BFA Authors Article in California Lawyers Association Newsletter Concerning Conspiracy to Boycott Competing Technology

Court Denies Motion To Dismiss In Case Concerning Conspiracy to Boycott Competing Technology: *Iowa Public Employees' Ret. System v. Merrill Lynch, et al.*, Case No. 17-cv-6221 (S.D.N.Y. Sept. 27, 2018)

Background and Summary

Iowa Public Employees' Ret. System v. Merrill Lynch, et al., Case No. 17-cv-6221, 2018 WL 4636993 *1-*3 (S.D.N.Y. Sept. 27, 2018) ("*Iowa Public Employees*'") is a class action brought by plaintiff investors who paid borrowing fees in connection with securities lending services financial firms who are the leading providers of securities lending services (the "Prime Broker Defendants") as part of stock loan transactions. The investors allege that defendants conspired to boycott trading platforms AQS, SL-x, and Data Explorers, new market entrants whose competing technology threatened Prime Broker Defendants by offering more direct and transparent trading. *Id.* at *1-*3.

The *Iowa Public Employees*' opinion is notable because the case analyzed horizontal conduct among competitors under Section 1 of the Sherman Act that included suppression of technology and information and applied the *per se* standard to Defendants' activities. The case is also important because it shows that the suppression of a more efficient technology can constitute an antitrust injury where it is alleged that in the absence of collusion there would be more transparent markets for products with lower costs for market participants.

In *Iowa Public Employees*' the investors alleged that alternative technologies from three new entrants promised users a variety of new tools promoting transparency and price-comparison in the stock loan market. EquiLend, the market leader, provided the incumbent technology, which did not "offer fully electronic, price-transparent trading capabilities or the ability to negotiate terms with multiple potential counterparties simultaneously, nor [did] it offer central clearing to market end users." *Id.* At *5. The Prime Broker Defendants occupied a majority of board seats in EquiLend, and were alleged to control its business decisions. The investors alleged the Prime Broker Defendants exercised their board control to boycott the competitors by starving them of data and liquidity.

Defendants jointly moved to dismiss the investors' complaint, arguing that their conduct was not *per se* unlawful because most of it was conducted through a single

entity which was a joint venture with legitimate objectives. Defendants also argued that the investors had not pled antitrust injury because their allegations concerning the rival trading technologies were too speculative and remote. Defendants contended aspects of the alternative technologies made them unsuitable as substitutes to the Defendants' trading services.

Judge Failla rejected Defendants' arguments and denied their motion to dismiss.

The *Per Se* Standard Applies to Actions Taken by Competitors to Suppress Competing Technology

Judge Failla reviewed the investors' allegations under both a *per se* and "rule of reason" standard in determining whether the allegations amounted to an unreasonable restraint of trade under Section 1 of the Sherman Act. *Iowa Public Employees*', 2018 WL 4636993 at *12. Only manifestly anticompetitive conduct is appropriate for *per se* analysis. The "rule of reason" is a relatively deferential level of review that requires courts to weigh "'all of the circumstances of a case in deciding whether a restrictive practice should be prohibited as imposing an unreasonable restraint on competition,' including factors such as the relevant business and the history, nature, and effect of the restraint." *Id.* (quoting *Leegin Creative Leather Prods.*, Inc. v. PSKS, Inc., 551 U.S. 877, 885 (2007).The *per se* rule, in contrast, applies to "agreements or practices which because of their pernicious effect on competition and lack of any redeeming virtue are conclusively presumed to be unreasonable and therefore illegal without elaborate inquiry as to the precise harm they have caused or the business excuse for their use." *N. Pac. R. Co. v. United States*, 356 U.S. 1, 5 (1958).

Defendants argued for "rule of reason" analysis because the actions were taken in the context of a joint venture since most of the allegations concern Defendants' actions taken on behalf of EquiLend. *Iowa Public Employees*', 2018 WL 4636993 at *23.

Judge Failla agreed with the investors, finding that the per se analysis was proper. *Id.* The Court's opinion rests on its conclusion that "the Prime Broker Defendants are direct competitors in the stock loan market." *Iowa Public Employees*', 2018 WL 4636993 at *24. Judge Failla noted that Defendants did not act as a joint venture but as "separate economic actors pursuing separate economic interests." *Id.* (quoting *Am. Needle, Inc. v. Nat'l Football League*, 560 U.S. 183, 195). Thus, Judge Failla relied on the economic reality of the Defendants' association overall—that they directly competed for stock lending services—rather than the legal formality of their joint venture relationship. This was true even if in many respects Defendants' EquiLend joint venture was "consistent with" the lawful objective of providing

securities lending technology. *Id.* It was important to this analysis that Defendants acted outside of EquiLend's rational best interests in certain respects, such as turning down a profitable takeover bid from SL-x, and also that EquiLend acquired both SL-x and AQS and made no use of their valuable competing technology. *Id.* at *6.

The Court also observed that EquiLend operated as a vehicle to further collusive activities, providing a place for six of the Prime Brokers to coordinate their efforts to undermine challenging technology, including acquiring and destroying a competitive threat. In this sense, the joint venture was conducted to pursue anticompetitive ends: Defendants "acting as separate and individual economic decision makers, conspired to boycott SL-x, Data Explorers, and also AQS, and that this conduct was undertaken on behalf of each prime Broker Defendant, and not in furtherance of a legitimate joint venture." *Id.* at *24. Although the joint venture offered legitimate services, these acted as a "smokescreen" for collusion. *Id.*

Suppression of Securities Trading Technology is an Antitrust Injury

Defendants also argued that the investors lacked antitrust standing. "To confer antitrust standing, an alleged injury must be 'of the type the antitrust laws were intended to prevent and [an injury] that flows from that which makes defendants' acts unlawful" and that the investors are an "efficient enforcer" of the antitrust laws. *Id.* at * 26 (quoting *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477, 489 (1977)). In determining, "efficient enforcer" status courts consider the following four factors, "[1)] direct or indirectness of the injury [2)] the existence of an identifiable class of persons whose self-interest would normally motivate them to vindicate the public interest in antitrust enforcement; [3)] the speculativeness of the alleged injury and [4)] the difficulty of identifying damages and apportioning them among direct and indirect victims so as to avoid duplicative recoveries." *Gatt Commc'ns, Inc. v. PMC Assocs.*, L.L.C., 711 F.3d 68, 78 (2d Cir. 2013). When reviewing these factors, courts apply a balancing test that will vary with the particular circumstances of the case.

The investors alleged that Defendants' collusion caused "the lack of a central marketplace of stock loan transactions," which was an antitrust injury because it "(i) creates bottlenecks, (ii) wastes resources, and (iii) causes volatile, opaque, and artificially inflated prices." *Id.* at *27. It was not disputed that this is the type of harm the antitrust laws are designed to prevent.

Defendants countered, however, that aspects of the alternative trading technology made the investors' injuries speculative. Under the speculativeness factor, courts deny standing to bring an antitrust claim only where it is "entirely uncertain . . . that

absent the scheme, the necessary infrastructural preconditions for [the alleged lost benefit] . . . would have developed." *Iowa Public Employees*', 2018 WL 4636993 at 28 (quoting *In re IRS*, 261 F.Supp. 430, 494 (S.D.N.Y. 2017) (internal citations omitted)). Even where the alleged injury "veers closer to speculative than prudence would advise, it would not eliminate Plaintiffs' standing" to bring an antitrust claim. *Id.* at *27.

Defendants argued that the investors' injury was too remote because an "all-to-all" trading platform, offering all the aspects of securities lending that exist in incumbent platforms, was not possible with the technology that had been suppressed. *Id.* at *27. Defendants argued that Data Explorers and SL-x had no plans to offer trading platforms in the United States and that AQS lacked the ability to enable "all-to-all" trading due to rules requiring broker-dealer intermediaries. The investors countered with specific allegations showing that the Data Explorers and SL-x offered a variety of technologies that enhance borrowers' and lenders' insight and would have increased efficiency and transparency in the market. *Id.* at *28. Further, the investors pointed out that AQS was well equipped to deal with broker rules and that AQS would have reduced lending risk and provided centralization via clearing brokers. *Id.*

The Court found that the investors had sufficiently alleged that the suppressed technology would have provided tangible benefits to trading, including increased transparency and efficiency. The Court concluded that, "Plaintiffs have plausibly alleged that the new market entrants were met with market demand, and would have provided benefits, including increased transparency and efficiency leading to lower prices, had the conspiracy not occurred." *Id.* at *28.

Finally, Defendant argued that the providers of the alternative technology were direct victims of the conspiracy and thus the investors were not "efficient enforcers" of the antitrust laws. In their response, the investors argued that these companies' decision not to sue had no bearing on their standing as both "direct purchasers" and "consumers" of the financial product. *Id.*

The *Iowa Public Employees*' decision is important because it shows that the per se standard can apply to agreements reached among competitors even if the agreements are not explicitly related to prices. The decision also shows that, at the pleading stage, antitrust injury can be caused by allegations that due to suppression of technology markets are less efficient and transparent, even if certain aspects of the suppressed technology did not have the same operability as the incumbent technology.

