ALERT MEMORANDUM

The "Twenty-First Century Antitrust Act" Raises the Risks of Doing Business in New York

June 8, 2021

The New York state Senate has passed the "Twenty-First Century Antitrust Act" (S. 933) to amend its state antitrust law, radically changing the risks of doing business in New York. It ostensibly aims at so-called "Big Tech," but applies to all businesses, even those having very little contact with New York. If enacted by the Assembly and signed into law by the Governor, the bill would have three primary implications:

1. The bill requires merger filings in New York 60 days before closing for a huge number of relatively small deals with little connection to New York—covering many more deals than are currently filed with the federal agencies under HSR. This may require major changes in how businesses track and report deals.
2. The bill adopts European-style "abuse of dominance" limits for conduct that US law has been more likely to view as aggressive, beneficial competition. It then goes further than European competition law by presuming firms with more than a 40% share are dominant, eliminating any defense that conduct had procompetitive effects, and applying special stricter provisions in labor markets. Antitrust enforcers often define very narrow markets—such as "entry-level on-premises sparkling wine"—so even smaller businesses might be surprised to find themselves deemed "dominant." Businesses could thus find routine practices such as minimum volume commitments or bundled pricing have become illegal, and will be barred from raising basic defenses. The bill also allows the NY Attorney General to make rules to define practices as abuses of dominance. The bill also allows private individual and class actions with treble damages. These provisions may well render routine business practices illegal or impracticably risky even when the practices were procompetitive—the opposite of the bill's intent.
3. The bill prohibits monopolization, not previously covered by the Donnelly Act, and makes it a possible criminal offense (as well as allowing private claims). The federal government has for many decades declined to bring criminal monopolization cases. While New York will hopefully follow that established, bipartisan principle, if it doesn't, businesses could be at risk of criminal penalties for conduct that might not be obviously illegal, or that might have seemed perfectly lawful and commonplace. Some indications during the legislative process unfortunately suggest that New York may well intend to make use of this new criminal monopolization authority.

The bill's changes to New York's state antitrust law

Creating a 60-day premerger notification obligation for transactions of $9.2 million or more will seriously burden many businesses

The bill creates an obligation to notify the NY Attorney General 60 days before the closing of any transaction that leads the acquirer to hold voting securities or assets of the acquired person exceeding 10% of the federal HSR thresholds. Currently that would be a transaction exceeding $9.2 million where one of the parties has annual net sales or total assets of more than $10 million and the other has annual net sales of more than $1 million (with some exceptions) or a transaction exceeding $36.8 million. The bill does not require much of a connection to New York, covering any transaction as long as either the acquiring or acquired firm has assets or annual net sales in New York exceeding 2.5% of the larger federal HSR threshold. Currently that would be $9.2 million. The bill includes a series of exceptions similar to those in the federal Hart-Scott-Rodino (HSR) Premerger Notification Act, such as the purchase of goods in the ordinary course. Failure to file on time will result in a penalty of $10,000 for each day a party is in violation, which the New York Attorney General can seek against both the company and individually against its officers and directors (or partners).

The very low value thresholds combined with the bill's sweeping applicability are likely to create serious burdens for business. For example, today executive compensation with voting shares is subject to HSR, but relatively rarely triggers a filing due to the high thresholds. Because the $9.2 million threshold is cumulative, it can lead to surprising results; for example, an executive who received stock now worth $902,000 each year over the course of 10 years would likely be required to make a filing. Similarly, if a large firm headquartered in and operating in New York sold assets in Arizona valued at over $9.2 million to a firm that operates only in California, a filing would be required. The law could also impact index funds, which will routinely hold positions of more than $9.2 million in their benchmark companies. Filing obligations under the bill would likely dwarf those currently required under HSR.

Some of the burden of the filing system may be ameliorated by the relatively simple information required—the names of the parties, a description of the assets being acquired, and the anticipated date of closing—as well as the fact that the notification does not suspend the parties' ability to close. That said, the New York Attorney General will have the ability to subpoena further information about any transaction in which it interested.

More concerning is the impact of the bill's timing requirement on unproblematic transactions—as many of these smaller deals will be. The bill requires filing 60 days before closing—double the initial HSR waiting period of 30 days and four times the length of the period that obviously unproblematic transactions typically face given early termination (when that was available). For transactions that are HSR reportable, the bill requires that a copy of the HSR be provided to the NY Attorney General "at the same time that they file those materials with…federal agencies." However, it is unclear whether that provision intends to exempt HSR-reportable transactions from the full 60-day waiting period, or whether this is an added obligation.

As with other sections of the bill, the Attorney General will be authorized to promulgate rules implementing the new filing system. These rules will be likely be very important.

This section of the bill may be susceptible to a variety of challenges under federal law. For example, given the wide applicability of the notification requirement to transactions that may have little or no effect in New York, it likely raises issues of creating undue burdens on interstate commerce under the dormant commerce clause.

Importing a European-style bar on abuse of a dominant position to be defined by the NY Attorney General and prohibiting the defense that the challenged practices are procompetitive will greatly expand antitrust liability for businesses engaged in normal activities, and will likely undermine competition, contrary to the bill's intent

The bill imports the concept of the "abuse of a dominant position" pioneered in European competition law and then further extends it by removing important protections. Unlike monopolization, which typically requires showing very high market shares, firms with relatively modest market shares can be found to have a dominant position under European competition law if certain other factors are present, such as a lack of other large competitors and durable barriers to entry. The bill, while nodding to this concept, creates an additional presumption that any firm with a share of 40% or more (or, in markets on the buy-side, 30% or more) is dominant. It's important to note in this regard that antitrust law often defines markets very narrowly, and in ways that would not be intuitive to businesses—actual examples from agency enforcement practice include "super-premium ice cream," "premium natural and organic supermarkets," or "entry-level on-premises sparkling wine." Thus, firms that might have no idea they were "dominant" could well be covered by this provision.

The concept of "abuse of dominance" in European and other competition laws goes beyond that in historical US antitrust law, which encourages aggressive competition even by monopolists. "Abuse of dominance" as developed in Europe and other jurisdictions imposes on dominant firms a "special responsibility" to avoid harming competition. For example, under current US law, even monopolists can charge monopoly prices or bargain for the best terms they can achieve—in fact, their ability to do so has been described as both an important incentive to strive for success, and a mechanism for attracting new competitors. Particularly in "abuse of dominance" regimes outside of Europe, competition law has been sometimes used as a tool for governments to micromanage the terms of trade between private businesses. Even in Europe, these cases have been used to attack excessive pricing (charging "too high" a price) and to apply stricter limits on potentially exclusionary conduct such as exclusive dealing.

Moreover, as with the definition of dominance, the bill goes further than European competition law in two ways. First, it broadens the concept of "abuse of dominance" to cover "any conduct that tends to…limit the…incentive of one or more actual or potential competitors to compete." Second, the bill eliminates any ability to defend conduct on the grounds that it benefitted consumers, specifically stating that "evidence of pro-competitive effects shall not be a defense to abuse of dominance and shall not offset or cure competitive harm." In European competition law, however, a dominant firm has always had the ability to show that its conduct was "objectively justified" by a legitimate business concern, such as protecting an investment specific to a customer relationship. Taken together, the broad sweep of the prohibition and inability to defend on the grounds that conduct benefitted customers could make procompetitive conduct such as aggressive price discounting, which would limit a competitor's incentive to compete for a customer's business, unlawful, even though it would benefit the customer through lower prices.

The bill will also incentivize businesses, particularly businesses that are less innovative, less efficient, or less successful, to demand that their rivals share technologies, assets, and other facilities with them, or cease aggressive competition—even when doing so would be anticompetitive. Business who want to free-ride on their rivals, or just don't want to compete very hard, will be able to claim that the rivals' superior skills or assets or more aggressive competition "limits" their ability or incentive to compete—and, under the bill, those more competitive rivals will be prohibited from responding that their behavior is beneficial to competition. The bill thus may well reduce competition, and even encourage businesses to behave like cartels—paradoxically producing exactly the opposite of the result the bill claims to seek. In all events, businesses operating in New York are likely to face a period of protracted uncertainty as the exact contours of these provisions are interpreted and developed in practice.

The bill may have the most significant impact on labor practices, including those involving independent contractors. In addition to a presumption of dominance where a firm has a 30% share in a relevant labor market, the bill also provides an option for the New York Attorney General to prove dominance through “direct evidence.” For labor markets, the bill defines direct evidence to include “the use of non-compete clauses or no-poach agreements.” Similarly, with respect to conduct in labor markets, an “abuse of dominance” includes “imposing contracts by which any person is restrained from engaging in a lawful profession, trade, or business of any kind, or restricting the freedom of workers and independent contractors to disclose wage and benefit information.” Non-compete clauses have widespread use by firms with no special market power in labor markets, such as for protection of confidential information or in connection with the sale of a business, but also in industries where firms spend significant sums on training workers in generally-applicable skills, which a competitor could easily free-ride off of by poaching recent hires. These provisions could have the combined effect of making non-competes or confidentiality requirements around wages and benefits *per se* illegal in New York.

The bill gives the NY Attorney General the authority to make rules that define how interpret market shares for finding dominance and what conduct constitutes an abuse. The NY Attorney General is not required to make any specific findings about the effects of a practice in order to make these rules. The rulemaking process is likely to be quite important in operationalizing the bill’s abuse of dominance provisions.

The bill also creates a private treble-damage right of action for abuses of dominance, which may be more problematic. While one might expect that the NY Attorney General will exercise some prosecutorial discretion and not pursue obviously procompetitive conduct such as price discounting, losing competitors are likely to have no such compunctions.

Criminalizing monopolization could create serious jeopardy for ordinary business practices

Today, New York’s state antitrust law, the Donnelly Act, covers only anticompetitive agreements—the equivalent of Section 1 of the Sherman Act. The bill would add a bar on conduct that lets a firm acquire or maintain a monopoly, similar to Section 2 of the Sherman Act. The bill would also add the new provision to the Donnelly Act’s criminal prohibitions, in the process enhancing the maximum penalty to $100 million for corporations and $1 million and 4 years imprisonment for natural persons.

Unlike the prohibition on anticompetitive agreements, which to date has only been used to criminally pursue serious offenses such as price fixing or bid rigging, the line between competition on the merits and acquiring or maintaining a monopoly is notoriously vague, and can cover business practices such as discounting or entering exclusive contracts. Further under the “responsible corporate officer” doctrine, company executives may find themselves in criminal jeopardy not only for acts that they directly sanctioned, but also those over which they had supervisory authority and failed to prevent.

Although the more than 100-year-old federal antitrust laws contain criminal prohibitions, federal antitrust authorities have refrained from bringing criminal cases for monopolization in the modern age. Should New York not follow this precedent, the scope of potential criminal liability for businesses with high market shares—even in narrowly-defined markets that may seem artificial to businesspeople—could be serious. During the legislative process, the active discussion of criminal penalties suggests that the NY Attorney General may well be expected to bring criminal monopolization cases, which would create very serious issues for businesses.

Next Steps

Although this is further than any antitrust reform legislation has made it to date, there is still a good chance that the bill will not become law this year.

The bill has now passed New York state's Senate and passes to the Assembly, the lower house. Because the current legislative session ends on June 10, if the Assembly does not schedule a vote and pass it before then, the bill will need to be reintroduced in the next session. The bill is unlikely to be a top priority for the next few days, and even if the Assembly were to pass the bill before June 10, it is unclear whether the Governor will sign it into law. However, one of the sponsors, Senator Genaris, has noted that while time is running out, he intends to continue pushing for the bill's passage next session.

Conclusions

The bill's wide new reach, vagueness, and anticompetitive provisions, combined with the extensive discretion vested in the NY Attorney General's office to make critical rules, should give anyone doing business in New York pause.

We also expect the NY Attorney General's ability to make rules defining abuse of dominance and governing merger filings to be subject to fierce lobbying. The state has seen bitter disputes around local businesses' attempts to prevent out-of-state competition before, such as the state's 2014 ban on the direct sale of automobiles in response to Tesla's entry. Similarly, empirical work by, among others, Judge Posner, a preeminent antitrust scholar and judge on the U.S. Circuit Court of Appeals for the 7th Circuit, suggests that state attorneys general are somewhat more likely to bring cases against out-of-state businesses that threaten in-state business interests. Should the bill make it to a final vote in the Assembly and obtain the governor's signature, businesses with interests in New York should re-evaluate their business activities in New York, their procedures for tracking their contracting, negotiating, and transactional activities, and whether their government affairs presence is sufficient, given the critical path to rulemaking through the NY Attorney General's office.

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