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New York Rejects Antitrust Defense To Breach Of Distribution Contract

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Your client is sued for failure to pay on a contract and says it shouldn't have to pay because the prices were fixed by a cartel or that it was strong-armed into paying for a "bundle" of services or distribution channels even though it only wanted a subset of the bundle. Is that a defense? After all, aren't contracts for unlawful ends unenforceable?

The answer, most often, is "no." A recent decision by a New York Commercial Division judge provides a useful reminder of the fairly limited allowance of antitrust defenses to contract claims.

In *Time Warner Cable Enterprises LLC v. Universal Communications Network, Inc.*, Justice Oing granted Time Warner Cable's ("TWC") motion to dismiss the defendant's affirmative defenses under federal antitrust laws. TWC leased channels to Universal Communications Network ("UCN") to distribute UCN's network. TWC sued after UCN allegedly defaulted on most of its payment obligations. In response, UCN alleged that TWC had violated Section 1 of the Sherman Act. Specifically, UCN alleged that TWC refused to carry UCN's channel in New York (where TWC allegedly held a dominant position) unless UCN also agreed to pay for TWC to distribute the channel in Los Angeles and Hawaii. UCN alleged that TWC had, therefore, unlawfully "tied" distribution in all three markets and UCN should not be required to pay for the resulting three-market bundle.

Drawing on decades of federal and state cases, the court held that UCN could not raise "tying" as an affirmative defense to TWC's contract claims.

The court set the stage by noting that antitrust defenses to contract claims are "disfavored."

In part, there is a concern that allowing the defense would invite a party to remain silent about alleged antitrust violations, make a deal and accept its benefits, and then refuse to pay for the benefits it has received. In addition, courts have recognized that allowing an antitrust defense is likely to increase the complexity, costs, and duration of a contract claim and, therefore, increase the defendant's settlement leverage regardless of the actual merits of the antitrust defense.

Because of these concerns, courts distinguish between contracts that are legal on their face and those that evidence a potential antitrust violation within the four corners of the contract. The former category "is not voidable [even if] it resulted from an antitrust conspiracy." The latter category is

amenable to an antitrust defense. The test for whether a contract falls in one category or the other is whether a judgment would enforce the "precise conduct made unlawful by the [Sherman] Act."

This distinction, however, can be illusive. In *TWC v. UCN*, UCN argued that its antitrust defenses should be allowed because the judgment TWC sought would enforce an allegedly unlawful tying arrangement. UCN argued, therefore, that its situation was like that of the defendant franchisee in *Big-Top Stores v. Ardsley Toy Shoppe*, where the court allowed an affirmative defense that the franchisor had unlawfully tied the grant of a franchise to the purchase of inventory from the franchisor.

Justice Oing disagreed. He reasoned that, in *Big-Top Stores*, the contract specifically said that the grant of a franchise was conditioned on the inventory purchase and, therefore, a court enforcing the purchase requirements would be enforcing the allegedly unlawful tying itself within the four corners of the agreement. By contrast, the court reasoned that UCN's contract did not say that distribution in New York was conditioned on distribution in Los Angeles and Hawaii. The contract simply provided for distribution in all three markets – a term that was not unlawful on its face. Thus, Justice Oing concluded, UCN's situation was more like that of the defendant sponsor in *American Broadcasting-Paramount Theatres, Inc. v. American Manufacturers Mutual Insurance Co.* There, the court held that the defendant could not raise an antitrust defense to the network's breach of contract claims on the theory that the network had strong-armed the defendant into sponsoring its show on "35 stations they did not want in order to get the sponsorship on 95 stations that defendants did want." Justice Oing concluded that in both the *TWC* and *American Broadcasting-Paramount Theatres* situations, the contracts were, on their face, "valid economic transaction[s] that [did] not memorialize the tying . . . or otherwise violate antitrust laws."

Is a defendant that believes it has been the victim of an antitrust violation without recourse? No. Even where an antitrust concern cannot be raised as an affirmative defense to a contract claim, an affirmative claim (or, possibly, counterclaim) might nonetheless be asserted and it may be possible to recover treble damages for any supra-competitive portion of the contract price or obtain other relief from allegedly anticompetitive effects of the contract, such as purchase of an unlawfully tied service or product.

One additional item to note is that UCN apparently pled affirmative defenses under the federal antitrust laws (the Sherman Act) and not under New York's Donnelly Act. The New York Court of Appeals has emphasized that New York generally follows federal antitrust law in construing the Donnelly Act. *E.g.,* X.L.O. Concrete Corp. v. Rivergate Corp. However, in *X.L.O.*, the Court of Appeals allowed antitrust defenses to a contract claim to proceed under the Donnelly Act where a contract, otherwise lawful on its face, may be "so integrally related to the agreement, arrangement, or combination in restraint of competition that its enforcement would result in compelling performance of the precise conduct made unlawful by the antitrust laws." Importantly, in *X.L.O.*, the antitrust defense was not that the contract itself contained any illegal tying or other provisions. Instead, it was alleged that the contract was part and parcel of a larger, mob-controlled conspiracy in the construction industry. The question, therefore, is whether antitrust defenses are given somewhat more leeway under the Donnelly Act than under federal antitrust law.

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