



MORGAN LEWIS ON COMPETITION

A NEWSLETTER FROM THE ANTITRUST PRACTICE ■ www.morganlewis.com

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COURT OF APPEALS RULES ANTITRUST LAWS APPLY TO UNDERWRITING

IS SECURITIES FRAUD NOW ACTIONABLE UNDER THE ANTITRUST LAWS? — By Jonathan M. Rich

The Second Circuit Court of Appeals recently decided that antitrust laws apply to underwriter syndicates.

The plaintiffs alleged that prominent underwriters and institutional investors reached agreements that inflated the price of securities after their initial offering to the public. Specifically, the defendants, who controlled the opportunity to purchase securities, purportedly demanded commitments to purchase securities in subsequent offerings or in the aftermarket, or a share of the profits from the anticipated IPO “pop.”

The decision runs counter to a trend in recent years to limit application of the antitrust laws in the securities markets. Under the doctrine known as “implied repeal” or “implied immunity” courts have found that SEC regulation preempts application of the antitrust laws. In one recent case involving equity options, a different panel of the same court found that the antitrust laws did not apply to an alleged agreement among the exchanges, even though the SEC had banned similar agreements, because the Commission could have permitted them. Here, the court wrote that “we do not agree that . . . the authority to

permit, alone, will establish that a statute has impliedly repealed the antitrust laws.”

The court found that in this case, the antitrust laws would not conflict with the securities laws because Congress, when it established the securities laws in the 1930s, intended to prevent (among other abuses) manipulation of IPO markets. Unlike every other case in the Second Circuit or Supreme Court that found implied repeal, the SEC had never authorized the behavior in question or (as the Justice Department wrote in arguing for reversal) “even considered doing so.”

We are concerned that this opinion will encourage the plaintiffs’ bar and the Antitrust Division of the Department of Justice to argue that the antitrust laws apply to securities fraud and to seek treble damages. For more information on this opinion and on how to avoid antitrust problems, please contact Jonathan M. Rich (jrich@morganlewis.com), John H. Shenefield (jshenefield@morganlewis.com), Willard K. Tom (wtom@morganlewis.com), Scott A. Stempel (sstempel@morganlewis.com) or Harry T. Robins (hrobins@morganlewis.com). ■

A PAINFUL INVESTMENT:

FTC FINES HEDGE FUND MANAGER \$350,000 FOR HSR ACT VIOLATIONS — By Harry T. Robins and Alexis J. Gilman

The Federal Trade Commission recently accused a hedge fund manager of twice violating the Hart-Scott-Rodino Act by failing to report to the FTC and Department of Justice when his fund bought more than \$50 million of stock in a company. The hedge fund manager, Scott Sacane, agreed to pay a \$350,000 fine.

Mr. Sacane got into trouble when his fund, Durus Life Science Master Fund, acquired stock in Aksys Ltd. and Esperion Therapeutics, Inc. Master Fund’s purchases pushed Mr. Sacane’s stock holdings in Aksys and Esperion over several HSR thresholds, including the basic threshold of \$50 million of voting securities.

The HSR Act required Mr. Sacane and the other parent of Master Fund, Durus Life Science Fund, LLC, to file notices with the FTC and Department of Justice prior to buying the stock because they “controlled” Master Fund for HSR purposes. Mr. Sacane, however, did not file notices until long after Master Fund acquired \$85 million (50.1%) of Aksys stock and \$102.3 million (33%) of Esperion stock. Mr. Sacane’s late filing violated the HSR Act for 799 days with respect to the Aksys stock purchases and 771 days with respect to the Esperion stock purchases. Because the HSR Act allows fines of \$11,000 per day of violation, the FTC could have demanded \$17.27 million.

(continued on page 4)

ARTICLES IN THIS ISSUE

- 2 APPEALS COURT DECISION IN *THREE TENORS* CASE LEAVES POLYGRAM SINGING THE BLUES
- 2 EUROPE’S COURT OF FIRST INSTANCE UPHOLDS EUROPEAN COMMISSION MERGER DECISION
- 3 SUPREME COURT TO CONSIDER JOINT VENTURE STANDARDS IN *DAGHER V. SHELL OIL CO.*
- 3 MERGER WATCH: HANDING OUT “BLANK CHECKS” AT THE DEPARTMENT OF JUSTICE? UNIQUE AGREEMENT ALLOWS MERGING PARTIES TO CLOSE PENDING FURTHER INVESTIGATION AND SUBJECT TO BROAD REMEDY
- 4 RECENT AND UPCOMING EVENTS
- 5 MORGAN LEWIS PARTNER DONALD C. KLAWITER NAMED CHAIR OF THE SECTION OF ANTITRUST LAW OF THE ABA
- 5 CHIEF JUSTICE JOHN ROBERTS ON ANTITRUST

Morgan Lewis

C O U N S E L O R S A T L A W

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APPEALS COURT DECISION IN *THREE TENORS* CASE LEAVES POLYGRAM SINGING THE BLUES — By Randall Conner

The D.C. Circuit Court of Appeals upheld the Federal Trade Commission's decision that PolyGram N.V. and its joint venture partner, Warner Communications, Inc., violated the antitrust laws when they agreed to curtail marketing Three Tenors albums in an effort to promote sales of a new, jointly marketed Three Tenors album (please see the October 2003 edition of *Morgan Lewis On Competition* for our analysis of the FTC's decision).

This action arose out of a joint venture between PolyGram and Warner to distribute a recording of a new Three Tenors concert in July 1998. The Three Tenors — Jose Carreras, Plácido Domingo, and Luciano Pavarotti — had previously performed together in 1990 and 1994; recordings of those concerts remain among the most successful classical music albums of all time. PolyGram held the rights to the 1990 recording and Warner held the rights to the 1994 recording.

Under the joint venture agreement, Warner would distribute the 1998 album in the United States while PolyGram would distribute it to the rest of the world, with the firms sharing equally any profits or losses on the project. The joint venture agreement provided that each company remained free to pursue its own marketing strategy for its earlier Three Tenors album.

The parties later agreed, however, to suspend advertising and discounting of the 1990 and 1994 Three Tenors albums leading up to the release of the 1998 album. The parties reaffirmed these commitments when the Three Tenors announced that the repertoire for the 1998 concert would substantially overlap the 1990 and 1994 concerts. The FTC found that this agreement ran afoul of the antitrust laws.

The *Three Tenors* case was significant because the FTC revived — and the D.C. Circuit has now approved — the analytical framework the FTC announced in the *Massachusetts Board of Optometry* case. Under this framework, the FTC presumes that a restraint on competition has unreasonably harmed competition when the restraint “appears likely, absent an efficiency justification, to restrict competition and decrease output.” When the FTC finds such a restraint, it requires the defendant to offer a plausible procompetitive justification for the restraint. The FTC performs a full rule of reason analysis only if the defendant offers such a justification.

The D.C. Circuit's decision upheld the FTC's analysis in these material respects:

- The court affirmed the FTC's analytical framework, finding that modern Supreme Court case law favors a competitive effects inquiry “tailored to the suspect conduct in each particular case.” The court rejected PolyGram's argument that “proof of actual anticompetitive effect (or market power as its surrogate) is required in *any* Rule of Reason case.”
- The court agreed with the FTC that the parties' agreement not to promote the earlier albums was “inherently suspect,” finding that “[a]n agreement between joint venturers to restrain price cutting and advertising with respect to products not part of the joint venture looks suspiciously like a naked price fixing agreement between competitors, which would ordinarily be condemned as per se unlawful.”
- The court also agreed that the parties' alleged procompetitive justification — the elimination of free-riding on efforts to

promote the 1998 album — was not legally cognizable because the only free-riding the parties sought to eliminate was “nothing more than the competition of products that were not a part of the joint undertaking.” Thus, the parties' procompetitive justification amounted to an argument that competition itself was undesirable, which the Court characterized as “nothing less than a frontal assault on the basic policy of the Sherman Act.”

For better or worse, the Three Tenors decision clarifies the circumstances in which joint venture participants can agree to curtail their own competitive activities for the benefit of the joint venture. The D.C. Circuit agreed with the Commission's underlying premise, noting that “if the only way a new product can be introduced is to restrain legitimate competition of older products, then one must seriously wonder whether consumers are genuinely benefited by the new product.”

Of course, single firms often limit their efforts to promote older products to help newer products gain a foothold in the market. In the joint venture context, an agreement to limit competition from older products controlled by the joint venture partners might reduce opportunistic behavior by a partner that would hurt the joint venture's products (and the other firm's older products). The Three Tenors decision will severely limit joint venture partners' ability to prevent this opportunistic behavior and may therefore deter firms from entering into procompetitive joint ventures.

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EUROPE'S COURT OF FIRST INSTANCE UPHOLDS EUROPEAN COMMISSION MERGER DECISION — By Jonathan N. T. Uphoff

On September 21, 2005, the Court of First Instance (“CFI”), the European Union's second-highest court, upheld the European Commission's decision to block a proposed joint acquisition of Gás de Portugal (“GDP”) by the Portuguese incumbent electricity company, Energias de Portugal (“EDP”), and an Italian energy company, Eni SpA.

The CFI's decision upholds the first Commission decision to block a merger since the CFI overturned three of the Commission's merger decisions in 2001. The CFI agreed that the merger would strengthen EDP's position in the relevant electricity supply markets, even

taking certain proposed remedies into account. However, the CFI also rejected several elements of the Commission's analysis.

First, the CFI held that the Commission erred as a matter of law in concluding that the acquisition would strengthen GDP's dominant position in gas supply markets and would significantly impede effective competition. GDP held a monopoly in its gas supply markets by virtue of the national legislative framework permitted by the Second Gas Directive. The CFI concluded that the acquisition could not strengthen a dominant position beyond a monopoly

protected by regulation. Nor, when regulation did not permit competition, could the acquisition significantly impede effective competition.

Second, the CFI rejected the Commission's position, set out in its Notice on Remedies, that parties who submit proposed remedies must demonstrate that they address the Commission's concerns. The CFI held that the Commission must prove the proposed remedies inadequate to safeguard competition. The CFI also held that the Commission must examine proposed

(continued on page 4)

SUPREME COURT TO CONSIDER JOINT VENTURE STANDARDS IN *DAGHER V. SHELL OIL CO.* — *By J. Clayton Everett, Jr.*

Are pricing decisions by economically integrated joint ventures per se illegal? The Supreme Court will consider that question this term in *Dagher v. Shell Oil Co.*

The *Dagher* case reviewed a challenge to the pricing practices of two joint ventures among Shell Oil Co., Texaco, Inc. and Saudi Refining, Inc. (SRI) that combined the gasoline refining, marketing and sales assets of those companies. The venture partners retained their separate oil drilling and exploration assets and their own trademarks, but transferred the day-to-day operation of all “downstream” refining, marketing and sales activities to the joint ventures. The FTC and several state attorneys general reviewed the proposed joint ventures prior to their formation.

A putative class of independent service station owners sued the joint ventures and their owners, alleging that they overpaid for gasoline as a result of the joint ventures’ practice of setting a unified wholesale price for Shell gasoline and Texaco gasoline. Plaintiffs

contended that the ventures’ pricing activities constituted per se illegal price-fixing. They disclaimed reliance on any theory that would require a rule of reason analysis.

The district court granted defendants’ motion for summary judgment, concluding that it would not condemn the joint ventures’ activities on a per se basis because the joint ventures generated substantial economic efficiencies.

A divided Ninth Circuit panel reversed. The majority characterized the joint ventures’ pricing activities as “price fixing” and concluded that it would find those activities per se illegal unless defendants could establish that discretion to set a single price for both Shell and Texaco gasoline was “reasonably necessary” to achieve efficiencies.

The defendants appealed to the Supreme Court, arguing that the structure of the joint ventures precluded price competition among the joint venture partners. Therefore, the joint ventures’ pricing decisions could not amount to

price fixing. Put another way, the defendants argued that the Ninth Circuit improperly disaggregated the joint ventures’ pricing decisions from the joint ventures’ other activities. The Solicitor General and several other amici supported the defendants’ request for Supreme Court review of this issue.

The outcome of the Dagher case will have great significance for companies considering entering joint ventures. Defendants argued with some justification that the per se standard proposed by the Ninth Circuit will chill the formation of numerous procompetitive joint ventures in the future and call the activities of numerous extant joint ventures into question. The Supreme Court should decide the case next spring. Pending the Supreme Court’s decision, it remains clear that economically integrated joint ventures do not enjoy immunity from potential per se liability.

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MERGER WATCH: HANDING OUT “BLANK CHECKS” AT THE DEPARTMENT OF JUSTICE?

UNIQUE AGREEMENT ALLOWS MERGING PARTIES TO CLOSE PENDING FURTHER INVESTIGATION AND SUBJECT TO BROAD REMEDY — *By Alexis J. Gilman*

In a little-noticed action earlier this year, the Department of Justice (DOJ) revived an interesting approach to resolving concerns arising from proposed mergers. Practitioners have likened this seldom-used procedure to “writing a blank check.”

In February 2004, Connors Brothers agreed to acquire Bumble Bee. If Connors Brothers failed to close the transaction by April 30, 2004, Canadian law would require it to return funds raised in a subscription agreement to subscribers. Although the parties had not yet finalized the terms of the merger, Connors Brothers, Bumble Bee, and the DOJ agreed that the parties could close the deal on that day on the condition that they would divest up to three sardine snack brands if the DOJ determined that restoring competition eliminated by the merger required divestitures. Connors Brothers and Bumble Bee signed a Hold Separate Stipulation and Order and a proposed Final Judgment and the DOJ agreed that it would not file these documents until it completed its investigation. In its proposed final judgment filed April 18, 2005, the DOJ required Connors Brothers to divest only its Port Clyde sardine snack brand and certain related inventory and assets, and a processing plant.

For obvious reasons, parties to proposed mergers do not often grant the reviewing

agency unilateral discretion to amend the assets to be divested. Indeed, parties often take the near-opposite “fix it first” approach: early in the review process, they present the reviewing agency with a proposed divestiture package and a third party interested in buying the divestiture package. This initial offer often leads to negotiation with the reviewing agency regarding the contents of the package and the identity of the buyer, which occurs in parallel with other aspects of the reviewing agency’s investigation.

The reviewing agencies have not often commented publicly regarding the blank check approach. In a 1995 speech, then Federal Trade Commission (FTC) Bureau of Competition Director William Baer noted that the Commission had taken this approach in Hoechst AG’s acquisition of Marion Merrell Dow (Dow). The FTC allowed the transaction to proceed on the condition that Hoechst not exert control over Dow’s operations until the FTC completed its investigation. Hoechst committed itself to a broad settlement that provided relief in every market that the acquisition might impact. At the conclusion of the investigation, the FTC could impose all, part, or none of the settlement relief. According to Baer, the case showed the FTC’s “willingness to be flexible in its enforcement procedures and to permit the

early consummation of a transaction in appropriate circumstances.” Baer noted that the FTC would use the approach infrequently and only where the parties meet “tough standards” to ensure the preservation of competition.

Baer laid out three prerequisites: “First, the relevant markets must be easily defined. . . . Second, we must be able to determine with a high degree of specificity the kind of relief that would be appropriate for whatever kind of competitive harm we may find, as well as the maximum relief that might be necessary. . . . Third, the parties must be willing to give us something approaching a blank check for such remedies.”

True to Baer’s prediction, merging parties and reviewing agencies seldom agree that a “blank check” approach will best resolve antitrust concerns. However, assuming the appropriate facts and industry characteristics, *Bumble Bee and Hoechst* offer a model for a creative approach to closing a deal before the government has concluded its merger investigation.

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A Painful Investment: FTC Fines Hedge Fund Manager \$350,000 for HSR Act Violations

(continued from page 1)

In this case, Mr. Sacane appears to have fallen into at least three HSR Act traps for the unwary financial investor. First, he may not have realized (or cared) that he controlled Master Fund for HSR Act purposes. Second, he may have failed to aggregate the value of his holdings of Aksys and Esperion stock to determine whether the Master Fund acquisitions would cross the \$50 million size-of-transaction threshold. Finally, he may have failed to realize that the “investment-only” and “institutional-investor” exemptions did not apply to these transactions.

The investment-only exemption applies to an acquisition of 10% or less a corporation’s outstanding voting securities if the acquisition qualifies as a “passive” investment. The institutional-investor exemption applies to institutional investors’ stock acquisitions, but only where the investor will hold 15% or less of the outstanding voting securities. The HSR Act’s aggregation rule means that an investor cannot avoid HSR Act notice requirements by making separate acquisitions of a corporation’s stock when, in the aggregate, the acquired stock’s value exceeds the statutory threshold.

The antitrust authorities have made it clear that they will pursue civil penalties against investors who violate the HSR Act. In 2004 alone, the government obtained penalties of \$2 million, \$800,000, and \$1 million against Smithfield Foods, Bill Gates, and Manulife Financial Corporation, respectively, for HSR Act violations. In a press release announcing the Sacane settlement, FTC Bureau of Competition Director Susan Creighton said that this significant penalty “should put hedge funds, their managers, and securities traders on notice that they are not exempt from filing pre-merger notification forms.”

Hedge funds and other financial institutions that actively trade for house accounts (so-called proprietary trading) should pay close attention to the HSR Act’s reporting requirements. We note that the FTC fined Mr. Sacane for Master Fund’s acquisition of Esperion stock, even though Mr. Sacane’s total Esperion holdings amounted to a minority and passive stake in the company. Even experienced investors may do well to consult HSR counsel before buying and selling significant amounts of voting securities. Morgan Lewis has experienced HSR lawyers who can help investors cut through the HSR Act’s complex rules. Morgan Lewis also offers an on-line resource called HSRscan, which contains information about the HSR Act and its rules, and includes a table of other enforcement actions and penalties for violations of the HSR Act. Please visit our HSRscan page <<http://www.morganlewis.com/index.cfm/nodeID/DCD37B78-0A96-4939-B32E-798653B58665/fuseaction/content.page>> for more information.

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EUROPE’S COURT OF FIRST INSTANCE UPHOLDS EUROPEAN COMMISSION MERGER DECISION

(continued from page 2)

remedies submitted after the statutory deadline when the Commission can determine their sufficiency on the basis of the facts before it and when the Commission has sufficient time to consult with the Member States.

Third, the decision makes clear that the Commission’s Notices bind only the Commission and do not amount to statements of law. While U.S. lawyers may find this concept obvious,

European practitioners have been reluctant to take positions that diverge from Commission Notices, even where the Notices conflict with the language of the underlying Regulations.

This CFI decision may have far reaching effects on European merger practice. In upholding the Commission, the CFI cited the Commission’s finding that the proposed acquisition would remove a “significant potential competitor” as evidence of a significant impediment to effective competition. Although Regulation 4064/89 (now superseded by Regulation 139/2004) applied to the case, the Commission’s finding indicates that it may interpret the new Regulation’s “significant impediment to competition” test broadly. Practitioners will also note that the case, handled under the expedited procedure, took “only” seven months. EDP sought to avoid limits on the size and scope of pleadings by referring to arguments in an attached economists’ report, but the CFI refused to admit the report except for the passages cited in the pleadings.

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RECENT AND UPCOMING EVENTS

ANTITRUST MODERNIZATION COMMITTEE HEARINGS

2005

june

- 27 • Indirect Purchasers Actions

july

- 28 • Robinson-Patman Act
- Civil Remedies Issues

september

- 29 • The State Action Doctrine
- Exclusionary Conduct

november

- 3 • Enforcement Institutions (Federal) Issues
- Remedies (Government Civil Remedies) Issues
- Criminal Remedies issues
- 8 • New Economy Issues
- 9 • International Issues
- Immunities and Exemptions (Statutory and Noerr-Pennington) Issues

december

- 1 or 5 • Regulated Industries Issues
- Follow-up and summary hearings

2006

january and february

- tbd • Follow-up and summary hearings

The Federal Trade Commission will host the Antitrust Modernization Commission (AMC) hearings at its headquarters or conference center locations. Please see the AMC website at www.amc.gov for times and further details. As noted in the June 2005 edition of *Morgan Lewis On Competition*, John Shenefield (jshenefield@morganlewis.com), a partner in the Antitrust Practice in the Washington, D.C. office of Morgan Lewis, serves on the AMC as one of its 12 Commissioners. On September 29, Morgan Lewis partner Will Tom testified before the AMC regarding exclusionary conduct.

MORGAN LEWIS PARTNER , DONALD C. KLAWITER NAMED CHAIR OF THE SECTION OF ANTITRUST LAW OF THE AMERICAN BAR ASSOCIATION



Donald C. Klawiter, a Washington, D.C.–based partner in the Antitrust Practice of Morgan Lewis, was elected Chair of the Section of Antitrust Law of the American Bar Association. He became chair for a one-year term at the conclusion of the ABA’s Annual Meeting on August 9, 2005.

The Chair of the Section of Antitrust Law is responsible for setting the agenda for the Section; producing the Section’s programming, including the Annual Spring Meeting, five other programs and numerous teleseminars; overseeing the many publications of the Section, including *Antitrust Law Developments*, *Antitrust Law Journal*, *Antitrust Magazine*, *Antitrust Source* and many books; advocating the Section’s views on legislation, guidelines and other government initiatives in the United States and abroad; and directing various task forces and over 40 committees working on various antitrust and litigation issues.

Under Mr. Klawiter’s leadership, the Section will focus its attention on a number of important issues, including reform of the Hart-Scott-Rodino pre-merger review process; harmonization and development of international competition laws and procedures; articulating corporate governance guidelines as they relate to antitrust matters for corporations; working with U.S. and international organizations on international cartel enforcement issues; evaluating the use and value of economic evidence presented to judges and juries; and assisting the work of the Antitrust Modernization Commission (a congressionally formed organization) to review U.S. antitrust laws, with testimony, position papers and analysis based on the Section’s collective antitrust experience.

With over 9,000 members, the Section of Antitrust Law is the largest organization of competition lawyers in the world. The Section’s Annual Spring Meeting, with approximately 2,000 attendees, is the largest competition law conference in the world.

Mr. Klawiter’s practice focuses on antitrust investigations and litigation, with special emphasis on international antitrust matters. He has substantial experience in defending corporations and executives in antitrust criminal and civil cases and in merger investigations. Prior to joining Morgan Lewis, he held several senior positions at the Antitrust Division of the U.S. Department of Justice. For additional information concerning this and related matters, please contact Donald C. Klawiter (dklawiter@morganlewis.com).

CHIEF JUSTICE JOHN ROBERTS ON ANTITRUST

In the Senate Judiciary Committee hearings held September 12–14 regarding U.S. Chief Justice Nominee John Roberts, few Senators spent time exploring antitrust issues with the nominee. However, Chief Justice Roberts appears to hold opinions that should comfort those hoping for a “stay the course” approach to antitrust law. In an article published in the 1994 *Public Interest Law Review* titled “Symposium: Do We Have a Conservative Supreme Court?” Roberts commented on three notable Supreme Court antitrust opinions: *Brooke Group*, *Spectrum Sports*, and *Professional Real Estate Investors*. Roberts characterized these opinions as the Court’s return “to a regime in which the objective economic realities of the marketplace take precedence over fuzzy economic theorizing or the conspiracy theories of plaintiffs’ lawyers. This is bad news for professors and lawyers, good news for business.”

Roberts wrote that in *Spectrum Sports*, an attempted monopolization case, “the Court overturned an attempted monopolization verdict because the plaintiff failed to show the requisite dangerous probability that the defendant would in fact be able to monopolize a particular market. The ruling focuses on objective market conditions, rather than any subjective evil intent on the part of the defendant. The defendant may be a dastardly villain and have every intent to monopolize, but if that goal is not a realistic prospect, the matter is of no concern under the Sherman Act. The ruling is of great practical significance, because it should help short-circuit unworthy cases before the Dickensian spectacle unfolds of countless lawyers poring over millions of documents and going through hundreds of depositions in search of evidence of evil intent.”

Regarding *Professional Real Estate Investors*, a *Noerr-Pennington* case, Roberts wrote that “the plaintiffs argued that they were entitled to discovery and depositions to learn why the defendant brought an unsuccessful copyright suit against them. The plaintiffs sought the discovery to show that the suit was a sham, brought only for harassment, not because the defendant thought it could win. But the Court ruled that such burdensome discovery into subjective intent should proceed only if a court first determines that the suit was objectively baseless. Because the copyright suit — though unsuccessful — was not objectively unreasonable, it was not a sham, and there was no need for discovery into the defendant’s subjective intent.”

Finally, regarding a predatory pricing case, *Brooke Group*, Roberts wrote that “the Court held that plaintiff’s claim of anticipatory predatory pricing in the cigarette market could not be submitted to a jury. Detailing the theory underlying the claim is beyond the scope of this comment (and the economic skills of the commentator), but the important point is that the Supreme Court did not reject the claim on grounds of economic theory. In a remarkable paragraph, the Court stated that the ‘theory of liability, as an abstract matter, is within the reach of the statute,’ but then concluded that the record in the case showed that the theory, ‘when judged against the realities of the market, does not provide an adequate basis for a finding of liability.’”

On September 29, the Senate voted 78-22 to confirm Roberts as the 17th Chief Justice of the United States.

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A T T E N T I O N

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