holding, stating “the perpetrators of antitrust offenses lack standing to complain about their own misconduct.”[107] The court also appeared to admonish the attorneys involved in the suit, saying when such perpetrators “do invoke the antitrust laws, likely they have other objectives in view.”[108] In the court’s view, those “other objectives” included the nearly $1 million in attorney’s fees the plaintiff’s lawyers stood to collect from a proposed settlement.[109]

The *Booth* decision has two important lessons for corporations. First, it reaffirms that Section 8 of the Clayton Act can and will be enforced. Although the FTC had not warned the Sears/K-Mart merged entity that it could be violating Section 8, the viability of a potential government claim was never disputed by the court.[110] In any merger, *Booth* serves as a reminder that the Board of the newly constituted company must be examined

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[103] Brunswick at 479.

[104] *Id.* at 480-81.

[105] *Id.* at 488. Compare *Reading International, Inc. v. Oaktree Capital Management LLC*, 317 F. Supp.2d 301 (S.D.N.Y. 2003) (competitor excluded from the market had standing to complain that two movie circuits, AMC and Regal, controlled, in part, by a private equity company with a person on the boards of both companies, had monopolized first run films in violations of Sherman Act Sec. 1 & 2 and violated Sec. 8.)

[106] *See Booth*, 2012 WL 2126314 at *1-2.

[107] *Id.* at *1.

[108] *Id.*

[109] *Id.* at *3 (“The only goal of this suit appears to be fees for the plaintiffs’ lawyers.”).

[110] Judge Easterbrook did note that the government often gave alleged violators an opportunity to cure the issue before initiating an enforcement action. *Booth*, 2012 WL 2126314 at *4. In this case, the two offending directors voluntarily extinguished their conflicts.

for potentially anti-competitive interlocks. We have extensive resources pertaining to evaluating interlock concerns available.

Second, *Booth* reaffirms prior precedent and helps to clarify a recurring problem in interlock litigation: who, exactly, the law is designed to help. The plaintiffs in *Booth* tried to argue the mere potential that the government would institute an enforcement action was a sufficient injury, but the Seventh Circuit flatly rejected that argument. Rather, the court was clear that in order to be harmed by an interlock violation, a plaintiff must prove she was harmed by the decrease in competition stemming from the interlock. Shareholders in a company alleged to be violating the interlock provision cannot, as a matter of law, suffer such an injury *as investors*, because their investment would presumably benefit from the violation. Therefore, shareholders would seem to almost never have standing to raise a suit based on an interlock violation, at least in a derivative action.

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