

Roundtable Conference with Enforcement Officials

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MODERATOR



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JAMES WILSON: Welcome to the Enforcers Roundtable. For me, this program is the highlight of a terrific Spring Meeting. We are honored to have the enforcers who are with us this morning. Let me introduce them and our panelists. Then we will launch into our questions.

Chairman Jon Leibowitz became the Chairman of the Federal Trade Commission on March 2nd of this year, appointed by President Obama. Previous to that, he had served as a Commissioner on the Federal Trade Commission since 2004. He has had a distinguished career, both in representing the Motion Picture Association of America and in a variety of positions on Capitol Hill. We are honored to have Chairman Leibowitz with us.

Commissioner Neelie Kroes needs no introduction to this group. She has been, since 2004, the Commissioner for Competition with the European Commission. Prior to that she also had a distinguished career in parliament and in the cabinet in her native Netherlands. We are honored to have you with us, Commissioner.

Bob Hubbard is the Chair of the Multistate Antitrust Task Force of the National Association of Attorneys General. He is also an attorney in the New York Attorney General's Office. We are grateful to have you here, Bob.

Scott Hammond is the Acting Assistant Attorney General for Antitrust, and I think the person most anxious for the confirmation of Christine Varney. For those of you who do not know, yesterday Christine was voted out of the Senate Judiciary Committee, and now awaits a vote on the floor of the Senate. I know that if Scott has any political connections, he is trying to facilitate that.*

Scott has had a distinguished career at the Department of Justice. He has led its criminal enforcement efforts for the last number of years and has been on the criminal side of the Division since he joined it in 1988.

* *Editor's Note:* Christine Varney was confirmed by the Senate as Assistant Attorney General for the Antitrust Division on April 20, 2009.

We are grateful for each of our enforcers being here.

I am also joined by two distinguished members of our Section to help me with the questions that we are going to ask this morning.

Roxane Busey was the Chair of this Section in 2001–2002. She is a partner in the Chicago Office of Baker & McKenzie. She has served the Section in innumerable ways, including chairing the Section's Task Force on the Antitrust Modernization Commission Report.

Bill MacLeod is one of the co-chairs of this Spring Meeting and responsible for the incredible success that we have had this week. He is a partner at Kelley Drye & Warren in both its Washington and Chicago offices and has a practice in both antitrust and consumer protection. He leads the firm's antitrust and trade regulation group.

With that, let's move on to our enforcers, starting with Chairman Leibowitz. One of the highlights of this meeting each year is our ability to hear firsthand from enforcers as to what policy we might expect to see in the future. So, Chairman Leibowitz, can you tell us what we are likely to see under your tenure?

The one area, and perhaps our highest priority going forward, in the health care space is stopping what we call "pay for delay settlements" or "reverse payments," in which brands pay off their generic competitors to stay out of the market.

JON LEIBOWITZ: Let me start by expressing my appreciation for the opportunity to speak with all of you. From my perspective, it has been a privilege to have been an FTC Commissioner for the last four years. I look forward to continuing to work with you.

What are our priorities in the years ahead for the Federal Trade Commission? Well, I see two things: continuity and challenge. On the continuity side, we all know that every new administration is about change to some extent, and we certainly will be, but we are also at the FTC about continuity. We are going to build on the many accomplishments of the Commission under Bill Kovacic and Debbie Majoras and Tim Muris, who himself built on some of the accomplishments of Bob Pitofsky. Tim Muris once said famously, or at least famously in antitrust circles, that he agreed with about 95 percent of his predecessor's agenda. I feel exactly the same way about the agendas of Bill Kovacic and Debbie Majoras.

In terms of continuity, let me give you a few areas. One is merger enforcement. Over the past twelve months, the Commission has been incredibly active on the competition side. We've brought more than thirty enforcement actions and added to a very heavy ongoing litigation workload. We've had success in the last few months, and some notable successes. First, *CCC/Mitchell*: we won our first P.I., I think, in six years, certainly since I came to the Commission. We had some success in *Whole Foods*—not at the district court level, but at the appellate level. And even in *Inova/Prince William* we managed to effectively block what we thought was an anticompetitive hospital merger. So, despite the drop that we have seen—and it has been precipitous—in Hart-Scott-Rodino filings, our merger agenda remains very, very full. Two cases we continue to litigate in court, six merger challenges this year.

Another area where you're going to see continuity is our health care agenda. As you know, for many years, going back to Tim Muris and Bob Pitofsky, we have devoted considerable attention to health care issues on the competition side, and also even on the consumer protection side. And, given the central role that health care plays in our economy and the upcoming debate on health care reform, we are going to stay very, very active in this area.

The one area, and perhaps our highest priority going forward, in the health care space is stopping what we call "pay for delay settlements" or "reverse payments," in which brands pay off their generic competitors to stay out of the market. We have a two-pronged approach, as I think many of you know. One prong is litigating cases. We have district court cases now in the Third Circuit and in the Ninth Circuit. We have more investigations in the pipeline.

—JON LEIBOWITZ

The other prong is supporting legislation, and legislatively, of course, we have the support of the Chairman of the Antitrust Subcommittee in the Senate, Herb Kohl, and there is a bipartisan bill introduced with Senator Kohl and Chuck Grassley and Senator Durbin and supported by President Obama. We have a lot of support for legislation in the House Energy and Commerce Committee. I think a bill will be introduced next week.

We are very optimistic that, either through litigation, or perhaps even legislation, in the context of health care we will solve this problem for American consumers and let them have access to generic drugs sooner.

Another area where you're going to see us stay active is unilateral conduct. We have a unilateral conduct case in court right now, *Cephalon*. And we are going to continue to stay active in the standards-setting area. Obviously, the *Rambus* case didn't turn out at the D.C. Circuit the way we wish it had, but we are going to continue to be active in that area, whether it's using Section 2 or Section 5.

Let me talk for a minute about some of the challenges that we are going to face. I'll try to be brief because I think we're going to talk about some of these issues in the Q&A.

One challenge over the last few years has been the FTC/Justice Department relationship. It's no secret that, whether it was reverse payments in the pharmaceutical area or views of unilateral conduct, we've had a series of policy disagreements—not personal disagreements at all, but policy disagreements—with the Justice Department. I am very optimistic that under Christine Varney, who is going to be a terrific Assistant Attorney General for Antitrust, that the Division and the Agency will be much, much more in synch. I look forward to her speedy confirmation, as I know Scott does.

We may revisit the Section 2 Report, but I think we'll have to wait until Christine gets onboard before we sit down and talk seriously about that.

We may also want to revisit the Merger Guidelines, which are badly in need of being updated. But again, a lot of this needs to wait until Christine gets settled in at the Antitrust Division.

On the litigation front, we have another challenge. That is the hostility of some courts—not all—to antitrust enforcement. We all know at some level what's driving this. I think it's the toxic combination, perceived or real, of treble-damage lawsuits and class actions. But the problem for the enforcement agencies—and I don't mean to speak for Justice, but certainly for the FTC—is that those restrictions placed on private plaintiffs often very much affect us. So that's one of the reasons that we are exploring as a Commission—and I think the whole Commission wants to do this—using Section 5, our unfair methods of competition authority, that goes beyond the antitrust laws. From our perspective we want to stop anticompetitive behavior, whether it's encompassed by the antitrust laws or not.

And, of course, as we all know, antitrust enforcement has shrunk over the last several decades. Some of that was probably good. Some of it might be a little bit too much.

In the Part 3 area, we recently issued revisions to our Regulations and to our Rules. We are very much committed to making Part 3 an effective tool for antitrust litigation. I think particularly on the conduct side it is going to be very, very interesting. We will be able to litigate a conduct case and have a decision by the ALJ in about eight or nine months and a decision by the Commission—if we follow our own rules, which hopefully we will—just a few months later. Where else can you get antitrust decisions within a year, or close to a year? Certainly not in the courts.

And finally, we are going to look at disgorgement remedies a little more often. We have a case where we're asking for disgorgement, the *Ovation Pharmaceuticals* case, where we think it's justified. There has been some interesting writing on the use of disgorgement by people like Einer

Elhauge. My own sense is that we will be looking at disgorgement as a remedy more often than we have in the past.

So, just to summarize, we are going to use all of the tools that we have in our arsenal, whether it's disgorgement, whether it's Section 5, whether it's Part 3, to try to stop anticompetitive behavior. That's what we're supposed to do. But let me also assure you we are never going to prejudge a matter. We are always going to go where the facts and the law lead us.

My door and the doors of our staff are always open to you. We want to work collaboratively as often as we can.

WILSON: Thank you, Jon.
Commissioner Kroes?

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—JON LEIBOWITZ

NEELIE KROES: Thank you, Jim. I'm delighted to join you again.

Jon was mentioning that continuation and change are his leitmotif. Continuation is that you are sitting next to me, on my left. Change is that you are looking different from Debbie. Having said that, I think that our cooperation is excellent and will be excellent. We had our first meeting yesterday. That was a good start.

I am a bit disappointed, on the other hand, that Christine is not yet joining. I am very careful, for I know that the Hill is quite sensitive on all remarks that are made about potential appointments. So I would just say that I am looking forward to Christine's joining as a colleague at the DOJ.

But having said that, I will add that if you have people like Scott in your midst, then it is a pleasure to do the job. I'm sure that we will do the job together, remembering coordination and cooperation is absolutely key.

You were asking me, "Are there specific issues that you could mention about how Europe is dealing with this crisis?" Well, as you are aware, we are in the same boat: the United States, Europe, and the other parts of the world. The financial and economic crisis overshadows everything. Because, as the competition authority, we have a major role in Europe to respond to the crisis, my answer to this question may be a little different from that of my American counterparts. But it is a matter of different contexts, rather than different outlooks, I assure you.

I want to add, even though certain headlines suggest big differences, there is no big difference. We are working hard, as our American colleagues and other colleagues are, to make a decisive and strong international response to the crisis. We are looking forward to your contribution in London with the G20. I think we are all aware that it makes more sense to do it together.

The economic crisis has brought the subsidy control arm of our work—and we call that state aid control in Europe—to center stage. It is remarkable how many issues are connected with state aid control.

But it is hard. We are working like hell, seven days a week, day and night. I am deeply impressed by my people; they are doing an extremely good job. So far so good. We are keeping the line (against protectionism) and we are consistent, and I hope that we are also predictable.

Sometimes I do hear people asking, "Are you predictable?" I am crystal clear, and I am sticking to my line. Sometimes, by the way, European leaders are not enjoying my predictability and my line. Those are necessary but nice discussions. Because even if we disagree at first the fact of the discussion means they are listening to the European Union and to the European Commission.

The Commission—and this is no news for you, but I still want to repeat it—is constitutionally obliged to review state aid applications and to control subsidies that are offered by the European

Union's twenty-seven national governments. Those governments are very aware of that. So they have to notify, and we have to do our job, with both of us acting as quickly as possible. What does that mean? Well, it means in a clear-cut way that the competition rules have had a seat at the table in dealing with the crisis. We were already aware that we are doing a very important job within Europe, but during this crisis it is even more important. Each rescue, each bailout, whether in the financial sector or the real economy—has been tailored to distort competition as little as possible.

A key part of getting out of this crisis is "enforcement as usual." Don't think that we are not alert, for then you are making a big mistake. We are alert. We have learned a lesson from the U.S. experience in the 1930s. We are sticking to the line that competition is essential.

—NEELIE KROES

I would like to add to that that I am still impressed that the six founding fathers of the European Community in the 1950s—only fathers; the mothers were at home, nowadays it has improved and a third of the Commission is female—were aware of the importance of competition policy. They were quite influenced by Harvard professors, I might add—so you see the way the U.S. can influence thinking in Europe.

In the competition chapter in the Treaty of Rome—can you imagine, in the 1950s?—they were writing down in that chapter how important competition is, and the need for fair and level playing fields and the need to limit state aid. That was attracting me when I took over from Mario Monti. I thought: That's great. That is my line. In essence they were saying state aid is only allowed when there is market failure and when state aid could be a medicine for the market failure to recuperate. Even then, the aid must be temporary and, by the way, as least distortive of competition as possible. So we still take that as the line today, and you can't imagine how often I am repeating it when ministers or leaders or bankers are knocking on my door.

So anyhow, we have to take into account that it means that the competition rules are a key instrument of the European Commission to tackle the whole crisis. In financial services we ensured a level playing field by intervening in more than forty cases requiring adjustments to the national proposals. That was a big, big first challenge.

But I am always saying to my people, and they are saying it to me, "This is just one hurdle." The second hurdle is perhaps even more challenging: restructuring. I am always saying, "My shareholders are the taxpayers and I have to take care of their interests." We have to be aware that one day this crisis will be over, and a normal, stable market will return. So we have to think of our line now, to decide: What is that normal market going to look like; with what type of regulation, with what type of supervision, with what type of recapitalization; but also, what type of competition do you want? We are not taking the line that, "Well, they were given a helping hand, but don't worry now—they are just there and nothing has to change or be repaid." So dealing with the restructuring, we are asking for a lot of effort. We cannot let the present crisis prevent the restructuring of banks that were in trouble before the crisis began, and we cannot let the present lack of clarity about toxic and impaired assets continue.

That is one of my main worries, that nowadays some industries, including in the United States—I won't mention the sector, but you are creative enough to imagine which they were—are coming over and asking for money in Europe. Well, they can try it, why not? But it doesn't mean that we will say, "Oh, that's great, we do have a lot of money for you."

My worry is—and now I am very serious—quite a number of those entrepreneurs, those CEOs and board members, are trying to present us with the bill for their past mistakes, thinking that we are idiots and that because there is a crisis we are taking and paying for everything. They are hoping they can pass on the problem when they didn't do their job properly before the crisis. Well, that is not the way we are dealing with that.

Day-to-day work in the competition field is going on. While keeping competition distortions to a minimum is important in the state aid area, it is also as important in all other areas of our activ-

ity. A key part of getting out of this crisis is “enforcement as usual.” Don’t think that we are not alert, for then you are making a big mistake. We are alert. We have learned a lesson from the U.S. experience in the 1930s. We are sticking to the line that competition is essential. Maintaining competition in our markets in today’s circumstances is an active and tangible contribution to recovery. It is one part of the medicine for all the usual reasons: more innovation, more research, more jobs, lower prices, and, as a consequence, greater purchasing power. That is what the people are badly looking for.

Talking about mergers, over the last year we have continued our merger enforcement, with around 400 new cases and a fairly constant intervention rate. We have seen a fall off in merger activity. But the mergers we have now will receive just as intense scrutiny as those we looked at before the crisis began. So it is done like we always did it.

Talking about cartels, we have also continued our cartel enforcement, with the most notable case being car glass, just one of those out of a list. That’s a record fine. It is a record fine both for the cartel, for this cartel about \$1.7 billion, and for an individual participant in that cartel, nearly \$1.2 billion.

I am happy that the level of fines now better reflects the impact that cartels have made on the market. When somebody is addressing me and saying, “Are you aware what the consequence can be?” I say, “Yes, I am aware. My advice to those who are planning to join a cartel is: don’t do it, for the fine will be high.”

Let me add one other remark, and that is motivating me quite a bit. We are all aware that in the financial sector we are faced with the public sector filling-in responsibilities it is not used to, to use diplomatic wording. I think that mess is inspiring me to be even more aware that also in the industrial sector we should never ever face a situation where we have to say, “We were aware that something was wrong and we weren’t acting even though it was judged that the situation was bad.”

Going back to antitrust cases, there have been several non-cartel antitrust cases. Notably, using commitment decisions—at the moment quite popular in Europe. We addressed E.ON, a big German/multinational energy company in the German electricity market, through a commitment decision. These commitment decisions have not received the attention they deserve in recent years. They are a new instrument, only available since 2004, but one which we have used effectively in a number of areas to resolve cases. They have an impact on the market more quickly.

In regards to fines, people are sometimes saying, “You must be in a good mood because you collected so much in fines.” I say that my best day will be when the fines are zero, because companies have behaved. But I don’t believe in heaven on earth, so that will be taking a bit longer yet.

But having said that, we should be aware that fines do make a difference. The goal is that it is a fair, level playing field, protecting consumers. So if that is the goal, protecting the consumer and the good guys in the business world, then when there are other instruments let’s use the whole diversity of instruments.

As well as cases, in the last year, we have also been busy with policy reforms. I jump through the list quickly:

- A settlements system.
- Article 82 Guidance.
- A revised Remedies Notice under the Merger Regulation.
- We have started our reviews of the Merger Regulation, Regulation 1, our horizontal and vertical block exemptions, and sectoral regulations in the automotive and insurance sectors.

The big gap that remains was—and I am so delighted to say “was”—the lack of an effective EU-wide private action system. We were successful in securing the European Parliament’s support for

our proposal. The day before yesterday, we received cross-border/cross-party support from the European Parliament for our proposals on the White Paper on damages.

It is indeed a great step forward, but not the final step. We will do it the European way, no doubt about that. It makes sense to give the opportunity to those who are victims of harm from cartels to get compensation. So it is absolutely clear, consumers, small and medium-size enterprises, victims of competition breaches, can claim compensation for harm.

We are still busy and thinking over the next step, but I can assure you we are alert, we are in a good mood. We are aware that 500 million citizens in Europe are expecting that we are doing our job properly, and I can assure you we are.

WILSON: Thank you, Commissioner.

Bob Hubbard, can you tell us what's happening in the states?

ROBERT HUBBARD: It has been a very interesting year.

I will try to adjust to the theme of change and continuity. There is plenty of continuity. In the past year, we worked with DOJ with the *JBS/National Beef* merger, with *Google/Yahoo!* I expect those relationships to expand and develop further.

With the FTC, we continue to have day-to-day relationships among staff throughout the country. Many of the litigations that Jon mentioned had state involvement. Minnesota sued along with the FTC in *Ovation*,¹ California in *Solvay Pharmaceuticals*,² Virginia in *Inova*.³ Lots of stuff is going on. We like to add our part to efforts when the laboring oar is with the federal enforcer, but when the states add local perspective and local expertise.

There are plenty of state-specific things going on too. Too many to list here.

We just updated our database.⁴ I think we are up to 506 cases now. Just in the past year, just to list a few of them, the states brought a fifty-state enforcement action against Bristol Myers Squibb in *Plavix* for the violation of court injunctions that we had in place.⁵ We got a \$1.1 million fine. Most of the antitrust compliance actions that you read about are not from the states. That was a rather major development.

We have a trial date set in *TriCor*. Texas settled a hospital boycott case.⁶ Pennsylvania keeps doing hospital transactions.

In New York we have successfully convicted some of the *Marsh* defendants who put together that bid rig.⁷ We're in our second trial. Emily Ganrud and others have been trying that case, which I hope will reach a similar conclusion.

Connecticut is suing the companies that engage in rating of municipal bonds.⁸

Is it time to talk about *Microsoft* as state-specific? DOJ is still doing some things, but most of the enforcement activity is being carried on by the states.⁹

¹ See <http://www.ag.state.mn.us/Consumer/PressRelease/081216OvarionPharmaceuticals.asp>.

² See <http://www.ag.ca.gov/newsalerts/release.php?id=1672&>.

³ See <http://www.ftc.gov/opa/2008/05/inova.shtm>.

⁴ The NAAG State Antitrust Litigation database is available at <http://www.naag.org/antitrust/search/>.

⁵ See http://www.oag.state.ny.us/bureaus/antitrust/notable_cases.html.

⁶ See http://www.naag.org/antitrust/search/viewCivilLitigation.php?trans_id=552.

⁷ *People v. Gilman*, No. 4800/2005 (N.Y. Sup. Ct., N.Y. County).

⁸ See <http://www.ct.gov/ag/cwp/view.asp?A=2341&Q=420392>.

⁹ Coordinated State Enforcement of Microsoft Antitrust Judgments, available at <http://www.microsoft-antitrust.gov/>.

This is my fourth Roundtable. I've not said much about consumer protection. I don't have much experience in consumer protection. So I thought maybe this time I would try to make up for that.

There has been lots of talk about predatory lending. The state consumer protection people have been doing a lot to fight predatory lending for a long time. In October of 2002 the states got a \$484 million settlement with Household Finance. In October of 2006 the states got a \$295 million settlement with Ameriquest, that similarly went to predatory lending claims.¹⁰ So the states tried to outdo themselves, and in October of 2008 got a \$6.8 billion settlement with Countrywide Home and Countrywide Financial.

Predatory practices continue to be of significant concern to states, and there were significant successes on that. Unfortunately, those actions didn't prevent the problems, but we're hopeful that we can start turning the corner and fixing some of the worst abuses.

This year I should mention some of the preemption battles that the state consumer protection people have to fight.

It also makes sense to think about how much we had been fighting a defensive battle within the states. I've mentioned some of the defensive battles among the antitrust enforcers, but I think this year I should mention some of the preemption battles that the state consumer protection people have to fight.

*Altria Group, Inc. v. Good*¹¹ was a Supreme Court case in which the claim was under the Maine state unfair trade practices. The claim was that the marketing of light cigarettes was deceptive—that light cigarettes actually did not deliver less tar or nicotine. The preemption argument was that the FTC tests and other things preempted the claim under Maine state law. We got help from the FTC. We were actually surprised that we prevailed in the Supreme Court, that the Maine action wasn't preempted.

I think many of you have also read about *Wyeth v. Levine*.¹² It's another instance in which a defendant looked at some sort of regulation and argued that traditional state law was not appropriate to use. In this case it was a Vermont failure-to-warn claim. The argument was that the labeling that the FDA approved for the drug was adequate and should preempt a state failure to warn claim. We were surprised again to prevail in that.

—BOB HUBBARD

Another preemption case is on the Supreme Court's agenda: *Cuomo v. Clearing House Association, LLC*.¹³ It's set for oral argument on April 28. In that case, a federal agency, instead of joining with us in trying to ensure that consumers are protected, took the formal position that New York State was not allowed to investigate what those entities were doing. The Office of the Controller of the Currency said that it was the only one that had visitation rights, so that the state wasn't allowed to investigate whether racial discrimination was going on in terms of the mortgage policies of those banks. We lost in the Second Circuit, but the Supreme Court granted certiorari.

We're hopeful that those kind of defensive battles are turning around and we're starting to make progress exercising authority without dispute.

As part of the transition to a new administration, NAAG put together an interim briefing memo for the president-elect, now President Obama, and emphasized some of these themes. If you go on NAAG's Web site, you can find the memo.¹⁴ It will give you some of the specifics. We're talking about how to resist preemption, how to enhance cooperation, how to increase enforcement.

¹⁰ See <http://www.ameriquestmultistatesettlement.com/>.

¹¹ 129 S. Ct. 538 (2008).

¹² 129 S. Ct. 1187 (2009).

¹³ 77 U.S.L.W. 3242 (U.S. Jan. 16, 2009) (No. 08-453) (certiorari granted).

¹⁴ See http://www.naag.org/assets/files/pdf/policy/Transition_Team_Briefing_Paper_20090110.pdf.

From a consumer protection perspective, the states emphasize that it's nice to have fifty-six cops on the beat. There are a lot of local things going on. We ought to be working together and try to make sure consumers are protected. We worry about debt collection, counseling scams. Those are far more prevalent when people are more vulnerable, in these difficult economic times.

The interim briefing memo wants the federal government to join together in those efforts, to finance some of them, join states in pushing against the preemption arguments that are being made.

In antitrust, the briefing memo also talks about renewing and prioritizing cooperation. We're hopeful that we'll build on our history of cooperation. Themes explored include resisting the preemption or weakening of state law, be they consumer protection laws that are used for traditional consumer protection or as a way around *Illinois Brick* or otherwise; opposing exemptions, specifically mentioning the railroads and insurance exemptions.

We are even getting so bold as to think about trying to fix some of the longer-term problems. We still think about *Illinois Brick*, which prohibits a consumer from recovering unless they have a contract with the violator. It's time to have actual injury as the touchstone for recovery. Maybe we'll make some progress on that. We made some progress with the AMC.¹⁵ I don't see any bill offered yet, but that's something in the briefing memo.

We, of course, are pushing for *Leegin* overrule.

We join the FTC in the fight on pharmaceuticals, to make generic entry occur more quickly.

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—BOB HUBBARD

WILSON: Thank you, Bob.

Scott, things certainly have been active under your stewardship at the Department of Justice. Can you share with us what's going on there?

SCOTT HAMMOND: Jim started by joking about my tenure, my very short tenure so far, as Acting. Actually, Jim, I'll tell you it has been somewhat charmed. I haven't had to deal with a single clearance dispute since I've been there. I have heard so much in the past about these clearance disputes, but I haven't had to get involved once. Jon, that has given me a lot of time on my hands.

LEIBOWITZ: In the last two weeks I've been involved in five clearance disputes.

HAMMOND: Well, they haven't brought me in on any. That has given me some time.

I have actually come up with a solution to this clearance dispute problem, and I've also come up with a solution to the controversy surrounding the Division's Section 2 Guidelines, which don't seem to be popular with everybody in the room. Going forward, the Antitrust Division will start looking at all Section 2 conduct criminally, and we will also review all mergers through our criminal enforcement program.

[Laughter]

I don't know, Jon, how you feel about that, but if you have any ties on the Hill, you may want to get Christine confirmed as quickly as you can.

[Laughter]

Transition has been a hot topic, obviously, this week. People want to know what policies are going to be rolled back. Are we returning to the past? Are we starting anew? I'll answer those

¹⁵ See Robert L. Hubbard, *The Antitrust Modernization Commission and the States*, ANTITRUST, Summer 2007, at 33.

questions with respect to the Division's criminal enforcement program. The blueprint for our criminal enforcement program has been to build on our policies just as we have built on past success.

I would submit that the biggest development this year in cartel enforcement, and the biggest developments that we can foresee on the horizon, all have their roots in policies implemented and achievements obtained more than a decade ago. To give you an example, I want to take you back to October of 1996. That was when Archer-Daniels-Midland Company pled guilty and agreed to pay a \$100 million criminal fine for its participation in both the worldwide lysine and citric acid cartels. At that point in time, the Division had never obtained a fine above \$10 million for a company convicted of a single antitrust count. The \$100 million fine was groundbreaking. In order to obtain the \$100 million fine, we relied, for the first time, on the alternative fine statute, Title 18 Section 3571(d), to obtain a fine above the Sherman Act's statutory maximum fine of then \$10 million. At that time, the highest aggregate fines that the Division had ever collected in a single year was roughly \$42 million. That year we collected \$207 million in criminal fines.

Ultimately, what we

foresee is a time when

if you violate the U.S.

antitrust laws, all

else being equal,

the punishment will

be the same regardless

of whether you are a

U.S. citizen or a

foreign national.

—SCOTT HAMMOND

Today, approximately sixty-eight companies have paid fines of \$10 million or more, including sixteen companies that have paid fines of \$100 million or more. In the first five months of this fiscal year, companies prosecuted by the Division have been fined nearly \$750 million.

Also in the lysine investigation, the Division obtained the first criminal conviction of a foreign national for participating in an international cartel aimed at United States businesses and consumers. A number of individuals from the companies that pled guilty agreed to cooperate pursuant to what were called "no-jail" deals. We were thrilled. We had never been able to persuade a foreign national to agree to cooperate and plead guilty to violating the U.S. antitrust laws before that investigation.

At that time, of course, extradition wasn't a credible threat. Moreover, we had not begun using Interpol Red Notices in our cases to obtain jurisdiction over international fugitives. In fact, I think our defendants feared the INS more than they feared the Antitrust Division, because a criminal antitrust conviction at that time would result in the individual being barred from traveling into the United States for personal or business purposes, as well as their removal and deportation. So in 1996, the year before the first foreign national agreed to enter a plea agreement in the lysine investigation, we entered into a novel—still to this day unique—Memorandum of Understanding with the INS, now the Department of Homeland Security, to assure that cooperating alien defendants in our investigation would receive immigration relief after their conviction. This MOU was instrumental in securing the first guilty pleas by foreign nationals and obtaining their cooperation.

By 1999, two years after the first individual pleas in the lysine investigation, we had already begun to build on the momentum of the lysine and citric acid cases. So then, in the Vitamins cartel prosecution, we obtained jail sentences against foreign nationals for violating U.S. antitrust laws for the first time. And boy, did that have a milestone impact on anti-cartel programs here and abroad. Today, I think, over forty-four foreign nationals from ten different jurisdictions have submitted to U.S. jurisdiction and served time in U.S. prisons for violating the U.S. antitrust laws.

The initial jail sentences that were imposed against foreign nationals were relatively short, beginning with about three months. The Division said publicly at that time that it was our plan to slowly but surely ratchet up the incarceration periods. Ultimately, what we foresee is a time when if you violate the U.S. antitrust laws, all else being equal, the punishment will be the same regardless of whether you are a U.S. citizen or a foreign national. Our goal is to ensure fairness and proportionality in antitrust sentencing. If you look at the Division's charts in the Antitrust Division's Newsletter showing the average sentences for U.S. and foreign individual defendants, you will see how successful we have been in moving towards this goal.

Now, if you go back two years before the *ADM* case—and this will probably be the only time that you'll hear me volunteer to talk about *United States v. General Electric*—two years before that case, Division attorneys were in a courtroom in Columbus, Ohio, when Judge Smith ruled in a Rule 29 motion that our case was dismissed on a judgment of acquittal. That was a very tough loss for the Division—a bitter pill made even tougher to swallow because the Division had been unsuccessful in obtaining evidence overseas that we believe existed and could have advanced our case. Not only were we not able to get that evidence from our counterparts abroad, we had trouble back then getting return phone calls in most cases from jurisdictions abroad where we believed evidence existed.

So after the last of the lysine defendants were convicted at trial, we put together a compilation of the FBI covertly recorded meetings and discussions that were played at trial and that vividly showed the international lysine cartel at work. The tape highlights the cartel activity that was targeting not just the United States, but consumers in every single country around the world. We took our show on the road with former Division Deputy Gary Spratling starring as lead vocalist. We toured Europe and Asia. We met not only with competition authorities, but also with members of parliament to promote legislation aimed at combating cartels. We showed the tapes to treasury officials to assist in increasing funding for cartel enforcement abroad. We played it before judges so that they could witness for themselves the harmful nature of cartel crimes.

In 1999, we hosted an international cartel workshop here in Washington that more than twenty-five jurisdictions attended. And this was several years before the ICN was created. We put together the workshop because we knew we had to develop relationships with our counterparts abroad and we had to change attitudes about the harm being caused by cartel offenses. Folks had to see with their own eyes the nature of the criminal activity that was captured on these tapes and understand how the conduct was harming their businesses and consumers. This was not a Gentlemen's Agreement; this was not a case of executives who didn't know where the line was and so accidentally crossed it. This was hard-core fraud, and it was, as I said, not just victimizing businesses and consumers in the United States, but those of every jurisdiction around the world.

Our goal was to develop a global network of enforcers, because we understood that not only did we need to build on our own successes, we could build on the successes of competition authorities abroad.

That is exactly what has happened. And so each year when I appear at the Spring Meeting and I am asked, "What's the biggest development in U.S. anti-cartel enforcement this year?" time and time again I point to a development abroad and predict that it will have the single biggest impact on U.S. antitrust enforcement in the next year.

That was true in 2002, when the European Commission revised their leniency program and brought it into convergence with the Antitrust Division's program. I can't tell you how significant that was. We knew when that was announced that it was not just going to boost the Commission's cartel enforcement program, it was going to boost our program, because companies would respond by simultaneously reporting cartel offenses in both of our jurisdictions. And that's exactly what has happened.

It was also true two years ago, when Japan introduced its leniency program. We knew it would be successful because they had put together all the necessary ingredients for a successful program, and we knew it would result not just in increased deterrence in Japan, deterrence that was sure to benefit U.S. businesses and consumers, but we knew that it would result in simultaneous leniency applications in Asia, Europe, and the United States. That has happened, and it has resulted in a sea change in the way Asian companies and their executives respond to our investigations.

The most significant development in U.S. antitrust enforcement this year, and I submit the most significant development for all of you who represent individuals and companies in international cartel investigations, is the jail sentences that were imposed in the United Kingdom earlier this year against the Marine Hose executives.

—SCOTT HAMMOND

Lastly, it was true again this year because the most significant development in U.S. antitrust enforcement this year, and I submit the most significant development for all of you who represent individuals and companies in international cartel investigations, is the jail sentences that were imposed in the United Kingdom earlier this year against the Marine Hose executives. It serves as proof positive now that if an executive engages in global cartel activity, the executive risks criminal prosecution not just in North America but in Europe.

So what will be the next big development? Looking forward, there is going to be a real competition because there are a lot of developments around the world that are contending to fill that slot. For example, Brazil's criminal cartel enforcement program has been tremendously successful, and we are currently running parallel criminal cartel investigations with them. Moreover, their leniency program is firing on all cylinders. In addition, there have been major domestic criminal cartel prosecutions in a number of jurisdictions around the world—in Japan, in Korea, in Israel, in Ireland, in Denmark, in the Czech Republic. All of these jurisdictions are poised to step up in the international cartel enforcement arena. On top of that, jurisdictions like Australia, the Netherlands, Russia, South Africa—all these jurisdictions are in the process of adopting or drafting legislation that will criminalize cartel offenses.

I would just sum up by saying that as you witness this next generation of jurisdictions adopt criminal sanctions, when you read news reports of an unprecedented number of jurisdictions working together and joining in simultaneous coordinated raids on target companies around the world, when you hear about another jurisdiction like Mongolia, which just introduced a leniency program, the DNA for all of those developments dates back to Division policies and practices that were put in place back in the 1990s.

We had to learn some lessons the hard way, like *GE*, but we've learned from our experiences and we're moving forward, and that's what we're going to continue to do, now with the assistance of our sister enforcement authorities abroad.

ROXANE BUSEY: Scott, I have a follow-on question for you. I was going to ask you for a bit more specificity. As more jurisdictions adopt criminal sanctions, how has that affected the Division's enforcement or its procedures?

HAMMOND: In terms of how will the Division's enforcement decisions, its charging practices, its sentencing recommendations, how will they be impacted by a criminal prosecution abroad, the answer to that depends on whether the Division is satisfied that a criminal prosecution abroad meets the deterrent interests of the United States. If we are satisfied that it does, then we would certainly take it into account.

Now, having said that, I think in the near term that it may be rare where we'll see a foreign prosecution of a target of one of our investigations meet that test. I say it's going to be rare for two reasons. Number one is, at least in the short term, I would expect that the United States will remain out in front of other jurisdictions in terms of our ability to put cases together to the point that they are ready to be criminally prosecuted, and I don't think we would defer a prosecution just waiting to see what another jurisdiction might do.

The second reason why it will likely take time before sentences imposed abroad satisfy U.S. deterrence interests is because there is likely to be a maturation process. It may take time before other jurisdictions that are introducing criminal sanctions begin to impose sentences that we would consider to amount to a sufficient deterrent to protect U.S. businesses and consumers.

Now, having said that, in the *Marine Hose* cases brought in the United Kingdom, we did take into

account a foreign sentence imposed by a court abroad in the sentencing of the same defendant in a U.S. court. In the *Marine Hose* case, we entered into plea agreements with three U.K. foreign nationals, where they admitted to fixing prices and agreed to serve lengthy jail sentences here in the United States. Then we put them on an airplane. They were escorted by federal agents back to London, where they also pled guilty to violating the U.K.'s criminal antitrust law, the U.K. Enterprise Act. They provided full cooperation to the U.K. authorities, and were sentenced. Our plea agreements with each of these three U.K. nationals provided that if the defendant was sentenced to a period of incarceration that met or exceeded the sentence called for in his U.S. plea agreement, then he would not have to return to the United States to serve his sentence. Thus, he wouldn't be subject to a consecutive sentence. That's exactly what happened. The sentences imposed in the United Kingdom matched those sentences called for in the U.S. plea agreements. Obviously, that is a new development. These were the first cases that were brought in the United Kingdom, and they were able to obtain some very substantial jail sentences. An extraordinary deterrent that will not only advance anti-cartel enforcement in Europe, but in the United States as well.

I would like to see this scenario repeated in other cases and with other jurisdictions. We are exploring whether it's possible with other jurisdictions, because I believe it is an important step to achieving our goal of creating a strong global network of anti-cartel enforcement.

WILLIAM MACLEOD: Commissioner Kroes, I want to turn to private rights of action. You mentioned in your opening remarks your White Paper. Could you update us on where the jurisdictions are within the European Union on bringing about private rights of action?

KROES: Just last Wednesday, our White Paper was agreed upon in the European Parliament, party-wide. So we are counting our blessings. It has triggered wide debate. But no one has questioned the core premise, that victims of competition infringements deserve the access to justice that our courts have mandated. But there was just the fear that we should import your system. I am just mentioning what is reality. I think that fear is not completely a joke, for you have done the job and you have perhaps just made it a bit too excessive.

Anyhow, I repeat that we will do it in the European way, because it is our commitment to that approach which allowed Parliament to accept it—and more than accept it, it is in favor of it. My belief remains the same. We have to deliver the right to compensation to consumers and law-abiding businesses.

MACLEOD: I have a question for Chairman Leibowitz. I think the bidding is currently at criminal enforcement of Section 2 from DOJ. Do I hear criminal enforcement of Section 5 from the FTC?

LEIBOWITZ: It's so funny, Bill, you raised this. I hadn't really thought about it until today. But on unilateral conduct, at least, we're somewhere between the report that the Justice Department issued, which wanted to use a disproportionality test, and where Scott is today, because he wants to put these people in jail on unilateral conduct.

On Section 5, one of the problems we've found is that it is very difficult—and *Rambus* is a perfect example of this—to win unilateral conduct cases, even when we feel the evidence is strong, in the courts. And so we have to look at all the tools in our arsenal to try to stop anticompetitive behavior that might harm consumers. One of the tools in our arsenal—and it is utterly clear if you read the congressional debate in 1914 about the creation of the FTC Act — is that Congress wanted to give us jurisdiction beyond the antitrust laws. Think of it as a penumbra around the antitrust

laws. Under Section 5, you have limited remedies if you bring a pure Section 5 case. You would use it to make people cease and desist from bad acts.

The antitrust laws have been enormously circumscribed over the past thirty years—and, of course, some of that circumscription and limitation is good. I don't think I want to go back to the days of, say, the *Neal Report* or *Von's Grocery*. But some of it, I think, has gone a little bit too far. Some judges have swallowed a bit too much of the Chicago School elixir. We need to move—to mix metaphors; I apologize—we need to move the pendulum back a bit to stop anticompetitive conduct.

And so I've been talking with my colleagues—I see Commissioner Harbour here—about using Section 5. And again, if we use Section 5, Bill, it won't be the same way that the Commission used it in the late 1970s, when antitrust law was extremely expansive and they wanted to go even beyond that. It would be in a way where we'd try to stop anticompetitive behavior that harms consumers and go outside the somewhat or very circumscribed area of antitrust enforcement.

And so I think, going forward, we're having a discussion with all the Commissioners about trying to find a case, an appropriate one. It might be in the unilateral conduct area. Although I also think there are still plenty of cases where we can use Section 2.

BUSEY: An important question has to do with *Leegin* and resale price maintenance. I think the audience would like to know where you all stand on that.

Bob, I'm going to start with you. The Supreme Court in *Leegin* recognized that there were at least some circumstances where there was no harm to consumers as a result of resale price maintenance. I know that in certain states, including New York, in enforcing their state antitrust laws *Leegin* is not being followed.

My question for you is: Can you envision any circumstances under which there would not be consumer harm under a resale price maintenance scheme?

HUBBARD: I have to admit that I don't look at it as a way to prove a theory, whether resale price fixing is always bad. There are instances in which manufacturers try to put in place a resale price-fixing arrangement and there actually is plenty of competition from other people and they can't implement it. It doesn't work. In that instance there's no consumer harm. In the instances in which it does work, there probably is consumer harm.

But it's more a question of looking at what harm occurs and trying to understand that and going from there, instead of getting stuck in the theoretical mud.

I think that in the past year, and ever since *Leegin* came down, the dynamic has significantly changed. The dispute used to be about whether there was an agreement, instead of what the effect was, how you measure the effect, and how the restraint impacts the market. I think that one of the effects that has had on state enforcers—I know that the FTC is having workshops on this also—is to ask those questions: What is the effect? How does it happen? When does it work and when doesn't it work? When is a brand a sufficiently differentiated product that you really shouldn't be thinking in market definition terms; you should be thinking about the power of that brand and whether a significant group of consumers can be harmed because of that power.

So I think that there is still some work to do to think through all those issues and to make prudent and wise decisions about how to enforce. We are making some progress, I think, on those fronts.

BUSEY: There is legislation pending to reverse *Leegin*. I know, Jon, you said that you would support that legislation. Maybe you would like to articulate your reasons for that.

LEIBOWITZ: Well, look, I would say that reasonable people can disagree about resale price maintenance and about the *Leegin* case. And, of course, at our Commission reasonable people do disagree. I think Bill Kovacic was a supporter of the decision, and I think Commissioner Harbour and I—and Commissioner Harbour has been a leader on this issue—were not.

I do think that one of the things that is very helpful to us is to do this series of workshops under Commissioner Harbour's leadership. We will finish up and we will write a report. I think we can help contribute to the policy debate.

I happen to think that per se treatment is appropriate. That is what the legislation would do. I think there will be a lot of momentum for the legislation going forward. But we are going to try to take a reasoned and balanced approach to our workshop and to our report, and we will see where that goes.

I worry that RPM

The only other point I wanted to make, just following up on yours, is that even after *Leegin* it is still clear that you can bring RPM cases. You might do it under a rule of reason. I think we suggested in our *Nine West* petition it possibly could be under some sort of intermediate scrutiny.

disadvantages

So if the legislation passes, we will use it as a tool in our arsenal. If it does not, we are still going to be involved and actively engaged in this area.

distributors who want

to compete based on

BUSEY: My specific question is: Why the per se rule? Given particularly what Bob has indicated, why is the per se rule needed when these factors can be taken into account under a rule of reason?

a low-price strategy.

LEIBOWITZ: Roxane, that is a fair question. But remember, this is an agreement between companies to set prices. One reason was because I think we believe here—I mean I am certainly a strong supporter of stare decisis, and *Dr. Miles* has been on the books since, I think, 1911—and again, is it like horizontal price fixing? I understand the argument that it isn't. But also I think we can do better things for consumers if we have the tool in our arsenal where we can use the per se approach.

It may be possible to

achieve benefits from

RPM, but there may be

BUSEY: Commissioner Kroes, I'd like to ask you as well. Canada, for example, has changed its law in light of our Supreme Court's decision. I don't know where the European Union stands in terms of looking at this issue.

other, and certainly

less harmful, ways to

KROES: We don't have a per se approach to resale price maintenance. But you can trust me, be sure that we are very, very skeptical of the concept.

achieve the same

There is, for example, a French case of effective resale price maintenance, the *Loi Galland*, that hurt consumers a great deal through higher prices, that is proven. To paraphrase Justice Breyer in his dissent in *Leegin*, he said, "We already know that it raises prices, so show me the benefit."

benefits.

—NEELIE KROES

So I remain to be convinced about the benefits and I worry that RPM disadvantages distributors who want to compete based on a low-price strategy. It may be possible to achieve benefits from RPM, but there may be other, and certainly less harmful, ways to achieve the same benefits.

WILSON: Not surprisingly, we have questions from our membership about the effect of the economy on antitrust enforcement, one in particular from Bob Langer for Chairman Leibowitz and Commissioner Kroes.

ROBERT LANGER: My question is for Chairman Leibowitz and Commissioner Kroes. What, if any, changes can we expect to merger control in the United States and in the European Union in light of the global recession?

LEIBOWITZ: I actually think you won't see major changes at the Federal Trade Commission. Speaking for myself, not for my colleagues, I think we are going to continue to vigorously enforce the antitrust laws. We will, of course, recognize that sometimes we may be dealing with failing firms and take that into account, as antitrust laws do. But I really do think that the antitrust laws have served us very, very well for many, many years, and they have adapted to boom times and to depression. Even though we are in a very severe economic recession, I think the antitrust laws will continue to be enforced in the manner in which we have, which is continuity.

KROES: Just to start with saying that the single market for Europe is the crown jewel. We are proud and we are aware that it is a great, great advantage to have a single market. It means that we are the biggest economic market on earth. We should be aware that a single market is only functioning if there is competition, and that it is not only linked to mergers, to cartels, but it is also linked to state aid. I was already mentioning that. So you can be absolutely sure that we are determined to be the referee for all those activities and for all those possible attacks on the single market.

I think we are, indeed, stimulated by the Treaty and the founders warning about how to deal with state aids.

We should also take a lesson out of the experience you have had in the United States during the Great Depression. I think there is an interesting research project done by a couple of faculty members of the UCLA University where they have proven that the recovery took several years longer because, with all respect, at that time they took competition away. Well, why should you make a mistake twice?

BUSEY: Jim, I have a follow-up question. It actually comes from your Chair's Showcase Program yesterday, where there was a lot of discussion about the concept of a failing economy exception in the Merger Guidelines, or the concept of "too big to fail."

My question, starting with you, Jon, again, would be: Is this something that the antitrust laws should be taking into account, and, if so, how?

—JON LEIBOWITZ

LEIBOWITZ: I would say this. We've heard a lot of chatter and discussion, I think, about the "too big to fail" doctrine. From my own perspective, the antitrust laws don't really ask whether a merged entity is too big to fail; they ask whether a firm would be able to exercise market power, raise prices for consumers, and lessen competition or substantially lessen competition.

I do think at the FTC, at least in my four-plus years on the Commission, I have yet to see a merger that we've cleared that in any way invoked the "too big to fail" doctrine. You know, in the banking area, where we don't have jurisdiction, that might be a very legitimate issue, and I defer to Commissioner Kroes on this, because she has far more jurisdiction than we have at the moment.

So I think it's interesting. The Commissioners' minds are always open to new arguments. I hope we never get to the point where we have to deal with the failing economy problem in the context of a merger or an investigation. I think we all feel that way.

BUSEY: Okay. But you did mention there might be some revisions to the Merger Guidelines, and this was proposed as a possible revision.

LEIBOWITZ: I think that's a great point. Again, I think I need to talk to my colleagues. We have started to talk. We need to wait until Christine Varney is firmly ensconced in the Justice Department, which hopefully will be soon. But if we proceed down the road of Merger Guidelines revisions,

Even though we are in a very severe economic recession, I think the antitrust laws will continue to be enforced in the manner in which we have, which is continuity.

I think we're going to want to talk to all stakeholders. We are going to keep our mind open. That's the way you should approach new Guidelines and really approach new issues. But again, I hope we don't get to the failing economy doctrine any time soon.

BUSEY: Commissioner Kroes, it has been deferred to you.

KROES: I saw that there was again one member of your audience that was addressing me.

Too big to fail. Okay, maybe, but don't say it too easily. Always thinking a bank or a company is too big to fail is a problem for the system. In this case it made sense to save the banks, but it is also true that no bank is too big to restructure, and that is my lesson now.

BUSEY: That's a good answer.

WILSON: One of our videotape questioners asks about consumer protection in a recession.

STEVE COLE: I'm Steve Cole, President and CEO of the Council of Better Business Bureaus, and my question is for Chairman Leibowitz. Mr. Chairman, will the economic problems have any effect on the consumer protection mission of the Commission? If so, where might we expect to see more consumer protection activity?

LEIBOWITZ: That's a great question, because just as I think we'll be approaching antitrust from the same perspective that we have in the past, I think in the consumer protection area we are going to in some ways emphasize certain areas.

One is clearly subprime and predatory mortgages. In the financial services area, over the last five years we've brought sixty-eight cases, about a third of them in the last year. In the last ten years, we've gotten in consumer redress—and I know it's not about the money, but when it involves consumers getting redress it can be about the money—\$465 million. We are going to make this a huge area because consumers are hurting, and we know that there are advertisements out there, because we've done sweeps, by companies that are patently, clearly misstating or clearly being deceptive in the terms and conditions they're offering. We did an Internet sweep and we found 200 different companies that had ads that were facially invalid. You know, "one percent mortgage"—it didn't say anything about where the mortgage would be six months later. So that's going to be an area where we focus.

We have been putting more resources into the consumer protection financial practices group—we are moving from about thirty attorneys who were working on this to about sixty, including the regional offices.

The other thing that will be enormously helpful to us is the Omnibus Appropriation Act. Senator Dorgan and Senator Rockefeller got us the ability to do APA rule making in this area. So we are going to look at the entire life cycle of mortgages. As some of you know, when we do rule making on the consumer protection side, we're under a kind of medieval form of rule making called the Magnuson-Moss Act. It takes six or eight years generally to do consumer protection regulations, which is a reason why we don't do very many of them. But when we have APA notice-and-comment rule making, we can be much more agile and swift in helping consumers. So this is going to be an area we focus on and an area where I think we can really help consumers who have been victims of predatory mortgages.

Just one other quick point and then I'll stop. We brought a case against a Bear Stearns subsidiary, EMC Mortgage, for deceptive practices. We settled the case for \$28 million, which is a lot

of money for us, last fall. It was deceptive mortgage servicing, which is one of the areas where I think we are going to do a rule making. We ended up writing 86,000 redress checks to American consumers. It is one of the things recently we are most proud of. I think there are more cases to bring in this area, and we're going to try to do our best.

MACLEOD: Bob, you mentioned in your opening remarks the increasing consumer protection emphasis as well. Do you see new things for the states to be doing on that side of your mission?

HUBBARD: Yes. There are lots. I just mentioned three of the biggest cases on predatory lending. There are lots of smaller-scale things going on.

In troubled economic times, credit scams and all sorts of debt collection abuses and other things are increasingly a problem. Many AG offices are redoubling efforts to make sure that people have access to good information, that they're not victimized. It's particularly important in these economic times. It has taken plenty of resources. It is retail work that makes a lot of sense to do.

LEIBOWITZ: Yes. And if I could add one more thing, just as we're going to continue to work with our international partners on conduct and merger investigations—and we do—we are going to ramp up our involvement with the state attorneys general on a lot of predatory financial practices and deceptive financial practices because, as all of us know, our resources are limited. We have to leverage our resources in the most effective way. Partnering with the state AGs, who also have somewhat limited resources, is one of the best ways to get the most bang for your buck in helping consumers.

HUBBARD: Right. We have done sweeps together and other things. Some of them have been very helpful in figuring out what the landscape is, where the problems are, how to get rid of the worst problems, and then focusing on how best to proceed.

WILSON: We never get too far from questions about the money. Our next question actually is another question about fines.

ANITA STORK: I'm Anita Stork with Covington & Burling in San Francisco. I have a question for Commissioner Kroes. Recently the fines in Commission cases have exceeded a billion euros a year. No matter what the exchange rate, that's a lot of money. Why are the fines imposed by the Commission so high? Are they too high? Do you think they will stay at these levels?

KROES: They are certainly not too high. But you are not surprised to hear me say that. And there are still cartels, so perhaps they are not high enough. Very seriously, we have to take into account in our calculations that at the end of the day we can defend our decisions in the court in Luxembourg. I can assure you that nearly everyone is going to court to argue that our calculations are too high! But if you are acting against the law you have to face the consequences.

By the way—I think that I touched upon the same issue last year—it is not only a matter of money. Nowadays it is also a matter that CEOs are coming over for a cup of coffee and they are saying to me, "We don't want to be on the front page of the *Wall Street Journal* or of the *FT* or whatever. We would love to be on the front pages with good news and not that you caught us." So now it's not just the fines that the company worries about, but the reaction of the outside world. Shareholders don't want to be involved in companies that are not following the rules.

Sometimes it is said that the fine is only for the benefit of consumers. But it is also for other businesses, for most businesses are acting in a correct way but can suffer harm from cartels. Sometimes we forget that. When a couple of businesses are not acting in a correct way, they should absolutely be fined.

In our calculations we take into account the size of the market affected, the duration of the cartel, and of course if you are a repeat offender, then we are really tough, I can assure you.

LEIBOWITZ: If I could add a word of support for Commissioner Kroes, we are an agency, the Federal Trade Commission, for the most part, without fining authority. From my perspective—if we had fining authority for consumer protection violations, and maybe for antitrust violations, although I would say not for pure Section 5 cases, we would be able to more effectively stop anticompetitive behavior and stop consumer harm. Forty-seven state attorneys general have fining authority. If you don't have fining authority—and it is particularly true on the consumer protection side—it is very hard to have an effective deterrent.

WILSON: Let me at least play the devil's advocate here for a moment. A lot of industries are distressed today. Scott, is there any point at which the financial distress of an industry facing these fines plays any role in the calculus, where you consider their financial condition in setting the level of the fines?

HAMMOND: Yes. Under the U.S. Sentencing Guidelines if the imposition of a Guidelines fine would jeopardize the viability of a company, then it must be reduced. However, we would reach that same conclusion regardless of whatever the Guidelines said. After all, we are the Antitrust Division, and we cannot be in the business of putting competitors out of business. So I can assure you we would take it into consideration.

When we're determining an appropriate fine for a company, we look at what a company can pay immediately. If they can't pay the appropriate fine immediately, then we consider an installment schedule of up to five years with interest. If we determine that the company cannot pay the determined fine over time, then we would determine whether the company could make the installment payments if the interest was waived. If we determine that the company is still not capable of paying the fine over five years, even without interest, only then would we drop the fine.

There are a number of defendants whose fines have been lowered based on an inability to pay. I can tell you, however, that it is a very rigorous review process that we put companies through in terms of determining the company's true ability to pay.

In the present economy, with credit markets drying up, it adds a new wrinkle to this analysis. It is more difficult to determine what a company can pay over time or to forecast what the company's financial situation is going to be over time.

Bottom line, however, is that when we make a determination of what we think is the appropriate fine, the Division will not settle for a penny less. I would hope, since so many of you represent businesses that are victims of cartel crimes, that that's exactly what you would want us to do. As the Commissioner said, businesses are usually the first victims of cartel activity.

And of course everybody knows what happens in desperate times. Sending a signal that we were going to be soft with respect to fining companies in these times would be absolutely the wrong message.

Finally, I want to give a shout out to General Counsel in the audience and other members of the business community here, who are obviously having to tighten their belts and make decisions on

where to put scarce resources, that you not shortchange your corporate compliance programs. I don't think I'll get a lot of disagreement from the rest of the folks in the audience on this. This is not the time to divert money away from corporate compliance, in all seriousness. Unfortunately, we expect to see an up-tick in cartel activity as competitors facing hard times look to alternatives to true competition.

WILSON: Commissioner, does the European Commission take the same approach?

KROES: Slightly the same. But I want to add to that that, in general terms—the fine limit of 10 percent of turnover, already put in the legislation in 1962, is in most cases far from reached. So we are well within our legal limits and the circumstances of today won't change our approach.

This is not the time to divert money away from corporate compliance, in all seriousness. Unfortunately, we expect to see an up-tick in cartel activity as competitors facing hard times look to alternatives to true competition.

Then I am coming back to my earlier remark. What we were facing in the management of the financial world is a need for some people to blame. But we should stop blaming and start taking responsibility. I don't want to be blamed by my granddaughter in a couple of years. I don't want to be blamed by her, when I was aware of what was going wrong in the business world, that I didn't act.

Having said that, I think sometimes it is difficult. I still remember a letter I got, a personal letter from a fourteen-year-old girl. She wrote me: "I asked for an explanation of your policy as Competition Commissioner and I got it. I think you are doing a great job. But in the case that is quite close to our own family business, I have to add to that that sometimes you are just the cause of big sadness in a family. My grandfather started the company, now my father was involved in a cartel, and now we are facing a big misery."

So I think that taking into account that even a girl of fourteen took the line that you have to be consistent, you have to be aware that ignoring the rules of the game doesn't fix any problems.

WILSON: I am encouraged to know that our antitrust policy will survive these difficult economic times. I do wonder whether perhaps here in the United States we'll be seeking technical assistance from the European Commission on the issue of state aid.

But let's move on to some of those issues that we as antitrust lawyers see in boom and bust times.

RICHARD GILBERT: I'm Rich Gilbert from Competition Policy Associates, California-Berkeley. I'll direct my question to Chairman Leibowitz, although I'm happy to hear from others as well. My question is on patents. Patent assertion is one of the few growth industries we have these days. In some situations, though, patent awards and settlements appear to reflect business strategy more than the technical merits of the patent. Holdup in standard setting is one example. Other examples relate to products that are covered by lots of intellectual property, as in the *Alcatel/Lucent* MP3 case. Will strategic patent assertion continue to be a priority for enforcement by the Commission, particularly in the post-*Rambus* legal environment? Also, will the Commission and the Division support patent reform legislation that will address, hopefully, strategic patent assertion?

LEIBOWITZ: I'd start by saying that we don't like to admit at the FTC that we're in the post-*Rambus* era. But I suppose we all but are.

I would say this. I'll make a couple of points. We are going to stay very, very actively involved in this area, the area of holdup and anticompetitive behavior involving the intersection of patents and antitrust. I'm not quite sure exactly—and I think it's going to require consultation among our

—SCOTT HAMMOND

colleagues—exactly where we are going to go, but we obviously have more standard-setting cases that we are looking at in the pipeline. We have used Section 5, I think, effectively in the context of *N-Data* to go after problematic and anticompetitive conduct relating to standard setting.

The other thing that we're doing on intellectual property is holding a series of workshops on intellectual property and patent matters that will result in a report. It's a follow-up to our 2003 report that was done under Tim Muris. I think that will help inform where we will be going in the future.

In terms of patent reform legislation, I'd say this. To some extent, it depends what's in this year's newest iteration of patent reform legislation. Obviously, some of the things we were very, very concerned about in 2003 have been addressed by the Supreme Court. Other things have not. The issue of patent ambush and patent trolls are ones that we will be thinking about going forward.

WILSON: Let me ask you, Jon, and Bob you may want to follow up, about another intellectual property issue. I think you alluded to this in your opening remarks, Jon. The issue of reverse payments has been a significant one for the Commission, but you haven't done well in the courts. Do you see any way to reconcile the position the Commission has taken with those decisions? Is Supreme Court review your only avenue, or is legislation the way out of this?

LEIBOWITZ: Well, it's a good question. We have not done terrifically well in the courts, it is true. Our position has only been vindicated in the *Cardizem* case, which is the case in the Sixth Circuit.

I do think that we are moving forward in this area for a variety of reasons.

First of all, if you listened to Christine Varney's testimony at her hearing, I think she is clearly supportive of the FTC position. Obviously, when we tried to get the *Schering* case to the Supreme Court, the Justice Department came out against us. Although it modified its position a little bit later in the *Tamoxifen* case, it clearly was on the other side. I don't think that's the case going forward because, of course, President Obama has said as recently as two weeks ago in his budget that he supports ending these pay-for-delay deals that harm consumers and prevent them from getting generic drugs in a timely manner.

So I think there is a case that is on appeal to the Supreme Court now out of the Federal Circuit. We have cases in the Third and Ninth Circuits, which are considered to be fairly progressive on antitrust issues, along with, I might now say, the Sixth Circuit.

And then there's a whole other avenue, which might be the cleaner and better approach, and that's the legislative approach. We have a lot of support for legislation. The Commission is firmly behind this legislation. Every Commissioner and every Chairman, going back through Tim Muris and Bob Pitofsky and Debbie Majoras and Bill Kovacic, supports legislation to ban these anti-competitive deals in which brands pay generics literally to stay out of the marketplace.

It is somewhat more complex, but not that much more complex than if I own a gas station and you want to build a gas station across the street. I can't say, "Here's \$200,000. Go away for five years." Now, when you're dealing with patents it's a little bit different. But the concept should be, at least from the perspective of all of the FTC Commissioners and the FTC staff, that these deals are anticompetitive.

So whether we solve it through the courts or whether we solve it legislatively, I think we are agnostic on that. I do think in some ways, if we get legislation in the context of health care that bans these deals, that is a cleaner solution, and actually would give the business community more certainty sooner, and that would be valuable, I think.

WILSON: And more predictable.

Bob?

HUBBARD: Certainly the states have supported the FTC in this effort. I mentioned the interim briefing memo to President-elect Obama in which this was one of the few items that was listed as important.

You know, I am an undying optimist—every so often I recognize that patent law developments are occurring and I wonder for example whether the restraint in *Cardizem* might have never been possible because the patent would have failed the Supreme Court's recent test for obviousness.¹⁶ And there are other things going on. Maybe part of the problem is that so much money is sloshing around that the patent system really has to be fixed. Maybe that will have the unintended benefit of getting rid of some of these problems.

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WILSON: The Section's Transition Task Force endorsed the use of retrospective analysis by the agencies as they are examining their enforcement policies. On that issue, we have a question from one of our videotape questioners.

DAVID ALTSCHULER: I'm David Altschuler from Akin Gump. This question is for Chairman Leibowitz. The FTC's Bureau of Economics recently published a retrospective study on a pair of consummated hospital mergers in Chicago and found that in one of the mergers prices increased significantly due to the combined firm's market power. President Obama has promised increased antitrust enforcement in health care. My question is: Should we expect more retrospective studies, and do you expect that they might lead to more enforcement actions?

LEIBOWITZ: I'd start with this point. When President Obama said that he wanted increased antitrust enforcement in health care, I'm not sure he was saying to us "do more retrospectives."

Anyway, I do think that we will continue to do retrospectives. They have been enormously helpful to us. Our hospital retrospective, which was begun under Tim Muris, informed our thinking in terms of our *Evanston* case. It was one of the few hospital merger cases that the Commission has won in recent—I would say years, but it's probably decades.

It also gave us enormous evidence going forward in other hospital merger cases, because what we found is six years after the *Evanston* hospital merger was consummated, that payers were paying two and three times the price they had paid before. I think that was probably helpful in the context of *Inova/Prince William*, another successful hospital challenge because the A-side company pulled out, and will be helpful and useful to us going forward.

So I think retrospectives can be enormously important. They can be enormously important in developing cases. They can also be enormously important in telling you you shouldn't develop cases. My immediate past predecessor, Bill Kovacic, is a strong supporter of retrospectives, and I see Commissioner Harbour nodding. So I think we'll continue to do this. I think it's a good thing.

Again, we're not about just bringing cases whimsically. We're about trying to figure out whether to bring cases that harm consumers and that violate the antitrust laws. That is a good way to go back and look at what we've done right and what we've done wrong.

—BOB HUBBARD

¹⁶ See *KSR Int'l Co. v. Teleflex Inc.*, 550 U.S. 398 (2007).

HUBBARD: On behalf of my colleagues in California, I particularly appreciated the retrospective on the *Sutter Summit Hospital* transaction.¹⁷ California lost the case challenging the transaction,¹⁸ but they were intrigued to see that the transaction may have been anticompetitive.

BUSEY: We all know that President Obama has health care reform on his agenda. My question for you is: What role do you expect competition/antitrust enforcement to play and, in particular, do you have a position with respect to single payer or price regulation?

LEIBOWITZ: I hate to dodge yet another one of your questions, Roxane, but I don't think we have a position on single payer or price regulation. I think that's a little bit out of our ambit.

I do believe that as health care reform goes forward, of course, we'd like to solve the reverse-payment/pay-for-delay/settlement problem in that context, that it's an opportunity to do that legislatively.

I think beyond that, on the competition side, to the extent that Congress wants our policy views, we are always happy to provide them. And indeed, under Bill Kovacic we started to think a little bit about biologics, and we are writing a report on generic biologics and what should be the pathway going forward, and some other health care issues.

On the consumer protection side, the Stimulus bill gave us rule-making authority to issue a rule on data security breaches relating to health entities not covered by HIPAA. So we're going to stay involved in this area, and we will see where health care goes and where our issues go with it.

MACLEOD: Commissioner Kroes, inquiries by the European Commission and the UK antitrust agencies into whether markets are working well have claimed to identify some significant competition issues. Can you tell us about them?

KROES: One, I'm delighted to have this instrument, for it is useful to find out if a market is functioning, and not only in one Member State, but that we are allowed to do it all over the whole single market, so to say.

We started with energy and financial services. I assure you that was an absolutely great experience. We were already aware of competition issues in these markets, but there is a difference when you are just thinking, feeling, having the impression that the market isn't optimally functioning, but finding out at that level in the inquiry that it indeed wasn't functioning. And we could take a couple of initiatives, for example, for energy policy. We did make a great step forward, for in Europe it was very much focused on the national markets. It was the incumbent who was playing the music. It was not making the investments that were absolutely a must for, for example, the infrastructure.

And by the way, when we were finding out, we in the meantime could also find out that there should be a couple of enforcement actions. Combining that, and then just to prove that it is not about money but it is about the goal that the market should function, the incumbents when they were aware that we had them on our screen and it was really big fines that we were talking of, then they came in, even against their own government, so to say. They came to us and they offered to make decisions that were in line with our goals in the energy market.

¹⁷ See FTC Bureau of Economics Working Paper No. 293, *The Price Effects of Hospital Mergers: A Case Study of the Sutter-Summit Transaction*, available at <http://www.ssrn.com/abstract=1301575>.

¹⁸ *California v. Sutter Health Sys.*, 84 F. Supp. 2d 1057 (N.D. Cal. 2000).

The same in financial services. And we are close to the final report of the sector inquiry into pharma. We were inspired by you in the United States to do an inquiry in that field. I think that, anyhow, with the draft we already found a couple of interesting things in the market.

So I would advise you, if you are aware that there is something rotten in the state, just find out via a sector inquiry.

BUSEY: Jon, our program wouldn't be complete unless we had a merger question for you. We know that the FTC has been very successful lately in enjoining Whole Foods and in *CCC/Mitchell*. We had an excellent program yesterday that talked about the cases. I'm not sure that many of us are concerned about the results in the cases, but there is a concern whether the standard for obtaining a preliminary injunction is different for the FTC and the Department of Justice.

So my question for you is: What is your position on that? Would you consider legislation that might change that?

The notion that a merging entity by having to go into Part 3 is going to have to pull its merger is one that we need to think about going forward, because I think that the business community has some points that are legitimate.

—JON LEIBOWITZ

LEIBOWITZ: I would say this. If you look at Section 7, the standard is absolutely identical for both the Justice Department and for the Federal Trade Commission.

Having said that, clearly procedurally it is a different standard. We have to show, if we want to get into Part 3, that the questions are so serious and so substantial that they need to go to Part 3. I know members of the bar have been concerned about this, and I don't think it's an illegitimate concern actually.

But having said that, I am hopeful that our reforms in Part 3, and really truncating the process of doing a Part 3 determination in a merger, will diminish any differences in procedures and any perceived differences in outcome.

So I think at this point the best approach isn't to look for legislation. I think it's to work through the Federal Trade Commission process. We should do our job, too, in trying to make Part 3 as fast as we possibly can. We have even had some discussions about speeding up the merger review, which is now very, very fast track in Part 3, somewhat more if companies want to do that.

I totally agree and believe that we shouldn't have different standards as a practical matter—I don't believe we have them—and also that companies deserve a—I wouldn't call it an up-or-down vote, but they deserve a determination by the agencies as quickly as we possibly can.

The notion that a merging entity by having to go into Part 3 is going to have to pull its merger is one that we need to think about going forward, because I think that the business community has some points that are legitimate. I think we are going to work very, very hard to diminish any concerns they have going forward.

MACLEOD: Competition concerns arise with intellectual property beyond patents. As a matter of fact, copyrights have been an issue recently on the other side of the ocean. Our next video question goes to Commissioner Kroes.

PATRICK THOMPSON: I'm Patrick Thompson from Goodwin Procter in San Francisco. My question is for Commissioner Kroes.

You've been involved in a few difficult copyright issues during your time as Commissioner, with *iTunes* and collecting societies cases, and perhaps most famously last fall, the roundtable with Mick Jagger. My question is: Why is this area important to you and what do you want to achieve?

KROES: The EU single market is based on a relatively straightforward premise: the fewer the barriers between markets, the more efficiency.

It was not only Mick, by the way, but it was also Steve Jobs and it was also the number one of eBay and of the consumer organization in Europe. We had an interesting meeting. It was all about, indeed, copyright issues and about *iTunes* and collecting societies cases.

What is really difficult to explain to the consumer—and that was one of my difficulties at that time, and it still is, is that in Europe distributors may need separate licenses from dozens of different collecting societies if they want to operate throughout the European Union, and that customers in one Member State may not be able to buy from an online store in another. Well, I can't explain that if you are talking about a single market.

The online market is more fragmented than the market for physical CDs, for example. So we have to come through and, so I started the discussion with top industry and consumer representatives about how those barriers can be eliminated.

This roundtable, by the way, did give a positive conclusion, some of the participants who were fighting each other before courts at the end of this online roundtable session said, "Why shouldn't we sit together, and can we use your office, Neelie, and just try to find a solution for what we should have in mind?"

I think that type of attitude makes sense. But, anyhow, we should make the single market more workable, and certainly for online issues.

WILSON: We have one final video question. This goes to Assistant Attorney General Hubbard.

PATRICIA CONNERS: This is Trish Connors from the Florida Attorney General's Office and the immediate past Chair of the NAAG Multistate Antitrust Task Force. My question is for Assistant Attorney General Bob Hubbard.

Bob, this will be your last year as the current Task Force Chair. Looking back over your period of service, would you say yours was a great term as the states' antitrust leader or perhaps the greatest term? What would you say have been your most significant accomplishments during your term?

HUBBARD: I'm speechless, Trish.

I've had the pleasure and the honor of being the Task Force Chair for four years. A lot of my time has been spent trying to prevent disasters.

The initial press release announcing the Antitrust Modernization Commission questioned the value of state enforcement.¹⁹ We were thinking about reinvigorating enforcement against vertical restraints, and then, shockingly, a pro forma decision out of the Fifth Circuit attracts the attention of the Supreme Court. All of a sudden there's going to be a decision on resale price maintenance. Everyone expected the Supreme Court to reject the per se rule decisively. I felt as if I were swimming up a waterfall. I think that now I'm only swimming upstream, and getting to that point is what I take pride in.

WILSON: One of my goals as the Chair of the Section was to actually hear Bob Hubbard say that he was speechless.

We have used our allotted time. Let's thank these enforcers for what I think has been a terrific way to end this Spring Meeting. ●

¹⁹ Robert L. Hubbard, *States and the Antitrust Modernization Commission*, ANTITRUST SOURCE, May 2005, <http://www.abanet.org/antitrust/antitrust-source/05/05/may05-hubbard.pdf>.

Obama's Antitrust Enforcers: What Can We Expect?

Sean Gates

A new president, elected on a platform of change, told the nation that the country had been “dying because trade and commerce had declined to dangerously low levels; prices for basic commodities were such as to destroy the value of the assets of national institutions such as banks, savings banks, insurance companies, and others. These institutions, because of their great needs, were foreclosing mortgages, calling loans, refusing credit.”¹

The president was Franklin D. Roosevelt. In an effort to shore up the economy, Roosevelt's National Industrial Recovery Act suspended the antitrust laws.² Some criticized this policy. The National Recovery Administrator responded that these critics “have really nothing to support them but the width of their mouths and the volumetric capacity of their lung power.”³

In 2009, the country faces another economic crisis. Now, too, there are those who argue that “[d]uring tight economic times, antitrust ‘is the first thing to go in terms of regulatory compliance.’”⁴

But someone seems to have forgotten to share this wisdom with President Obama. During the campaign, Obama sharply criticized the Bush administration, contending that it had “what may be the weakest record of antitrust enforcement of any administration in the last half century.”⁵ He vowed to “reinvigorate antitrust enforcement.”⁶ Now the President has chosen two outspoken advocates of expanded antitrust enforcement to head the nation's antitrust agencies: Christine Varney, a former Federal Trade Commissioner under President Clinton, to head the Antitrust Division, and Commissioner Jon Leibowitz to chair the FTC.

What can we now expect from the antitrust enforcement agencies? In a word, change. If their records are any indication, the two appointees will likely lead a resurgence of antitrust enforcement in both the conduct and merger areas.

More Aggressive Enforcement Against Single-Firm Conduct

Section 2 and the DOJ. Perhaps no area of antitrust law has created more controversy in the last few years than single-firm conduct. From 2006 to 2007, the DOJ and FTC jointly conducted a year-long series of hearings to study Section 2 enforcement. The result was not a joint report from the

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¹ Franklin D. Roosevelt, Second Fireside Chat (May 7, 1933), available at <http://www.presidency.ucsb.edu/ws/index.php?pid=14636>.

² Act of June 16, 1933, ch. 90, 48 Stat. 195 (codified as 15 U.S.C. § 703), invalidated by *Schechter Poultry Corp. v. United States*, 295 U.S. 495 (1935).

³ ARTHUR M. SCHLESINGER, JR., *THE COMING OF THE NEW DEAL: 1933–1935, THE AGE OF ROOSEVELT* 131 (2003).

⁴ Brian Wingfield, *Obama's Antitrust Dilemma*, FORBES.COM, Feb. 1, 2009, http://www.forbes.com/2009/02/01/obama-antitrust-regulation-technology-enterprise_0201_antitrust.html (quoting Professor Daniel Crane).

⁵ Barack Obama, Senator, Statement for the American Antitrust Institute (Sept. 27, 2007), available at http://www.antitrustinstitute.org/archives/files/aa-i-%20Presidential%20campaign%20-%20Obama%209-07_092720071759.pdf.

⁶ *Id.*

agencies. Instead, the DOJ issued its own report,⁷ which drew sharp criticism from FTC Commissioners Harbour, Leibowitz, and Rosch. These Commissioners called the DOJ report “a blueprint for radically weakened enforcement of Section 2 of the Sherman Act.”⁸

President Obama’s appointee to head the DOJ concurs. Ms. Varney declared in her confirmation hearings that she does not support the report’s conclusions and is open to amending, withdrawing, or reworking the report.⁹ More important, she rejects a central tenet of the DOJ’s report.

According to the report, the application of antitrust law to single-firm conduct must be carefully tailored to avoid false positives—the mistaken condemnation of conduct that benefits competition—which the DOJ argued chill procompetitive conduct:

Standards of section 2 liability that overdeter risk harmful disruption to the dynamic competitive process itself. . . . Importantly, rules that are overinclusive or unclear will sacrifice [the] benefits [of competition] not only in markets in which enforcers or courts impose liability erroneously, but in other markets as well. Firms with substantial market power . . . must . . . determin[e] in advance whether a proposed course of action leaves their business open to antitrust liability or investigation and litigation. If the lines are in the wrong place, or if there is uncertainty about where those lines are, firms will pull their competitive punches unnecessarily, thereby depriving consumers of the benefits of their efforts.¹⁰

Ms. Varney, however, has made it clear that she does not agree with this presupposition:

[T]here is no such thing as a false positive, you know, let’s get real. I have counseled numerous incumbents who are dominant as well as numerous new entrants. I can tell you, at least in my own experience, there is not a dominant incumbent who hasn’t done something that was lawful because they were afraid that it might be reviewed by the DOJ or a state attorney general or the FTC. I just don’t see it. Ten years back in the private sector I have never once seen it, so I think that this ruse of, you know, we have to be restrained in our enforcement because false positives will chill innovation, take an economic toll on society, and overall result in negative economic consequence, slowing output, increasing cost, I just think is false. I think the more people in the bar start rejecting this idea of false positives the better off we’re going to be.¹¹

The potential chilling effects of false positives has led to what some call “overly-cautious” Section 2 enforcement.¹² In fact, the Bush administration DOJ did not bring a single monopolization case. Ms. Varney’s rejection of the DOJ report’s key proposition will surely lead to more aggressive DOJ enforcement against single-firm conduct.

Section 5 and the FTC. While Ms. Varney will likely reanimate Section 2 enforcement at the DOJ, Chairman Leibowitz could well expand the FTC’s use of Section 5 to challenge single-firm con-

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⁷ U.S. DEP’T OF JUSTICE, COMPETITION AND MONOPOLY: SINGLE-FIRM CONDUCT UNDER SECTION 2 OF THE SHERMAN ACT (2008), available at <http://www.usdoj.gov/atr/public/reports/236681.pdf> [hereinafter SECTION 2 REPORT].

⁸ Statement of Commissioners Harbour, Leibowitz, and Rosch on the Issuance of the Section 2 Report by the Department of Justice at 1 (Sept. 8, 2008), available at <http://www.ftc.gov/os/2008/09/080908section2stmt.pdf>.

⁹ *Hearing of the S. Judiciary Comm.: The Nomination of Christine Anne Varney to be Assistant Attorney General in the Antitrust Division*, FED. NEWS SERVICE, Mar. 10, 2009 [hereinafter *Varney Confirmation Hearings*].

¹⁰ SECTION 2 REPORT, *supra* note 7, at 14.

¹¹ Recorded Remarks, Panel: Re-Energizing Section 2 Enforcement, American Antitrust Institute Annual National Conference, available at <http://www.antitrustinstitute.org/Archives/2008conferenceaudio.ashx>.

¹² See, e.g., Harvey J. Goldschmid, *Comment on Herbert Hovenkamp and the Dominant Firm: The Chicago School Has Made Us Too Cautious About False Positives and the Use of Section 2 of the Sherman Act*, in *HOW THE CHICAGO SCHOOL OVERSHOT THE MARK: THE EFFECT OF CONSERVATIVE ECONOMIC ANALYSIS ON U.S. ANTITRUST* (Robert Pitofsky, ed. 2008).

duct. Relying on *FTC v. Sperry & Hutchison Co.*,¹³ the Chairman insists that the FTC has powers that reach beyond the bounds of Section 2, allowing the FTC to condemn conduct that neither the DOJ nor private antitrust litigants may challenge.

Chairman Leibowitz's position is contrary to the prevailing view, which holds that the FTC's authority under Section 5 is no broader than authority provided under the other antitrust laws.¹⁴ This view is buttressed by a series of appellate court decisions rebuffing FTC attempts to go after conduct beyond the reach of the Sherman Act.¹⁵ Chairman Leibowitz nonetheless challenges the prevailing view as "cramped or confused."¹⁶ He argues that the "legislative history, statutory language, and Supreme Court interpretations reveal a Congressional purpose that is unambiguous and an Agency mandate that is broader than many realize."¹⁷ He therefore encourages the Commission to "place greater emphasis on developing the full range of its jurisdiction."¹⁸

According to Chairman Leibowitz, unilateral conduct may violate Section 5 even if the FTC does not show actual competitive harm, so long as the FTC shows "sufficient anticompetitive attributes," such as "oppressiveness, lack of an independent business justification, anticompetitive intent, predation, collusion, deceit, [or] a tendency to impair competition."¹⁹ This is a far lower standard than the "exclusionary conduct" and likely harm to competition needed to show a violation of Section 2. Chairman Leibowitz would have FTC enforcement efforts consider that "the framers of the FTC Act gave the Agency a mandate—one unique to the Commission—to use Section 5 to supplement and bolster the antitrust laws by providing, in essence, a jurisdictional 'penumbra' around them."²⁰

If embraced by the full Commission, Chairman Leibowitz's views may lead to a substantially enhanced enforcement agenda. This is especially true, as Chairman Leibowitz himself has suggested, with regard to single-firm conduct in the areas of standard setting and pharmaceuticals.²¹

For instance, the FTC's use of Section 5 in *N-Data*²² may well be a precursor of things to come. That case involved representations regarding intellectual property before a standard-setting

¹³ 405 U.S. 233, 244 (1972) (holding that Section 5 of the FTC Act is not limited to enjoining practices "likely to have anticompetitive consequences after the manner of the antitrust laws").

¹⁴ Richard A. Posner, *The Federal Trade Commission: A Retrospective*, 72 ANTITRUST L.J. 761, 766 (2005) ("It used to be thought that 'unfair methods of competition' swept further than the practices forbidden by the Sherman and Clayton Acts, and you find this point repeated occasionally even today, but it is no longer tenable. The Sherman and Clayton Acts have been interpreted so broadly that they no longer contain gaps that a broad interpretation of Section 5 of the FTC Act might be needed to fill."). See also 5 JULIAN O. VON KALINOWSKI ET AL., ANTITRUST LAWS AND TRADE REGULATION § 77.02 (2007) ("[T]he prevailing view is that there are limitations on Section 5's applicability to conduct which stretches beyond the letter of [the Sherman or Clayton Acts].").

¹⁵ See *E.I. du Pont de Nemours & Co. v. FTC*, 729 F.2d 128 (2d Cir. 1984); *Boise Cascade Corp. v. FTC*, 637 F.2d 573 (9th Cir. 1980); *Official Airline Guides Inc. v. FTC*, 630 F.2d 920 (2d Cir. 1980).

¹⁶ *Rambus, Inc.*, FTC Docket No. 9302 (Aug. 2, 2006) (concurring opinion of Commissioner Jon Leibowitz), available at <http://www.ftc.gov/os/adjpro/d9302/060802rambusconcurringopinionofcommissionerleibowitz.pdf>.

¹⁷ *Id.*

¹⁸ *Id.*

¹⁹ *Id.*

²⁰ *Id.*

²¹ See Jon Leibowitz, "Tales from the Crypt," Episodes '08 and '09: The Return of Section 5 ("Unfair Methods of Competition in Commerce Are Hereby Declared Unlawful"), Remarks Before the FTC Section 5 Workshop (Oct. 17, 2008), available at <http://www.ftc.gov/speeches/leibowitz/081017section5.pdf> [hereinafter *Tales from the Crypt*].

²² Statement of the Commission, *Negotiated Data Solutions LLC*, FTC File No. 051 0094 (Jan. 23, 2008), available at <http://www.ftc.gov/os/caselist/0510094/080122statement.pdf>.

organization, but it was not the traditional “patent ambush” case. There was neither failure to disclose nor deception. Instead, the FTC alleged that N-Data had repudiated a prior licensing commitment made to a standard-setting organization, demanding royalties higher than the original offer made when the organization was deciding whether to adopt the patented technology. Because there was no failure to disclose or deception, this conduct arguably did not violate Section 2.

Then-Commissioner Leibowitz joined the majority in a sharply divided 3–2 decision to challenge the conduct under the FTC’s Section 5 powers. The majority maintained that the conduct was an “unfair method of competition” because “[t]his form of patent hold-up is inherently ‘coercive’ and ‘oppressive’ with respect to firms that are, as a practical matter, locked into a standard.”²³ In a sharp dissent, then-Chairman Majoras protested that condemning a party for breaching its prior licensing commitment without finding a concurrent Sherman Act violation set the Commission on a “slippery slope.”²⁴ She charged the majority with failing to identify any “meaningful limiting principle” to discern an ordinary breach of contract case from an “unfair method of competition.”²⁵

But the majority went even further. It also alleged that the conduct was an “unfair practice” under Section 5, an allegation normally reserved for consumer protection matters, not competition matters involving major corporations, such as those subject to N-Data’s royalty demands. In response, then-Chairman Majoras expressed “serious policy concerns about using our consumer protection authority to intervene in a commercial transaction” to protect these “victims.”²⁶

As Chairman, Mr. Leibowitz is now in a position to lead a renaissance of FTC power to police single-firm conduct. Everyone’s eyes should be on the FTC in this area.

Good-bye to Reverse Payment Settlements?

The President’s appointments may well be a death knell for so-called reverse payment patent infringement settlements, in which a branded pharmaceutical company makes payments to a generic to delay entry. The FTC has led an antitrust offensive against this practice. But the FTC’s efforts have been at best unaided, and at worst undermined, by the DOJ. When the Eleventh Circuit vacated the FTC’s decision condemning reverse-payment settlements in *Schering-Plough*,²⁷ the FTC petitioned for certiorari. Not only did the DOJ refuse to join the FTC’s petition, when invited to file its views by the Supreme Court, the DOJ opposed the FTC’s petition.²⁸ The Supreme Court denied the petition, and since then, two other federal courts of appeals have followed the Eleventh Circuit in holding that reverse payment settlements do not violate the antitrust laws absent a sham or overly broad settlement.²⁹

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²³ Analysis of Proposed Consent Order to Aid Public Comment, Negotiated Data Solutions LLC, FTC File No. 051 0094 (Jan. 23, 2008), available at <http://www.ftc.gov/os/caselist/0510094/080122analysis.pdf>.

²⁴ Dissenting Statement of Chairman Majoras, Negotiated Data Solutions LLC, FTC File No. 051 0094 (Jan. 23, 2008), available at <http://www.ftc.gov/os/caselist/0510094/080122majoras.pdf>.

²⁵ *Id.*

²⁶ *Id.*

²⁷ *Schering-Plough Corp. v. FTC*, 402 F.3d 1056, 1068 (11th Cir. 2005).

²⁸ See Brief of the United States as Amicus Curiae, *FTC v. Schering-Plough Corp.*, No. 05-273 (May 2006).

²⁹ *In re Ciprofloxacin Hydrochloride Antitrust Litig.*, 544 F.3d 1323 (Fed. Cir. 2008); *In re Tamoxifen Citrate Antitrust Litig.*, 466 F.3d 187 (2d Cir. 2006).

With agency unity in this area, we may be saying good-bye to reverse payment settlements. Whether by legislation or litigation, this conduct will likely face a renewed challenge.

Undeterred, Chairman Leibowitz has championed a two-pronged offensive—using litigation to create a circuit split to get the issue before the Supreme Court³⁰ and advocating legislative action.³¹ Since *Schering-Plough*, the FTC has brought two cases challenging reverse payment settlements. In February 2008, the FTC sued a branded pharmaceutical company,³² alleging that it entered into unlawful settlements with four generic companies.³³ Then-Commissioner Leibowitz wrote a partial dissent to the FTC’s decision to sue, arguing that the agency should have gone further by suing the generic manufacturers as well.³⁴ Eleven months later, in January 2009, Leibowitz’s views seem to have prevailed. The FTC filed suit against a brand company as well as two generic companies, alleging that the defendants entered into unlawful reverse payment settlements.³⁵ In a concurring statement, then-Commissioner Leibowitz maintained that “[e]liminating these pay-for-delay settlements is one of the most important objectives for antitrust enforcement in America today.”³⁶

With Ms. Varney’s appointment, Chairman Leibowitz will have an ally at the DOJ. In her confirmation hearings, Ms. Varney said that she “was disappointed that the Justice Department essentially lined up on the side of the parties making these deals and, in so doing, opposed the FTC petition.”³⁷ She promised to “work with the Department of Justice to align the Federal Trade Commission and the DOJ on the reverse payment issue” as well as to support legislation to outlaw these settlements.³⁸

With agency unity in this area, we may be saying good-bye to reverse payment settlements. Whether by legislation or litigation, this conduct will likely face a renewed challenge. Moreover, look for the agencies to further explore the patent-antitrust interface with a view to push back on practices such as “evergreening” of pharmaceutical franchises.³⁹

Renewed Interest in Resale Price Maintenance

Another conduct area that is sure to get close scrutiny in the new administration is resale price maintenance (RPM). The Bush administration did not bring a single challenge to an RPM policy. Instead, it urged the Supreme Court to overturn the per se rule against RPM, which the Court did

³⁰ See Jon Leibowitz, Cmm’r, Fed. Trade Comm’n, Exclusion Payments to Settle Pharmaceutical Patent Cases: They’re B-a-a-a-ck! (The Role of the Commission, Congress, and the Courts), Remarks to Second Annual In-House Counsel’s Forum on Pharmaceutical Antitrust 8–9 (Apr. 24, 2006), available at <http://www.ftc.gov/speeches/leibowitz/060424PharmaSpeechACI.pdf>.

³¹ See *FTC v. Watson Pharms., Inc.*, FTC File No. 071 0060 (Feb. 2, 2009) (Leibowitz, Cmm’r, concurring), available at <http://www.ftc.gov/os/caselist/0710060/090202androgeleibowitzstmt.pdf>.

³² Complaint, *TC v. Cephalon, Inc.*, Civ. A. No. 08-cv-2141-RBS (E.D. Pa. Feb. 13, 2008), available at <http://www.ftc.gov/os/caselist/0610182/index.shtml>.

³³ See Sean P. Gates & Jeffrey Jaeckel, *Cephalon: FTC’s Shot at Reverse Payments*, COMPETITION LAW 360, Feb. 15, 2008.

³⁴ See *Cephalon, Inc.*, FTC File No. 061-0182 (Feb. 13, 2008) (statement of Commissioner Jon Leibowitz concurring in part and dissenting in part), available at <http://www.ftc.gov/os/caselist/0610182/080213comment.pdf>.

³⁵ Complaint, *FTC v. Watson Pharms., Inc.*, Civil No. CV-09-00598 (C.D. Cal. Feb. 2, 2009), available at <http://www.ftc.gov/os/caselist/0710060/090202androgeleicmpt.pdf>.

³⁶ See *FTC v. Watson Pharms., Inc.*, FTC File No. 071 0060 (Feb. 2, 2009) (Leibowitz, Cmm’r, concurring), available at <http://www.ftc.gov/os/caselist/0710060/090202androgeleibowitzstmt.pdf>.

³⁷ *Varney Confirmation Hearings*, *supra* note 9.

³⁸ *Id.*

³⁹ Leibowitz, *Tales from the Crypt*, *supra* note 21.

in *Leegin Creative Leather Products v. PSKS, Inc.*⁴⁰ Since that time, there has been much speculation regarding when, under a rule of reason analysis, RPM is unlawful.

During her confirmation hearings, Ms. Varney said she was “quite surprised” by the *Leegin* decision but thought that the decision “left the division a lot of room to continue to prosecute retail price maintenance where it results in anticompetitive consequences.”⁴¹ If her past enforcement positions are any indication, the DOJ will be exploring that room.

During her tenure at the FTC, Ms. Varney pushed for enforcement against RPM.⁴² She joined in several important RPM challenges. In a case against American Cyanamid, for instance, Ms. Varney joined the majority in inferring the existence of an illegal RPM agreement despite the fact that the defendants had never announced resale prices nor sought a commitment from distributors to sell at or above a certain price level.⁴³ In a case against Reebok, Ms. Varney joined the Commission in condemning an RPM policy, enjoining Reebok from using “structured terminations” to effect RPM even though such a termination “falls into the ‘gray’ area of RPM jurisprudence.”⁴⁴ Ms. Varney also joined in a number of other cases challenging vertical price fixing agreements.⁴⁵

Revitalized Merger Enforcement

During his campaign, President Obama criticized the Bush administration’s record in merger challenges. He cited statistics showing that between 2001 and 2006, the antitrust agencies challenged mergers at less than half the rate of the prior four years under the Clinton administration.⁴⁶ Obama promised to “step up review of merger activity and take effective action to stop or restructure those mergers that are likely to harm consumer welfare.”⁴⁷ His appointees promise to do just that.

In a provocative statement before the Senate Judiciary Committee, Ms. Varney promised to “rebalance legal and economic theories in antitrust analysis.”⁴⁸ She contended that in the last eight years “a lot of economic theory has been used to inhibit prosecuting mergers” and that “the Chicago school analysis” has led to “a real reluctance for government to go forward and attempt to block mergers.”⁴⁹ She therefore promised to bring “new rigor to economic analysis that underpins any prosecution.”⁵⁰

This may mean that we will see a resurgence of innovation market analysis and vertical merger challenges, two areas that were prominent during the Clinton administration but fell into relative disuse due to “conservative” economic analysis.

⁴⁰ 127 S. Ct. 2705 (2007).

⁴¹ *Varney Confirmation Hearings*, *supra* note 9.

⁴² Christine Varney, Vertical Restraints Enforcement at the FTC, Remarks before the ALI-ABA Eleventh Annual Advanced Course on Product Distribution and Marketing (Jan. 16, 1996), available at <http://www.ftc.gov/speeches/varney/varnmg.shtm> [hereinafter Vertical Restraints].

⁴³ *Am. Cyanamid Co.*, 123 F.T.C. 1257 (1997).

⁴⁴ *Varney, Vertical Restraints*, *supra* note 42.

⁴⁵ See, e.g., *New Balance Athletic Shoe, Inc.*, FTC Docket No. C-3683 (Sept. 13, 2006) (decision and order), available at <http://www.ftc.gov/os/1996/09/c3683.do.pdf>.

⁴⁶ Obama, *supra* note 5.

⁴⁷ *Id.*

⁴⁸ *Varney Confirmation Hearings*, *supra* note 9.

⁴⁹ *Id.*

⁵⁰ *Id.*

There are also indications that the FTC may be more willing to adopt novel approaches to merger enforcement. In a recent merger challenge, for instance, Commissioners Leibowitz and Rosch wanted to challenge a transfer of patent rights that did not result in any accumulation of patents or create a patent thicket. The Commissioners believed that the acquisition violated Section 7 merely because the acquiring firm did not have the same reputation-related constraints on its pricing that the selling firm had. Thus, the Commissioners would have challenged the acquisition because monopoly pricing was more likely to occur.⁵¹

Mergers in Innovative Industries. During her tenure at the FTC, Ms. Varney was on the leading edge of the development of innovation market analysis. In 1995, the FTC and the DOJ issued guidelines that formally recognized the concept of innovation markets—markets consisting of the research and development directed toward particular goods or services.⁵² The agencies thereby defined a means to evaluate the competitive effects of merging competing research and development efforts, even if the product of the research and development may be years off. The idea is that preserving competing research and development efforts can spur innovation.

The guidelines were criticized by some economists, but Ms. Varney defended this development as necessary for the antitrust agencies to “understand all of the dimensions of competition among firms” and to thereby protect innovation.⁵³ She also joined in several decisions applying innovation market analysis to require that merging parties make divestitures to protect innovation. For instance, the FTC used innovation market analysis as the basis for requiring American Cyanamid to out-license its vaccine research as a condition of being acquired by American Home Products.⁵⁴ Similarly, Ms. Varney joined the majority in using innovation market analysis to impose compulsory licensing in *Ciba-Geigy/Sandoz*.⁵⁵ The majority brushed aside objections that the licensing scheme was based on the much-maligned “essential facilities” doctrine and would put the Commission in the role of price regulator.⁵⁶

During the Bush administration, however, innovation market analysis was used less often. In 2004, for instance, the FTC closed its investigation of the Genzyme/Novazyme merger even though the merging parties were the only two companies seeking to develop a particular drug. Dissenting, Commissioner Thompson argued that the FTC should challenge this merger to monopoly and apply the standard presumption that a merger to monopoly is anticompetitive.⁵⁷ In response, Chairman Muris wrote that even a merger to monopoly in an innovation market should not be presumed anticompetitive. Instead, Chairman Muris focused on the potential that the merger would be “efficient” by improving the likelihood of a successful product development.⁵⁸

During her tenure at the FTC, Ms. Varney was on the leading edge of the development of innovation market analysis.

⁵¹ See *FTC v. Ovation Pharms., Inc.*, FTC File No. 08-10156 (Dec. 16, 2008) (Rosch, Cmm’r, concurring), available at <http://www.ftc.gov/os/caselist/0810156/081216ovationroschstmt.pdf>; *FTC v. Ovation Pharms., Inc.*, FTC File No. 0810156 (Dec. 16, 2008) (Leibowitz, Cmm’r, concurring), available at <http://www.ftc.gov/os/caselist/0810156/081216ovationleibowitzstmt.pdf>.

⁵² U.S. Dep’t of Justice & Fed. Trade Comm’n, *Antitrust Guidelines for the Licensing of Intellectual Property* (1995), available at <http://www.usdoj.gov/atr/public/guidelines/0558.pdf>.

⁵³ Christine A. Varney, *Innovation Markets in Merger Review Analysis*, ANTITRUST, Summer 1995, at 16.

⁵⁴ *Am. Home Prods. Corp.*, 59 Fed. Reg. 60,807 (Nov. 28, 1994) (proposed consent agreement with analysis to aid public comment).

⁵⁵ Separate Statement of Chairman Robert Pitofsky, and Commissioners Janet D. Steiger, Roscoe B. Starek, III, and Christine Varney, *Ciba-Geigy, Ltd.*, FTC Docket No. C-3725 (Apr. 8, 1997), available at <http://www.ftc.gov/os/1997/04/others.htm>.

⁵⁶ *Id.*

⁵⁷ *Genzyme Corp.*, FTC File No. 021-0026 (Jan. 13, 2004) (Thompson, Cmm’r, dissenting), available at <http://www.ftc.gov/os/2004/01/thompsongenzymestmt.pdf>.

⁵⁸ *Genzyme Corp.*, FTC File No. 021-0026 (Jan. 13, 2004) (Statement of Chairman Timothy J. Muris), available at <http://www.ftc.gov/os/2004/01/murisgenzymestmt.pdf>.

Given her support for the use of innovation market analysis, Ms. Varney may well “rebalance” economic theory in this area. We may see this type of analysis become more common, especially if mergers in innovation-intensive industries increase.

Vertical Mergers. Ms. Varney’s appointment may also signal a return to a more aggressive stance in vertical mergers. As with innovation market analysis, vertical merger enforcement was less prevalent in the Bush administration than it was in the Clinton administration.⁵⁹ While at the FTC, Ms. Varney emphasized that vertical mergers may create entry barriers, raise rivals’ costs, and facilitate collusion.⁶⁰ Although she recognized that there is “a great deal of theoretical controversy about the effects of vertical mergers,” Ms. Varney argued that antitrust enforcers have “the tools” to separate those vertical mergers that are likely to cause anticompetitive effects from those that are not.⁶¹

Ms. Varney’s commitment to vertical merger enforcement was borne out in her enforcement decisions. In *Silicon Graphics*, Ms. Varney joined a 3–2 Commission decision that relied on a vertical foreclosure theory.⁶² The majority was concerned that the merger would raise barriers to entry in the entertainment graphics workstation and software markets. It therefore required the merging parties to maintain an open architecture and publish their applications programming interfaces. Similarly, in *Cadence Design Systems*, Ms. Varney joined the majority in applying vertical merger theory to an acquisition in another software market.⁶³ The majority found that Cadence’s acquisition of the only firm that developed the most advanced version of a particular software tool to be used with Cadence’s dominant software could raise entry barriers. The Commission therefore required Cadence to allow other tool developers continued access to interface protocols for its software. Ms. Varney also joined the majority in the Commission’s challenge to Time Warner’s acquisition of Turner and TCI, which involved a vertical theory.⁶⁴

Ms. Varney may well “rebalance” legal and economic theories in this area as well. No longer will vertical integration essentially be assumed to result in an efficient outcome. Especially where a firm has market power, vertical mergers are more likely to be challenged in the new administration.

Pushing the Merger Envelope at the FTC. The President’s appointment of Mr. Leibowitz to chair the FTC also portends more aggressive merger enforcement. While the FTC has been assertive in this area even under the Bush administration, Chairman Leibowitz has indicated a willingness to push the envelope even further. For example, in December 2008, the FTC filed a complaint in

⁵⁹ See, e.g., Deborah A. Garza, *A Comparative Analysis of the Clinton Antitrust Program and Suggestion of Changes to Come*, ANTITRUST, Summer 2001, at 64, 67.

⁶⁰ See Christine Varney, Vertical Merger Enforcement Challenges at the FTC, Remarks before the PLI 36th Annual Antitrust Institute (July 17, 1995), available at <http://www.ftc.gov/speeches/varney/varta.shtm> [hereinafter Vertical Merger Enforcement]; see also Christine Varney, The Dangers of Health Industry Consolidation and Corporatization and the Effect on Quality, Cost and Access, Remarks before the Citizens Fund Conference (May 10, 1995), available at <http://www.ftc.gov/speeches/varney/citi.shtm> (“I am concerned about the overall competitive impact of vertical integration by drug companies into the pharmacy benefits management market.”); Christine Varney, Efficiency Justifications in Hospital Mergers and Vertical Integration Concerns, Remarks before the Health Care Antitrust Forum (May 2, 1995), available at <http://www.ftc.gov/speeches/varney/varht.shtm>.

⁶¹ See Varney, Vertical Merger Enforcement, *supra* note 60.

⁶² See Press Release, Fed. Trade Comm’n, FTC Settlement Would Preserve Competition on Price and Innovation for Entertainment Graphics Software and Hardware (June 9, 1995), available at <http://www.ftc.gov/opa/1995/06/sgj.shtm>.

⁶³ See Cadence Design Systems, Inc., FTC File No. 971-0033 (May 8, 1997) (Statement of Chairman Robert Pitofsky and Commissioners Janet D. Steiger and Christine A. Varney), available at <http://www.ftc.gov/os/1997/05/state01.htm>.

⁶⁴ See Time Warner Inc., FTC File No. 961-0004 (Sept. 12, 1996) (separate statement of Chairman Pitofsky and Commissioners Steiger and Varney), available at <http://www.ftc.gov/os/1996/09/twother.htm>.

federal district court challenging Ovation Pharmaceuticals' 2006 acquisition of the drug NeoProfen.⁶⁵ NeoProfen is one of two pharmaceutical treatments sold in the United States for a congenital heart defect primarily affecting premature babies.⁶⁶ Prior to its acquisition of NeoProfen, Ovation had acquired the rights to Indocin, the only other pharmaceutical treatment for the condition, from Merck Pharmaceuticals. Commissioner Leibowitz joined Commissioner Rosch in the view that the FTC should also challenge this earlier acquisition, even though Ovation did not produce a competing product or possess any related patent rights at the time.

The Commissioners' theory for challenging Ovation's acquisition of the rights to Indocin was novel. Merck had not charged a monopoly price for Indocin because charging high prices for a drug used by premature babies might hurt its reputation.⁶⁷ As a smaller company without a broad product line, Ovation did not have these concerns. Thus, even though Ovation's acquisition of Indocin did not reduce the number of competitors, it made the imposition of a monopoly price for the product more likely. While no case has held that a transaction removing a reputation-related restraint violates the merger laws, Commissioners Rosch and Leibowitz argued that this is indeed a viable theory under Section 7.⁶⁸

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The President promised change. He promised reinvigorated antitrust enforcement. Despite the poor economy and the resultant nay-sayers, the President's picks to lead the antitrust enforcement agencies are likely to fulfill these promises. ●

⁶⁵ Complaint, FTC v. Ovation Pharms., Inc., No. 08-10156 (D. Minn. Dec. 16, 2008), available at <http://www.ftc.gov/os/caselist/0810156/081216ovationcmpt.pdf>.

⁶⁶ *Id.* at 1–2.

⁶⁷ See FTC v. Ovation Pharms., Inc., FTC File No. 08-10156 (Dec. 16, 2008) (Rosch, Cmm'r, concurring), available at <http://www.ftc.gov/os/caselist/0810156/081216ovationroschstmt.pdf>; FTC v. Ovation Pharms., Inc., FTC File No. 0810156 (Dec. 16, 2008) (Leibowitz, Cmm'r, concurring), available at <http://www.ftc.gov/os/caselist/0810156/081216ovationleibowitzstmt.pdf>.

⁶⁸ *Id.*

Through the Looking Glass: Ruminations on Improving the Current U.S. Merger Enforcement Guidelines

By Ilene Knable Gotts and Étienne Renaudeau

“Now, *here*, you see, it takes all the running you can do, to keep in the same place. If you want to get somewhere else, you must run at least twice as fast as that!”

—Red Queen, *Through the Looking Glass*, by Lewis Carroll

The time has arrived for the U.S. agencies to re-examine their merger enforcement guidelines to ensure that they are not misleading and remain the gold standard model for other jurisdictions. This article discusses numerous areas in which the current U.S. merger enforcement guidelines (MEGs)¹ might be revised. In addition, the article considers the advantages and disadvantages of revising the MEGs, alternatives to issuing new MEGs, and some procedural considerations for developing new MEGs.

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Substantive Areas in Which MEGs May Not Reflect State-of-the-Art Analysis

With the exception of the efficiencies section, it has been more than twenty-five years since the U.S. Department of Justice and the Federal Trade Commission issued MEGs. Moreover, the last update, in 1992, concerned horizontal transactions only; the agencies left intact the 1984 Guidelines’ analysis applicable to vertical and conglomerate transactions and potential competition theories.²

The MEGs have become widely accepted by courts³ and competition authorities throughout the world. Indeed, since the 1980s, over 50 percent of U.S. merger decisions have cited and relied upon the analytical framework contained in the MEGs. Since 1992, other mature competition authorities have issued one set, and in some cases, multiple generations, of guidelines that in many respects adopt the concepts found in the MEGs.⁴ In contrast, rather than issuing new

¹ Fed. Trade Comm’n & U.S. Dept. of Justice, Horizontal Merger Guidelines (1992, revised 1997) [hereinafter MEGs], available at <http://www.ftc.gov/bc/docs/hmg080617.pdf>.

² U.S. Dep’t of Justice, Non-Horizontal Merger Guidelines (1984) [hereinafter 1984 Guidelines], available at <http://www.usdoj.gov/atr/public/guidelines/2614.pdf>.

³ See, e.g., *United States v. Oracle Corp.*, 331 F. Supp. 2d 1098, 1108, 1111–13, 1117, 1122–23 (N.D. Cal. 2004); *FTC v. Whole Foods Market, Inc.*, 548 F.3d 1028, 1037–38 (D.C. Cir. 2008); see also James F. Riill & Christopher J. MacAvoy, Written Statement Concerning Antitrust Merger Enforcement Before the Antitrust Modernization Commission 3–5 (Oct. 31, 2005), available at http://govinfo.library.unt.edu/amc/commission_hearings/pdf/Riill_Statement.pdf.

⁴ See, e.g., Competition Bureau, Canada, Merger Enforcement Guidelines (Sept. 2004), available at [http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/vwapj/2004%20MEGs.Final.pdf/\\$file/2004%20MEGs.Final.pdf](http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/vwapj/2004%20MEGs.Final.pdf/$file/2004%20MEGs.Final.pdf); Eur. Comm’n, Guidelines on the Assessment of Horizontal Mergers under the Council Regulation on the Control of Concentrations Between Undertakings, 2004 O.J. (C 31) 5 [hereinafter EC Horizontal MEGs], available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2004:031:0005:0018:EN:PDF>; Eur. Comm’n, Guidelines on the Assessment of Non-Horizontal Mergers under the Council Regulation on the Control of Concentrations Between Undertakings, 2008 O.J. (C 265) 6, available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2008:265:0006:0025:EN:PDF>.

MEGs, the U.S. agencies have informed the public of evolving nuances in their analysis through the issuance of speeches, data, and, in 2006, the publication of a joint Commentary on the Horizontal Merger Guidelines.⁵ The interpretations issued to date in these sources, however, do not provide an accurate or complete explication of the analysis that the agencies believe is state-of-the-art. As a result, the MEGs have the potential to mislead the business and legal community, particularly those practitioners who live “outside the Beltway.”

There are numerous sections of the MEGs that might be revised to describe accurately and completely the analyses that the agencies believe are state-of-the-art. These areas for improvement are discussed below in the same sequence as delineated in the MEGs.

Updated Description of the Analysis Process. The MEGs as currently drafted combine pieces of different theories that do not necessarily fit together coherently, if at all. A literal reading of the MEGs would have the reader engage in a step-by-step analysis of defining the relevant market, determining the current competitors, and calculating concentration levels (and drawing presumptions as a result of these levels), all before considering competitive effects. It is only after these steps are completed that entry, countervailing buyer power, efficiencies, and the failing firm defense are considered.

As more recently indicated in the Merger Commentary, however, the agencies do not rigidly engage in separate step analyses but instead seek to apply an integrated approach that focuses on the potential competitive effects. The MEGs would benefit from an explicit description of this integrated approach. It would be useful as well to explain how such an approach applies in evolving markets (e.g., high-technology or converging markets).

It is also unclear how the step approach in the current MEGs should work in the context of a unilateral effects analysis, where the focus is first on the effects of the merger (e.g., whether the merger will lead to a price increase), and where—as discussed in the Unilateral Effects Analysis section below—a market share threshold and structural presumptions may not be the best tools to assess the likely competitive effects of a merger. Some commentators, therefore, suggest that the analysis should start with competitive effects.⁶ A concern with such an approach, however, is that the agency may fail to delineate a cognizable relevant market, which remains a fundamental and a critical component for establishing a Clayton Section 7 claim in court.

Market Definition and the SSNIP Test. Under the MEGs, the analysis commences with the delineation of the narrowest market cognizable when applying a “small but significant and non-transitory increase in price” (SSNIP) test. Usually a 5–10 percent increase is used in a SSNIP test, although the MEGs are silent as to when to depart from the 5–10 percent benchmark. Utilization of this test is not easy in practice and may portray an inaccurate picture of the actual state of market competition. Nor is it by any means clear that, in practice, either agency engages in such a sequential analysis of potential market definitions, but rather, organizes the evidence to select a test market and alternative broader markets.⁷

Nor is it by any means clear that, in practice, either agency engages in such a sequential analysis of potential market definitions, but rather, organizes the evidence to select a test market and alternative broader markets.

⁵ Fed. Trade Comm’n, U.S. Dep’t of Justice, Commentary on the Horizontal Merger Guidelines (2006) [hereinafter Merger Commentary], available at <http://www.ftc.gov/os/2006/03/CommentaryontheHorizontalMergerGuidelinesMarch2006.pdf>.

⁶ See, e.g., Fed. Trade Comm’n, Unilateral Effects Analysis and Litigation Workshop, tr. at 190 (Feb. 12, 2008) (statement of Constance Robinson), available at <http://www.ftc.gov/bc/unilateral/transcript.pdf>.

⁷ Malcolm B. Coate, *An Overview of Transparency at the Federal Trade Commission: Generalities and Innovations in Merger Analysis* 3–5 (Oct. 2008), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1111687.

The focus on the SSNIP test may also cause agency staff to focus too much on short term effects. As suggested by one commentator:

[G]iven the costs of effecting and implementing a merger, it is difficult to conceive of a merger done for the purpose of exploiting short run market power. . . . The short run analysis of the Guidelines has occasionally been misdirected at industry or firm restructurings that reduce capacity but that are not anticompetitive.⁸

Moreover, this test (or any test forcing the agency to focus on the smallest possible market) may result in too narrowly delineated markets, which recent history suggests courts find defy common sense.⁹ Thus, it is important to keep the dialogue—and focus—even during the market definition stage on sustainable long-term effects, which might be longer than two years.

This criticism of the SSNIP test is not intended to suggest that there is no role for applying a critical loss analysis.¹⁰ Although there can be problems in implementation, particularly in the analysis of unilateral effects, the use of critical loss analysis is clearly useful for both market definition and competitive effects analysis. Some of these concerns can be dealt with by undertaking the critical loss analyses for several different postulated price increases. Other of these concerns can be dealt with by augmenting the analysis with models that derive demand elasticities and costs, bidding model analysis, or natural experiments to minimize potential problems that can arise by relying on wrong assumptions from one set of data and analysis.¹¹

At a bare minimum, a more robust discussion of the critical loss analysis and its various inputs would be useful in a revised set of MEGs including the role that economics plays in these types of analyses. The agencies should clearly specify that they take a more holistic approach, taking into account data, customer and industry testimony, and documents, and focus on the overall industry and long-term marketplace dynamics. Economic analysis should be a complement to, not a substitute for, the full evidentiary record that supports a properly defined market.¹²

The MEGs also fall short in discussing a SSNIP test for defining a relevant geographic market. In addition, the MEGs do not address geographic cluster markets. For instance, spatial relationships between different geographic markets can lead to a broader geographic market definition through a chain of substitution effects (cluster markets are also not discussed on the product side).¹³

⁸ David T. Scheffman, *Ten Years of Merger Guidelines: A Retrospective, Critique, and Prediction*, 8 REV. INDUS. ORG. 173, 186 (1993).

⁹ See, e.g., *FTC v. Whole Foods Market, Inc.*, 548 F.3d 1028, 1037–39 (D.C. Cir. 2008).

¹⁰ Critical loss is the percentage of sales that the hypothetical monopolist can lose and still break even. See Barry C. Harris & Joseph J. Simons, *Focusing Market Definition: How Much Substitution is Necessary?*, 12 RES. IN L. & ECON. 207 (1989).

¹¹ The choice of model and analysis should depend on the characteristics of the market; for example, how is it that firms compete with each other for customers.

¹² See David T. Scheffman, *Assessment of U.S. Merger Enforcement Policy*, Testimony Before the Antitrust Modernization Commission 9 (Nov. 17, 2005), available at http://govinfo.library.unt.edu/amc/commission_hearings/pdf/Scheffman_Statement_FINAL.pdf.

¹³ The MEGs only address the aggregation of markets “as a matter of convenience.” MEGs, *supra* note 1, § 1321, at 11 n.14. The Canadian Guidelines dedicated to bank mergers contain a detailed discussion of these cluster markets for this sector. See Competition Bureau, Canada, *The Merger Enforcement Guidelines as Applied to a Bank Merger* ¶¶ 34–37, at 13–14 (Jan. 2003), available at <http://strategis.ic.gc.ca/pics/ct/ct02484e.pdf>. The European Commission’s Relevant Market Guidelines address the issue of cluster markets, specifically on the geographic side. See Eur. Comm’n, *Commission Notice on the Definition of Relevant Market for the Purposes of Community Competition Law*, 1997 O.J. (C 372) 5, ¶¶ 57–58, available at [http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:31997Y1209\(01\):EN:HTML](http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:31997Y1209(01):EN:HTML).

A more fundamental question is whether there should be any presumptions of harm drawn on the basis of concentration.

HHI Thresholds and Presumptions. The data released by the agencies clearly show that the HHI thresholds specified in the MEGs for various levels of investigation are out of sync with actual merger enforcement priorities. In 2003, then FTC Chairman Timothy J. Muris noted that “[m]ore than 20 years have passed since the introduction of the Herfindahl-Hirschman Index as an important initial factor in the review of horizontal mergers.”¹⁴ A 2003 report, and subsequent workshop,¹⁵ engaged the private bar in a dialogue regarding the role of concentration in agency decision making. The report shows that the vast majority of government challenges from 1998 to 2003 involved market concentration levels (concerning both postmerger HHI and increases in HHI) far above the safe-harbor thresholds set forth in the MEGs. The data indicate that less than 5 percent of the challenged markets had concentration levels below 1,800 (and almost all of these enforcement actions were in the petroleum sector). Only 13 percent of the challenged markets involved concentration levels of 2,500 or below. Indeed, more than half of the challenged markets involved postmerger concentration levels of more than 4,000.¹⁶

The only industries in which there are any examples of enforcement at or near the levels in the MEGs are supermarkets and the petroleum industry. Thus, it is potentially misleading to set safe harbor levels that are significantly below what is in practice likely to be problematic and, as such, the current MEGs may result in less experienced practitioners and the business community drawing the wrong conclusions regarding the scrutiny that a particular transaction might face.

In addition, just as the paucity of recent appellate court and Supreme Court precedent may suggest that concerns and presumptions expressed in older precedent¹⁷ may still be appropriate, the MEGs, as drafted, may lead a court to reach conclusions of law that a merger is likely to create an anticompetitive concentration at levels below what current economic thinking or retrospective studies support. Keeping these levels in place could erode the very credibility of the MEGs. Thus, the agencies, should, at the least, indicate higher safe harbor levels that would be more in line with enforcement trends.¹⁸ In addition, these low presumptions may also impede the global leadership role of the U.S. agencies since the MEGs have served as a model for other jurisdictions.

Moreover, the Merger Challenges Data report is silent regarding when, despite the absence of market shares, the agencies might be concerned with a merger premised upon “innovation markets” and “potential competition” theories. It is also not clear that the harms the MEGs presumptions are designed to prevent are valid in innovation markets where competitive characteristics unique to these markets may exist. It would be useful if the agencies expressly excluded innovation markets from such presumptions.

A more fundamental question is whether there should be any presumptions of harm drawn on the basis of concentration. The 1992 presumptions are a remnant of prior guidelines. Although the presumption for mergers in the 1,800/100 category are considerably weaker in the current MEGs

¹⁴ Press Release, Fed. Trade Comm’n, FTC and DOJ Plan Analysis of Past Merger Enforcement Cases (Nov. 18, 2003), available at <http://www.ftc.gov/opa/2003/11/mergercases.shtm>.

¹⁵ See Fed. Trade Comm’n & U.S. Dep’t of Justice, *Merger Challenges Data, Fiscal Years 1999–2003* (Dec. 18, 2003) [hereinafter *Merger Challenges Data*], available at <http://www.ftc.gov/os/2003/12/mdp.pdf>; see also Press Release, Fed. Trade Comm’n, FTC and Department of Justice Issue Merger Challenges Data, Announce Upcoming Merger Enforcement Workshop (Dec. 18, 2003), available at <http://www.ftc.gov/opa/2003/12/mergereffects.shtm>.

¹⁶ See *Merger Challenges Data*, *supra* note 15, tbl. 1.

¹⁷ See, e.g., *Brown Shoe Co. v. United States*, 370 U.S. 294, 341–44 (1962) (the merged firm would have a combined share of 5 percent).

¹⁸ The HHI levels set forth in the EC Horizontal MEGs are higher than the MEGs’ HHI levels. Compare EC Horizontal MEGs, *supra* note 4, ¶¶ 19–20, with MEGs, *supra* note 1, § 1.5.

than in its predecessors, the MEGs nevertheless continue to state that mergers in this category will be challenged absent offsetting evidence. The record is far from clear regarding at what level of concentration, if at all, a presumption of decreased competition should follow. The inclusion of presumptions of competitive harm results in too much attention being drawn to the exercise of delineating narrow markets, rather than on the ultimate analysis of competitive effects. Too often the outcome is “won or lost” on market definition rather than the ultimate likelihood of harm.

Although perhaps too radical a change from the current analysis paradigm, a better approach might be not to include any presumptions or conclusions of concern based on concentration levels or changes, but rather to have the number of participants and the respective size of each of the participants be one of a series of factors discussed in detail that could impact the competitive dynamics of the affected market. Such presumptions tend to focus attention on market definition, while market definition is not the ultimate purpose of merger review. In the meantime, presumptions—when they reflect state-of-the-art analysis—may provide clarity if they effectively perform a safe harbor screening role. Thus, the MEGs could still include safe harbor screens indicating where no issue will likely arise, even if the remainder of the benchmarks and presumptions were dropped.

Coordinated Effects Analysis. Section 2.1 of the MEGs indicates that a coordinated effect will arise if the merger increases the likelihood that the remaining firms will coordinate their actions to reduce competition due to a change in the incentives and/or the ability of the competitors to engage in tacit or explicit coordination. The current discussion of factors for detecting markets susceptible to coordination is in many ways too simplistic. For instance, traditional coordinated interaction theory assumes that collusion will reduce the firms’ incentives to innovate and create new products. It would be helpful to have a more robust discussion of the structural factors that impact the likelihood of coordination and the limitations of such analysis.

Coordinated interaction often turns in large part on the number of significant competitors operating in the market. “A ‘significant competitor’ is a firm whose independence could affect the ability of the merged firms to achieve an anticompetitive outcome.”¹⁹ Although such an analysis is typically part of the unilateral effects model, it appears that in practice the agencies also consider this information (and the respective “leadership” and “fringe” roles of firms) as relevant to a coordinated interaction theory when coupled with additional structural considerations. The MEGs should discuss how these factors interact, particularly in light of such models of competitive concern as “regime shifts” or loss of the “maverick” in the market as increasing the likelihood of less competitive performance. To the extent that the agencies believe that structure can impact market performance, the MEGs should identify the relevant variables (e.g., the ratio of the share of the leading firm to its largest rival, customer sophistication, product homogeneity, vertical interaction, and dynamic efficiencies). The DOJ now has had significant experience with large industry-wide cartels through its criminal enforcement program and should be in a good position to provide guidance based on its empirical experience.

Unilateral Effects Analysis. Although the concept of unilateral effects theory existed prior to 1992, the 1992 MEGs constituted the first MEGs to recognize “unilateral effects” as a separate theory of harm. In the ensuing two decades, the agencies have almost always asserted unilateral

¹⁹ Malcolm B. Coate & Shawn W. Ulrick, *Economic Issues, Transparency at the Federal Trade Commission: The Horizontal Merger Review Process 1996–2003* at 51 (FTC Bureau of Economics, Feb. 2005), available at <http://www.ftc.gov/os/2005/02/0502economicissues.pdf>.

effects as a basis for their enforcement actions rather than challenging the transaction solely on the basis of coordinated effects.²⁰

As with the description of concentration levels that could give rise to a concern, the discussion of unilateral effects is one of the most frequently referenced sections where practice diverges from the MEGs. Section 2.2 of the MEGs indicates that a “merger may diminish competition even if it does not lead to increased likelihood of successful coordinated interaction, because merging firms may find it profitable to alter their behavior unilaterally following the acquisition by elevating price and suppressing output.”

Section 2.2 of the MEGs currently distinguishes between firms that are primarily differentiated by their products (i.e., so-called Bertrand oligopoly model), and firms that are primarily differentiated by their capacities (i.e., so-called Cournot oligopoly model). This distinction is complicated, however, and economists may differ in their conclusions about which model applies in a particular merger. These models all suffer to some extent by being static and assumption driven. In addition, while the MEGs focus on two models, there are at least four different models describing unilateral behavior: Bertrand oligopoly, Cournot oligopoly, auction situations, and bargaining situations.

At a minimum, merger analysis would be improved if more precise thinking and discussion were provided regarding the theories of harm that are currently lumped together under the unilateral effects nomenclature. Also, the agencies should discuss when they might be concerned with a transaction despite the harm identified by the investigation not fitting neatly into either a unilateral effects theory or the coordinated effects theory.²¹ In addition, reference to a 35 percent market share threshold (or any market share presumption) should probably be eliminated or explained.²² As discussed elsewhere, the inclusion of such shares may cause the agencies to focus on delineating markets that are too narrow to be sustainable in court. Instead, as discussed in the above section on coordinated effects, the number of significant rivals and the ability to expand/enter/reposition is likely to significantly impact the likelihood of unilateral effects. The MEGs, however, are effectively silent regarding these factors.

Finally, the distinction between coordinated interaction and unilateral effects is complicated and the MEGs do not do an adequate job of explaining the differences. Perhaps the agencies would be better off abandoning the need to label the harm as being either coordinated or unilateral in nature, but instead focus on the dynamics of the marketplace and an assessment of whether such dynamics are likely to be conducive to harm from the combination of the merger parties.

Committed and Uncommitted Entrants, Entry, and Potential Competition. The MEGs currently create a distinction between uncommitted entrants (which count as being in the market under Section 1.3 of the MEGs as firms that are likely to participate through a supply response) and com-

²⁰ See Thomas O. Barnett, Assistant Att’y Gen. Antitrust Div., U.S. Dep’t of Justice, Current Issues in Merger Enforcement: Thoughts on Theory, Litigation Practice, and Retrospectives, Lewis Bernstein Memorial Lecture 3–5 (June 26, 2008), available at <http://www.usdoj.gov/atr/public/speeches/234537.pdf>.

²¹ The Merger Commentary points out that the agencies do not narrowly apply these two theories and that they challenge anticompetitive mergers even if they do not neatly fit in the unilateral effects or coordinated effects theory. See Merger Commentary, *supra* note 5, at 17.

²² Indeed, the utility of structural presumptions, and specifically a market share threshold may depend on the context (e.g., Bertrand oligopoly, or Cournot oligopoly). Revisions to the MEGs only should be made if they improve upon the existing framework. Joseph Farrell and Carl Shapiro, for example, propose an alternative unilateral test that raises many of the same concerns as the market share presumptions discussed above and would not be the sort of change we would favor. See Joseph Farrell & Carl Shapiro, *Antitrust Evaluation of Horizontal Mergers: An Economic Alternative to Market Definition* (Nov. 25, 2008), available at <http://faculty.haas.berkeley.edu/shapiro/alternative.pdf>.

mitted entrants (which are considered as entrants under Section 3.0 of the MEGs and, therefore, can provide a mitigating force in the attempted exercise of market power). Such a distinction raises not only theoretical problems but also practical problems of correctly factoring into the analysis the impact of such potential competitors.²³ Thus, it may be better merely to consider whether these firms are considered actual potential competitors such that they may actually be playing a role in discouraging or defeating the exercise of market power. As a fundamental point, it is important that market definition, and likelihood and timing of supply responses, not be too rigidly defined to determine if a firm is “inside” the market (and therefore counted as an effective competitor) or “outside” of the market, and ignored. It would be useful to state in the MEGs that even if a firm is not “counted” initially in its analysis, its existence will be considered ultimately in the effects analysis. This distinction also potentially creates a dichotomy with the burden of proof—on the agencies to demonstrate that the committed entrant is not in the fringe, and on the merging parties to demonstrate that entry is likely within the two year time frame stated in the MEGs, which may be resolved if the agencies bear the burden in both situations.

The agencies could also specify that the relevant issue is not whether entry will occur within the two year time frame, but rather whether a credible threat of entry exists that is sufficient to deter or counteract the anticompetitive market behavior of the merging firms.

Section 3.2 of the MEGs discusses what the agencies consider “timely” entry: “The Agency generally will consider timely only those committed entry alternatives that can be achieved within two years from initial planning to significant market impact.” The MEGs indicate that for durable goods products, consumers may defer purchases and in this way deter or counteract for a time the competitive effects of concern. Accordingly, “[i]n these circumstances, if entry only can occur outside of the two year period, the Agency will consider entry to be timely so long as it would deter or counteract the competitive effects of concern within the two year period and subsequently.”

In practice, there have been other situations in which entry beyond two years was considered relevant (e.g., in XM/Sirius, where there were long-term contracts).²⁴ It would be useful for the MEGs explicitly to recognize a broader set of circumstances in which a longer time horizon will be used for entry analysis (as well as for market delineation), or where a shorter period might be appropriate.

Interestingly, the MEGs do not expressly limit the examination of competitive effects to two years, and the agencies have considered expected effects beyond the two year horizon, particularly in matters involving innovation or next generation products. The agencies should consider whether for entry, as well, a presumptive two year time frame should apply or perhaps instead delineate a more flexible time frame that could take into account the specific dynamic characteristics of the impacted marketplace.²⁵ The agencies could also specify that the relevant issue is not whether entry will occur within the two year time frame, but rather whether a credible *threat* of entry exists that is sufficient to deter or counteract the anticompetitive market behavior of the merging firms.

The MEGs do not directly address the other side of potential competition, i.e., the harm to competition that may arise from the elimination of a potential competitor as a result of the transaction. The most recent statement of the potential competition theory by either agency was the 1984 Guidelines dedicated to non-horizontal mergers. Paradoxically, the FTC did not issue a special

²³ See U.S. Dep’t of Justice & Fed. Trade Comm’n, Joint Workshop on Merger Enforcement, tr. at 198–204 (Feb. 18, 2004) (Remarks of A. Douglas Melamed), available at <http://www.ftc.gov/bc/mergerenforce/040218ftctrans.pdf>.

²⁴ See Press Release, U.S. Dep’t of Justice, Statement of the Department of Justice’s Antitrust Division on Its Decision to Close Its Investigation of XM Satellite Radio Inc.’s Merger With Sirius Satellite Radio Inc. (Mar. 24, 2008), available at http://www.usdoj.gov/atr/public/press_releases/2008/231467.pdf.

²⁵ See Ilene Knable Gotts, Scott Sher & Michele Lee, *Antitrust Merger Analysis in High-Technology Markets*, 4 EUR. COMPETITION J. 463 (2008), available at <http://www.wsg.com/PDFSearch/sher1208.pdf>.

official statement addressing this theory,²⁶ but briefly mentions it in its Guide to Mergers.²⁷ The 1984 Guidelines describe the elimination of a perceived or actual potential competitor as one of the principal theories of competitive harm.

Under the theory of harm to perceived potential competition, a merger may significantly impede competition if the potential entry of the acquired firm previously threatened the market participants. Under the theory of harm to perceived actual competition, a merger may significantly impede competition through the elimination of an impending entrant. Surprisingly, the theory of potential competition was barely mentioned during the joint workshop held by both agencies in 2004 on merger enforcement, and the Merger Commentary does not discuss the theory at all. Yet, the enforcement decisions that involved either innovation markets or nascent markets often raise concerns regarding the elimination of potential competition, as did some recent matters.²⁸ Typically, these matters involve the assertion that there are only a few firms in the market and/or only a few firms have the ability to enter the market due to unique assets or attributes, referred to as “entry advantage.”²⁹ The agencies should provide better guidance regarding the criteria that they would apply to determine whether the elimination of potential competition by a merger party will be a basis for challenging the transaction and how such a role differs simply from the analysis to be undertaken as to all parties as uncommitted entrants.

Efficiencies. The 1997 revision to the MEGs added for the first time a section on efficiencies as a defense. This express recognition constituted a significant advance in merger analysis, but as drafted in the MEGs, is still a remnant of static price theory models rather than the dynamic analysis found in modern economic thinking.³⁰ Moreover, placing efficiencies in a separate step of the analysis suggests that efficiencies are only relevant after market delineation and analysis of potential competitive effects occurs. It is only in the Merger Commentary—not in the MEGs themselves—that the agencies clarify that efficiencies are not to be analyzed at the end of such a linear progression. It would be helpful if the agencies made clear that efficiencies are expressly to be considered in Section 2 of the MEGs, rather than Section 4, as part of the net assessment of the merger’s likely effects.³¹

In addition, the current MEGs do not go far enough in recognizing the types of efficiencies that can be procompetitive. As recommended in the Antitrust Modernization Commission (AMC) Report,³² the MEGs should expressly recognize certain fixed-cost savings in addition to savings in R&D, dynamic efficiencies,³³ and synergies that result from combining complementary

²⁶ The only official statement is the endorsement of Section 4 of the 1984 Guidelines when the current MEGs were issued.

²⁷ See Fed. Trade Comm’n, *An FTC Guide to Mergers 2–3*, available at http://www.ftc.gov/bc/antitrust/factsheets/FactSheet_Competitive.pdf.

²⁸ See, e.g., Press Release, Fed. Trade Comm’n, *Inverness Medical Innovations Settles FTC Charges that It Stifled Future Competition in U.S. Market for Consumer Pregnancy Tests* (Dec. 23, 2008), available at <http://www.ftc.gov/opa/2008/12/inverness.shtm>.

²⁹ See 1984 Guidelines, *supra* note 2, § 4.133.

³⁰ See U.S. Dep’t of Justice & Fed. Trade Comm’n, *Joint Workshop on Merger Enforcement*, tr. at 66 (Feb. 19, 2004) (remarks of William J. Kolasky, former Deputy Assistant Att’y Gen., Antitrust Div.), available at <http://www.ftc.gov/bc/mergerenforce/040219ftctrans.pdf>.

³¹ The EC Horizontal MEGs, for example, indicate that efficiencies are part of the “overall competitive appraisal.” See EC Horizontal MEGs, *supra* note 4, ¶ 76.

³² See ANTITRUST MODERNIZATION COMM’N, *REPORT AND RECOMMENDATIONS 58–59* (2007), available at http://govinfo.library.unt.edu/amc/report_recommendation/amc_final_report.pdf.

³³ This category of efficiencies could be particularly relevant in declining or financially distressed industries. See Ilene Knable Gotts & Calvin S. Goldman, *The Role of Efficiencies in M&A Global Antitrust Review: Still in Flux?*, in *ANNUAL PROCEEDINGS OF THE FORDHAM CORPORATE LAW INSTITUTE 201* (Barry E. Hawk, ed. 2003).

strengths, which may have a significant positive impact on competition long-term but may be difficult to quantify. The AMC Report further urges that a longer time horizon be taken for counting efficiency gains, particularly in sectors in which innovation is important. The AMC Report points out that the current MEGs only mention innovation in a footnote. It would be useful if the agencies set out a detailed discussion regarding how to assess the effects of a merger on innovation, and how to balance an improvement in innovation against possible anticompetitive effects of the merger.

Perhaps the most troubling aspect of the MEGs efficiencies discussion is the emphasis on “merger specificity,” particularly given the oft-overlooked language that “the Agency will not insist upon a less restrictive alternative that is merely theoretical.”³⁴ The agencies should make clear that parties do not need to show that there is not “a less restrictive alternative means” to achieve the efficiencies. Moreover, in considering “merger specificity” the agencies should also give credit to the transaction to the extent that the achievement of the efficiencies by the parties to the transaction may change behavior in the underlying game; e.g., if efficiencies create greater diversity/asymmetry in costs, then they frustrate coordination, or if, as a result, other firms step up innovation or collaboration to achieve synergies, consumer welfare is further enhanced.

One of the politically most sensitive issues is how to treat efficiencies that may result in a market outside the relevant market, or in the case of a world market, outside of the United States itself as an offset to possible adverse effects in the relevant market. The MEGs are silent on this point (apart from a footnote relating to “inextricably linked markets,” for which the MEGs do not explain how and under what circumstances such efficiencies should count).

Given the important role of efficiencies in lowering costs and fostering innovation, which in the long-term promotes competition, some consideration should be given to how the consumer welfare standard is applied. Former FTC Chairman Robert F. Pitofsky indicated before he became Chairman of the FTC, that the “pass through” requirement is a “killer qualification.”³⁵ In Canada, for instance, a broader social welfare perspective is used.³⁶ Perhaps, if a long enough time horizon is permitted for the recognition of the efficiency gains, the social welfare approach converges into the consumer interest standard for many mergers.³⁷ Accordingly, the recognition of a longer time frame would be a good starting point.

Also, the standard of proof required of the parties regarding likely efficiencies gains should be the same as that deployed in reaching the decision that a proposed merger is problematic rather than using a sliding scale standard. Such a standard creates a disconnect between the agencies and the merging parties, whose burden of proof increases proportionately with the agencies’ concerns.

Financial Distress. The financial condition of a company is expressly considered in Section 5, which is dedicated to the failing firm and failing division theories. The MEGs require four conditions to be fulfilled to enable merging parties to invoke successfully the failing firm defense: (i) a grave probability of a business failure, (ii) no alternative transaction or position available to the firm that poses less damage to competition, (iii) the firm is not capable of successful reorganization under Chapter 11, and (iv) absent the acquisition, the assets of the firm would exit the market. Until

³⁴ See MEGs, *supra* note 1, § 4, at 28.

³⁵ Robert Pitofsky, *Proposals for Revised United States Merger Enforcement in a Global Economy*, 81 GEO. L.J. 195, 207 (1992).

³⁶ See Gotts & Goldman, *supra* note 33.

³⁷ See Dennis W. Carlton, *Does Antitrust Need to be Modernized?*, J. ECON. PERSP., Summer 2007, at 155.

the recent financial crisis, these conditions were difficult to meet.³⁸ The Merger Commentary does not even contain any discussions on failing firm case examples.

As with efficiencies, the failing firm defense should no longer be treated as a separate consideration, but rather should be integrated into the competitive effects analysis. Indeed, having the failing firm defense in the last step suggests that the failing condition of a firm is considered only after the potential competitive harm of a merger, even though the failing condition precisely affects the competitiveness of a firm.

In addition to Section 5, the MEGs acknowledge the *General Dynamics*/failing firm defense in subsection 1.521 relating to the changing market conditions, where they provide that “recent or ongoing changes in the market may indicate that the current market share of a particular firm either understates or overstates the firm’s future competitive significance.” This concept is broad enough to recognize the situations currently arising in the economy, although it might be useful if the MEGs addressed how these concepts, i.e., failing/flailing firm, work when an entire industry/economy is failing.³⁹

Countervailing Buyer Power and Monopsony. The MEGs identify “buyer characteristics and the nature of the procurement process” as one factor that must be considered in analyzing a merger’s potential to facilitate coordinated interaction. Such buyer power exists to the extent that buyers have access to reasonable commercial alternatives, i.e., are not captives of the merging parties. It would be useful if the agencies could expand the discussion of buyer countervailing power, particularly the discussion of fringe expansion by alternative suppliers and sponsored entry as a part of such countervailing customer disciplinary behavior. For instance, the EC Horizontal MEGs contain an entire section discussing the countervailing effects of buyer power.⁴⁰

In the last decade, the concern that the merger may lead to the exercise of too much buyer power has arisen as an issue in some investigations and even a few enforcement actions.⁴¹ The agencies have focused on whether the merging parties on a combined basis constitute a sufficiently large percentage of the purchases of a product such that they might be able to and can exercise “monopsony” power post-transaction. The MEGs limit the discussion of such market power to the introductory section and indicate that “[i]n order to assess potential monopsony concerns, the Agency will apply an analytical framework analogous to the framework of these Guidelines.”⁴² It is unclear from this statement how such analogous framework would apply and at what level of concentration a concern would arise.⁴³

Indeed, having the failing firm defense in the last step suggests that the failing condition of a firm is considered only after the potential competitive harm of a merger, even though the failing condition precisely affects the competitiveness of a firm.

³⁸ See Ilene Knable Gotts & Nathaniel L. Asker, *Antitrust Aspects of Acquisitions of Financially Distressed Businesses*, ANTITRUST REP., Dec. 2008, at 6.

³⁹ See Ramsey Shehadeh, Joseph Larson & Ilene Knable Gotts, *The Effect of Financial Distress on Business Investment: Implications for Merger Reviews*, ANTITRUST, Spring 2009, at 12. Robert D. Willig even suggests adding a new “Section 5.3” to the MEGs, recognizing a “failing economy defense.” See *ABA Chair’s Showcase Probes Effects of Faltering Economy on Enforcement*, ANTITRUST & TRADE REG. REP. (BNA), Apr. 3, 2009, at 315. Other commentators posit that the failing firm defense as currently discussed in the MEGs is adequate, even in the current economic environment. See Ken Heyer & Sheldon Kimmel, *Merger Review of Firms in Financial Distress*, Economic Analysis Group Discussion Paper, Mar. 2009, available at <http://www.usdoj.gov/atr/public/eag/244098.pdf>.

⁴⁰ See EC Horizontal MEGs, *supra* note 4, ¶¶ 64–67.

⁴¹ See Complaint, United States v. JBS S.A., No. 08CV5992 (N.D. Ill. Oct. 20, 2008), available at <http://www.usdoj.gov/atr/cases/f238300/238388.htm>.

⁴² MEGs, *supra* note 1, § 0.1.

⁴³ The EC Horizontal MEGs contain a framework specifically describing mergers creating buyer power in upstream markets. See EC Horizontal MEGs, *supra* note 4, ¶¶ 61–63.

Minority Interests. Throughout the last two decades, many of the transactions investigated have raised issues as a result of minority equity holdings by one or both merging parties.⁴⁴ Yet the MEGs are silent as to the theories of competitive harm that such relationships can raise, both in terms of incentives and ability to raise price or restrict output, including those situations in which a minority holding can raise a more significant potential for anticompetitive harm than would an outright combination of the two firms.⁴⁵ In addition, the inclusion of a discussion of minority interests in the MEGs would be an appropriate place to provide safe harbors for such transactions.

Non-Horizontal Mergers. The AMC Report (and the ABA Section of Antitrust Law Transition Report for 2008,⁴⁶ as well as the American Antitrust Institute Transition Report⁴⁷) recommend a revision of the MEGs to describe the analysis applicable to non-horizontal mergers. To leave intact the discussion contained in the 1982 and 1984 Guidelines when there have been significant developments in analyzing competitive effects of such mergers since 1984 is misleading.

There has recently been a renewed interest in vertical merger enforcement, based on “Post-Chicago” analysis.⁴⁸ In that regard, the recently issued EC Non-Horizontal MEGs reflect a generational leap over the 1982/1984 Guidelines that the United States indicates are to be relied upon for vertical and conglomerate mergers. The global policy debate would be furthered if the United States were to issue its own state-of-the-art discussion of how vertical and conglomerate mergers should be analyzed, particularly if the statements contained in the 1984 Guidelines do not mirror the current discussion of burdens of proof for efficiencies in vertical transactions and portfolio effects for conglomerate mergers. To the extent that the MEGs use concentration levels as indicators of levels of scrutiny for horizontal mergers, the non-horizontal merger discussion should also include safe harbor thresholds.

Innovation and High-Tech Markets. The MEGs are silent as to how the agencies assess mergers involving innovation or high-tech markets even though distinctions may be appropriate in such situations. For example, the assumptions underlying the coordinated effects theory (i.e., collusion reduces the incentives to create new products) may not be applicable to high-tech markets, particularly where there are only limited sunk up-front costs. In such high-tech markets, products are usually highly differentiated, and coordinated effects are difficult to prove. The inclusion of a discussion of innovation and high-tech markets in the MEGs would, therefore, be useful.

⁴⁴ See, e.g., Ilene Knable Gotts & Robert C. Weinbaum, *Partial Ownership Interests: The Antitrust Concerns and Structural Techniques for Minimizing Them*, ANTITRUST REP., Oct. 2000, at 18.

⁴⁵ The inclusion of a discussion of minority interests in the MEGs would be an appropriate place to provide safe harbors. More generally, the discussion contained in the Antitrust Guidelines for Collaborations Among Competitors might constitute a useful starting point to address the issue of minority interests. See Fed. Trade Comm’n & U.S. Dep’t of Justice, *Antitrust Guidelines for Collaborations Among Competitors* (2000), available at <http://www.ftc.gov/os/2000/04/ftcdojguidelines.pdf>.

⁴⁶ See ABA Section of Antitrust Law, *2008 Transition Report on the Current State of Federal Antitrust and Consumer Protection Enforcement* 36–37 (Nov. 2008), available at <http://www.abanet.org/antitrust/at-comments/2008/11-08/comments-obamabiden.pdf>.

⁴⁷ See Am. Antitrust Inst., *The Next Antitrust Agenda: The American Antitrust Institute’s Transition Report on Competition Policy to the 44th President of the United States* 151 (Oct. 2008), available at <http://www.antitrustinstitute.org/Archives/transitionreport.ashx>.

⁴⁸ See Michael A. Salinger, Director, Bureau of Economics, Fed. Trade Comm’n, *Is It Live or Is It Memorex? Models of Vertical Mergers and Antitrust Enforcement*, Speech Before the Association of Competition Economics Seminar on Non-Horizontal Mergers (Sept. 7, 2005), available at <http://www.ftc.gov/speeches/salinger/050927isitlive.pdf>.

Does It Make Sense to Revise the MEGs?

Those who oppose issuing new MEGs suggest that the current MEGs are flexible enough to permit tweaking, with such tweaks being best reflected through the issuance of policy statements (e.g., closing statements/analysis to aid public comment, speeches, and commentary).⁴⁹ These commentators suggest that the MEGs have a unique place in the global competition arena, being widely accepted and cited as the gold standard of review. To revise the MEGs could constitute an opening of Pandora's Box and it is unclear that there would be a consensus on appropriate revisions. To issue new MEGs could alter the United States position as the policy leader and raise the need to continue to update the MEGs periodically to meet expectations that they remain current. Such an ongoing exercise would not only be resource draining, but potentially infeasible on a joint agency basis given the rifts that exist from time to time between the FTC and DOJ. In addition, the agencies may find that a more elaborated exposition of their analysis in new MEGs will provide more fodder to be used against them in court, or on the other hand, that courts will place less weight on the MEGs, believing that there is nothing concrete in their exposition. There is some merit to keeping the existing MEGs as *the* "Bible" and having the interpretations be Talmudic in stature. Such interpretations can more easily be drafted and issued (as well as revised from time-to-time) than trying to reexamine and agree upon the fundamental principles.

But there is something intellectually honest and educational in the process of starting from scratch to draft MEGs that build upon our learning over the last few decades of merger enforcement and that can be held out as state-of-the-art. After all, the 1992 Guidelines were not the first guidelines issued by a U.S. competition authority (the 1968 Guidelines were followed by the 1982 and 1984 Guidelines). Rather, when the guidelines no longer accurately represented enforcement policy, agency officials have issued new guidelines. Having the up-to-date analysis reflected in one document ensures that there is no ambiguity regarding what the analysis should be, and such transparency is useful for merger parties, agency staff, and the courts. Indeed, the agencies, having already issued guidelines, created the expectation that they would be maintained to reflect accurately current agency thinking. Moreover, relying on the existing MEGs to ensure the United States' role as the competition policy leader going forward is by no means a given outcome. That leadership role is more likely to be bestowed upon the authority that provides the best practices in analysis in its guidelines, rather than merely the longest standing guide.

Procedural Considerations If the MEGs Are to Be Revised

The process followed by other jurisdictions provides some guidance as to how the MEGs might be revised, were they to be revised. Of course, the situation in the United States is complicated by the existence of two agencies with concurrent jurisdiction that may nevertheless diverge on some important aspects. Indeed, until 1992, each agency had its own statement of analysis. It is essential, however, that a consensus be reached for any guidelines to be issued in the future, with the possibility that divergence might exist due to specific conditions unique to an industry that one or the agency reviews exclusively. Clarification for that industry could be provided in a separate statement. We are unaware of any such peculiar industry analysis, however. Perhaps the process itself can help to mend the gap between the agencies that appears to exist today.

⁴⁹ See Rill & MacAvoy, *supra* note 3, at 16.

Merger Retrospectives. An important preparatory step could be for the agencies to assess the actual effects of the “close-call” consummated mergers. An ex post evaluation of a significant and relevant set of enforcement decisions may help the agencies to gain deeper insight into whether or not their merger analysis always fits with the market conditions and the evidence at hand, and to identify potential rooms for further improvements, if any. The European Commission, for example, recently conducted an ex post analysis of ninety-six of its decisions clearing mergers subject to commitments. As a result of this retrospective study, the European Commission then issued a new notice on remedies in 2008, revising the previous 2001 notice.

Indeed, some commentators have strongly urged the U.S. agencies to analyze the effects of mergers, both those consummated mergers that the agencies permitted to proceed despite staff recommendations to challenge the merger and those transactions that the agencies unsuccessfully tried to stop.⁵⁰ In addition, the agencies could study what efficiencies parties have been able to achieve in those transactions in which efficiencies played an important role in the enforcement decision. These merger retrospectives could then be used to flesh out the conditions and criteria that impact competition.

Public Consultations. Both the FTC and DOJ have held hearings on various aspects of their merger analysis during the past two decades since the MEGs were issued. As a result of the joint workshop held in 2004, the agencies found that the MEGs achieve their underlying goal, and therefore concluded that they did not need to be revamped.⁵¹ Rather, the agencies issued the Merger Commentary. Having the antitrust analysis contained in a compilation of documents, i.e., the MEGs and the Merger Commentary, may be confusing. Additionally, the Merger Commentary in some instance departs from the MEGs, at least facially (e.g., the MEGs describe the analytical framework that the agencies follow on a step-by-step basis while the Merger Commentary specifies that the agencies conduct an integrated assessment of mergers). It would be useful to start the drafting process by holding a series of hearings or workshops on various aspects of the analysis. The agencies could thereafter endeavor to draft guidelines, preferably circulated for public consultation.

Conclusion

Numerous areas of the MEGs do not reflect the current enforcement policy of the agencies or the economic developments of the past two decades. In addition, the MEGs lack sufficiently detailed discussions to ensure that the courts, business community, and enforcement staff understand what recommended practices should be part of merger analysis. The MEGs therefore do not achieve their intended and primary goal, and, in this respect, should be revised. Moreover, although burdensome, the very process of revising the MEGs could result in a productive study and dialogue that could improve further our understanding of markets, competitive harm, and mitigating factors. Even if at the end of such an exercise, the two agencies are not able to reach a consensus and issue new MEGs, the thought process that takes place and the work product that is generated would be a step in the right direction, allowing the United States to maintain its leadership role globally. ●

Moreover, although burdensome, the very process of revising the MEGs could result in a productive study and dialogue that could improve further our understanding of markets, competitive harm, and mitigating factors.

⁵⁰ See, e.g., Dennis W. Carlton, *The Need to Measure the Effect of Merger Policy and How to Do It*, ANTITRUST, Summer 2008, at 39.

⁵¹ See Merger Commentary, *supra* note 5, at v.

Antitrust Risk-Shifting Provisions in Merger Agreements After the Financial Collapse

Darren S. Tucker and Kevin L. Yingling

The global financial crisis has drastically altered the market for corporate acquisitions. Merger volume globally was down in 2008 by almost a third from a year earlier.¹ The stock market's collapse in October 2008 further exacerbated the market uncertainty for deals, and several large announced transactions imploded in the aftermath, including BHP Billiton/Rio Tinto, Waste Management/Republic Services, and Walgreens/Longs Drug Stores. The BHP Billiton/Rio Tinto transaction, originally valued at \$188 billion, was the largest deal ever to fail.² Merger activity in early 2009 continues to be anemic.³

The global economic contraction and credit tightening has reduced the capital available to finance acquisitions, particularly for private equity funds. Some observers have noted that private equity firms have been essentially absent from larger deals.⁴ This development contrasts sharply with previous years when ever-higher-priced take-private deals were announced seemingly on a daily basis.⁵

Strategic buyers, which struggled to compete with private equity purchasers during the easy-money bubble years, have now become the most viable purchasers. Indeed, nearly all of the largest deals since August 2007, when the fissures in the credit firmament began to emerge, have been strategic combinations. From emergency bank deals (Bank of America/Merrill Lynch and Wells Fargo/Wachovia) to consumer goods transactions (InBev/Anheuser-Busch, Mars/Wrigley, and Altria/UST), transportation (Delta/Northwest), pharmaceuticals (Pfizer/Wyeth and Merck/Schering-Plough), and technology (Hewlett Packard/EDS and Oracle/BEA Systems), the most high-profile and transformative deals have been predominantly strategic.

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¹ Jessica Hall, *Global M&A Falls in 2008*, REUTERS, Dec. 22, 2008, available at <http://www.reuters.com/article/businessNews/idUSTRE4BL36B20081222>.

² Stephen Taub & Roy Harris, *Withdrawal of BHP-Rio Tinto Bid Is Biggest Ever*, CFO, Nov. 25, 2008, available at <http://www.cfo.com/printable/article.cfm/12672723>.

³ Michael J. de la Merced, *Anemic Recovery for Mergers and Acquisitions*, N.Y. TIMES, Mar. 26, 2009, available at <http://www.nytimes.com/2009/03/26/business/26merge.html> ("Worldwide, about \$443.7 billion worth of deals have been struck this year That's a 34 percent drop from the same period in 2008."); David P. Wales, Acting Director, Bureau of Competition, Fed. Trade Comm'n, Remarks, Breakfast with the FTC Bureau Directors, ABA Section of Antitrust Law Spring Meeting 9 (Mar. 27, 2009) (noting that the number of Hart-Scott-Rodino merger filings declined from 112 in February 2008 to 31 in February 2009) (presentation on file with the authors).

⁴ Matthew Karnitschnig & Dana Cimilluca, *M&A Went MIA and May Stay that Way*, WALL ST. J., Jan. 2, 2009, at R8 ("Private equity-led buyouts, which accounted for about 15% of all M&A in 2007, fell to 6% of the total in 2008, and aren't likely to recover until firms can secure the large financing packages they need to undertake buyouts."); Vance Cariaga, *Merger Action Percolates Anew, But It Won't Reach 2007's Level*, INVESTOR'S BUS. DAILY, July 22, 2008, at A1 ("Private-equity firms drove last year's M&A boom, but they've spent much of this year on the sidelines.").

⁵ David Marcus, *Desperately Seeking Certainty*, THE DEAL, July 18, 2008, available at <http://www.thedeal.com/newsweekly/features/desperately-seeking-certainty.php> ("The past year has been brutal for private equity. . . . The 523 buyouts worth \$65 billion since Aug. 1[, 2007] pale in comparison to 2005, 2006 and the first half of 2007.").

With many potential buyers unable to secure funding or handicapped by their own low stock price, potential sellers—many facing their own financial challenges—now have significantly fewer options than in the past several years. Consequently, merger agreements have shifted from generally favoring sellers to favoring buyers. Contracts now tend to contain more buyer-friendly provisions, such as explicit specific performance disclaimers and reverse termination (sometimes called reverse breakup) fees, that essentially function as call options for acquirers.⁶

The trend toward more buyer-friendly merger contracts contrasts with some commentators' expectations at the beginning of the credit crunch. After a number of private equity firms abandoned high-profile acquisitions, several observers predicted that sellers would demand either explicit specific performance requirements or more onerous reverse breakup fees. For the most part, this did not happen.⁷ Sellers, faced with fewer prospective purchasers, have had to accept merger contracts tending to favor buyers.⁸

Sellers, faced with fewer prospective purchasers, have had to accept merger contracts tending to favor buyers.

Whether the recent trend toward more buyer-friendly merger covenants has also affected antitrust risk-shifting provisions has not yet been examined. We surveyed the thirty largest non-financial, non-private-equity merger agreements in each of 2007 and 2008 to identify any patterns or trends in antitrust risk-shifting terms and to see if merging parties have found new ways to apportion antitrust risk in the current deal environment. This sampling provides the first attempt to quantify the effect of the economic downturn on merging parties' assessment of antitrust risk.

Antitrust Risk-Shifting Provisions

Antitrust risk-shifting devices are a common feature of U.S. merger agreements. The purpose of these provisions is to apportion risks and establish obligations related to potential competition issues raised by the transaction. The most basic risk-shifting provisions set forth in general terms the efforts each party must expend to obtain antitrust clearance. More complex covenants may specify litigation obligations, information-sharing requirements between the parties, divestiture requirements, reverse breakup fees, and regulatory clearance deadlines.

Antitrust risk-shifting provisions in merger contracts can address several important issues for buyers and sellers. After an acquisition is announced but before closing, the seller may have difficulty maintaining its business, in particular, retaining customers and key employees. The target company will want contractual provisions that facilitate a rapid closing and that protect the viability of the firm as a standalone entity should the transaction not close. The buyer, on the other hand, may seek risk-shifting clauses giving it flexibility to address potential antitrust concerns raised by merger regulators. For example, the buyer may want the option to abandon the transaction if the antitrust authorities demand the sale of critical assets to resolve competition issues.

⁶ *Id.* (quoting an M&A lawyer: "The merger agreements in the deals that have been done since the bubble burst have largely followed the reverse break fee, no-financing condition, no-specific-performance paradigm."); Steven M. Davidoff, *Deal Book: Brocade's Financing Problems in Foundry Deal*, N.Y. TIMES, Nov. 17, 2008, available at <http://dealbook.blogs.nytimes.com/2008/11/17/brocades-financing-problems-in-foundry-deal> (discussing the "new strategic [acquisition] model that incorporates a reverse termination fee private-equity-type provision").

⁷ Vipal Monga, *Seller Beware*, THE DEAL, Aug. 8, 2008, available at <http://www.thedeal.com/newsweekly/features/seller-beware.php> ("Last year, when the first financial sponsor-backed deals began to implode, conventional wisdom argued that boards of selling corporations would react by demanding more certainty in deals. . . . The conventional wisdom was wrong."); Marcus, *supra* note 5 ("The run of collapsed deals has led some observers to predict that sellers would demand greater contractual certainty from PE shops in merger agreements, but so far that hasn't happened.")

⁸ For example, instead of demanding specific performance requirements or larger reverse breakup fees, sellers have sought some greater assurances of consummating the transaction by negotiating stronger financing requirements up front and shortening the time between signing the deal and closing. *See* Marcus, *supra* note 5.

Although antitrust risk-shifting provisions can help parties deal with a variety of issues that arise prior to closing, there are some potential drawbacks to including these provisions in a merger agreement. Most significantly, these clauses may function as a red flag to antitrust regulators. By addressing the potential antitrust risks in the merger agreement, the parties may signal regulators that the transaction raises significant competitive concerns. Moreover, specific provisions that state which assets the buyer must divest to obtain merger clearance may hamper the ability of the parties to negotiate the terms of a consent decree with the government.

There are a few common antitrust risk-shifting provisions. Cooperation clauses ensure coordination between the buyer and seller in obtaining merger approval from the antitrust authorities. These clauses require the parties to coordinate and agree on a strategy for winning antitrust clearance. This cooperation may include drafting white papers and presentations jointly, meeting with government regulators together, and coordinating communications with the antitrust agencies. These clauses encourage the buyer and seller to develop and maintain a unified approach in communicating with the competition authorities.

The “best efforts” clause dictates the parties’ obligations to satisfy the conditions to closing, such as antitrust approvals. These covenants typically require the parties to use “commercially reasonable efforts” or “reasonable best efforts,” to satisfy the conditions to closing, including the regulatory requirements. Although these covenants usually provide only vague parameters and may be difficult to apply in specific factual circumstances, they do provide a general guide of what is expected from both sides to close the deal.

A purchase agreement may provide more specific requirements for the parties if and when they are confronted by antitrust roadblocks. These requirements may include the buyer agreeing to divest assets to satisfy the antitrust authorities. The precise obligations in these divestiture clauses can vary considerably and are often subject to vigorous negotiation between deal counsel. These provisions sometimes require the buyer to divest all non-material assets required by the antitrust regulators in order to complete the deal but may be silent on the definition of “materiality.” Alternatively, the parties may specify assets or businesses to be divested or cap divestitures at a certain dollar amount. At the extreme, a “hell or high water” clause commits the buyer to undertake any obligations or divestitures that the government requires to consummate the transaction, regardless of cost.

Termination clauses in the merger agreement permit one or both parties to abandon the transaction after a certain period of time has passed or a specified event has occurred. For example, an agreement may provide that either party can abandon the deal after nine months or if there is a final, nonappealable government order prohibiting consummation. In general, buyers seek a longer duration for the termination clause to ensure that there is sufficient time to satisfy the closing conditions. Sellers generally prefer a shorter timeframe to minimize the potential deterioration of their businesses while the merger is pending.

Finally, a reverse breakup fee provision requires payment to the seller by the buyer if the acquisition does not close for certain reasons. Reverse breakup fees have been used with increasing frequency as a means of compensation to the target for undergoing the onerous and lengthy review process and the risk of the government blocking the transaction on antitrust grounds.⁹

⁹ Darren S. Tucker & Kevin L. Yingling, *Keeping the Engagement Ring: Apportioning Antitrust Risk with Reverse Breakup Fees*, ANTITRUST, Summer 2008, at 70.

Antitrust Covenants Tested in the Market Downturn

Antitrust provisions are often hotly debated by the buyer and seller during merger negotiations but are rarely tested in litigation. The recent unraveling of Apollo's acquisition of Huntsman resulted in one of the few judicial discussions of merging parties' obligations under an antitrust "best efforts" covenant.¹⁰

In May 2007, Huntsman, a chemical manufacturer and marketer, solicited offers for itself and received competing bids from two other chemical companies, Hexion (owned by Apollo) and Basell. Huntsman signed a merger agreement with Basell only to receive a subsequent superior offer from Hexion. Basell refused to match Hexion's higher offer, citing the additional antitrust scrutiny that a Hexion/Huntsman deal would face. Huntsman subsequently terminated the agreement with Basell and, three weeks later, entered into the more lucrative, but riskier, agreement with Hexion.

During the regulatory review process, Huntsman announced disappointing financial results. The merging parties had signed their agreement "just before the onset of the ongoing crisis affecting the national and international credit markets," and Huntsman's first half of 2008 earnings fell by approximately 20 percent over the previous year.¹¹ Hexion, seeking to abandon the transaction and avoid paying the \$325 million reverse termination fee, sued for a declaratory judgment that Huntsman had suffered a material adverse condition, which would permit Hexion to abandon the transaction without liability.

The judge rejected Hexion's claims, holding that no material adverse condition had occurred and that Hexion had knowingly and intentionally breached the agreement by failing to satisfy its obligations under the antitrust "best efforts" provision. The merger agreement required Hexion to "take any and all action necessary" to secure approval from the antitrust agencies.¹² According to the court, this "hell or high water" provision was not satisfied because Hexion had yet to secure approval from the FTC and still had not certified compliance with the FTC's second request even though the termination deadline was only three weeks away. The judge found that "[r]ather than being a diligent party making all necessary efforts to obtain antitrust clearance, come 'hell or high water,' the court was left with the impression that Hexion had, since May or June, been dragging its feet on obtaining that clearance, pending the outcome of its attempts to avoid the transaction, in contravention of its obligations under the merger agreement."¹³

Effects of the Financial Downturn on Antitrust Covenants

To see whether antitrust risk-shifting devices changed as the financial downturn intensified at the end of 2007, we examined the purchase agreements for the thirty largest acquisitions of U.S. companies in each of 2007 and 2008, excluding going-private transactions and acquisitions of distressed financial institutions. The survey revealed that the current economic slump affected sev-

Antitrust provisions are often hotly debated by the buyer and seller during merger negotiations but are rarely tested in litigation.

¹⁰ Hexion Specialty Chem., Inc. v. Huntsman Corp., 965 A.2d 715 (Del. Ch. 2008).

¹¹ *Id.* at 720–21, 740.

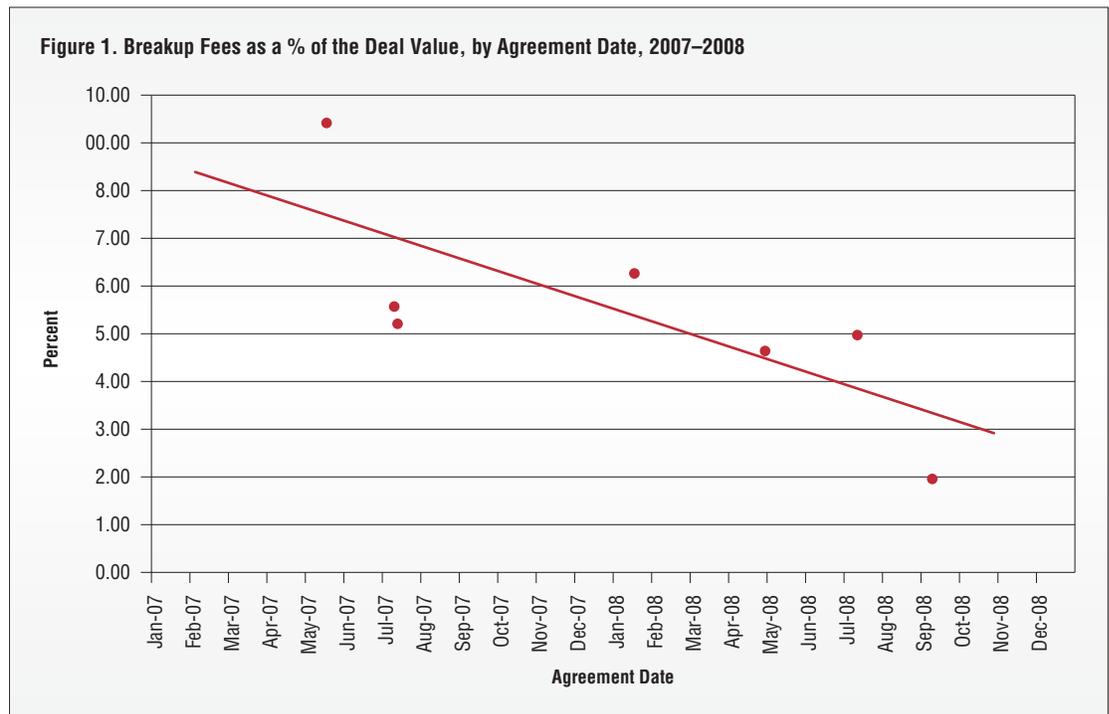
¹² *Id.* at 734, 756.

¹³ *Id.* at 756. Despite the judge's criticism of Hexion's conduct, Hexion's antitrust counsel testified that Hexion would be able to receive antitrust approval in time to satisfy its obligations under the merger agreement. *Id.* Indeed, after the court ordered it to satisfy its obligations under the merger agreement, Hexion was able to secure a consent decree with the FTC before the merger deadline. See Press Release, Fed. Trade Comm'n, FTC Intervenes in Hexion's Proposed Acquisition of Huntsman Corp. (Oct. 2, 2008), available at <http://www.ftc.gov/opa/2008/10/hexion.shtm>.

eral antitrust risk-shifting covenants to the benefit of buyers and resulted in deals closing faster. In contrast, there was no effect on covenants designed to speed the regulatory process or on covenants addressing litigation requirements.

Traditional Antitrust Risk-Shifting Devices. As previously noted, reverse breakup fees have become more widely used to mitigate antitrust risk to sellers in recent years. Since the onset of the financial downturn, the frequency of reverse breakup fees has not changed. Throughout the survey period, approximately 10 percent of the agreements included reverse breakup fees conditioned on failure to obtain regulatory approval. But while the frequency of these termination fee provisions remained steady over the 2007 to 2008 period, their dollar value declined. Figure 1 shows the fees as a percentage of the deal value by agreement date. The downward sloping trend line is statistically significant at the 10 percent level.¹⁴

The survey revealed that the current economic slump affected several antitrust risk-shifting covenants to the benefit of buyers and resulted in deals closing faster.



Another notable trend is buyers' increasing reluctance to make curative divestitures. In eight of the surveyed transactions in 2007, the buyer agreed to divest assets without a monetary cap to the extent necessary to obtain regulatory approval.¹⁵ No surveyed agreements in 2008 contained a similar provision. Likewise, the number of merger agreements expressly disclaiming a divestiture obligation increased from three in 2007 to five in 2008.

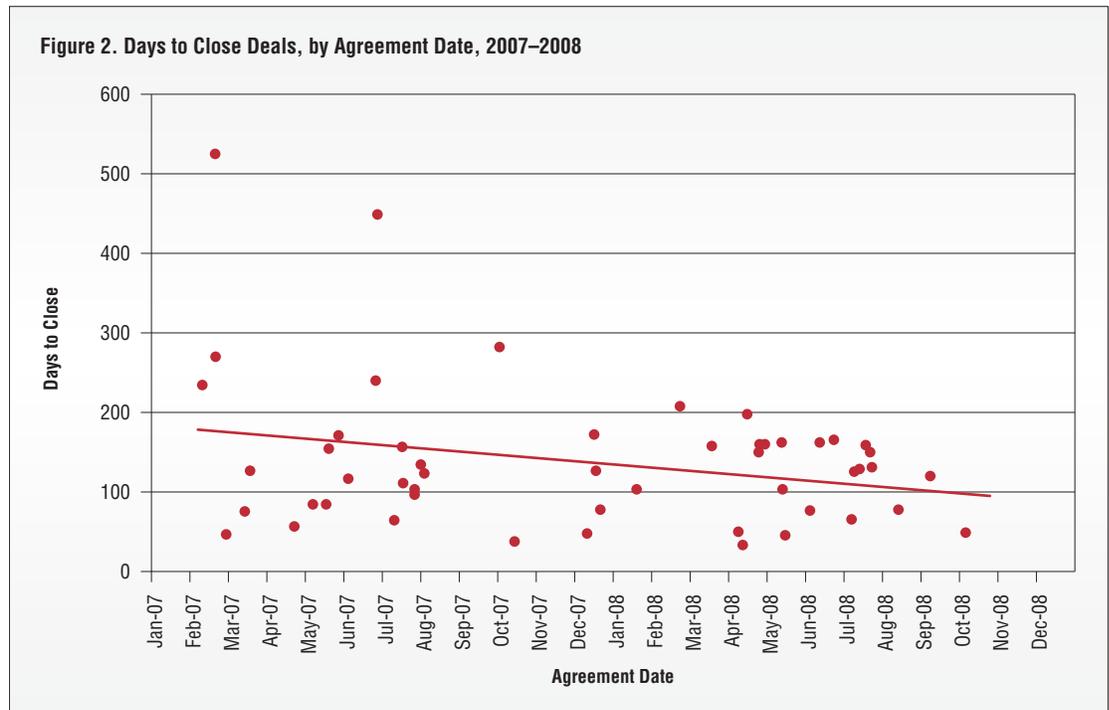
There was no significant change in the time that had to elapse before either merging party could terminate the transaction without penalty. The average time actually increased in 2008 rel-

¹⁴ Microsoft's acquisitions of aQuantive before the credit collapse and Greenfield Online in 2008 provide a useful, albeit rough, illustration of the trend. Microsoft "managed to negotiate a beneficial antitrust provision, which left it paying only \$5 million [or 1 percent of the deal value] if the [Greenfield Online] deal failed on antitrust grounds, a much better deal than Microsoft received when it acquired aQuantive and agreed to a break fee of \$500 million, or 10 percent of the value of the deal." Steven M. Davidoff, *DealBook Blog: The Deal Professor's Year-End Review*, N.Y. TIMES, Dec. 29, 2008, available at <http://dealbook.blogs.nytimes.com/2008/12/29/the-deal-professors-year-end-review>.

¹⁵ These provisions would not necessarily be characterized as "hell or high water" clauses because some disclaim an obligation to divest any assets of the purchaser or to hold separate assets of the target company, while others give the buyer the right to seek to minimize the scope of the divestiture.

ative to 2007, but the difference was not statistically significant. One year remained the most common termination period, with a range from 3 to 18 months.

Even though the termination periods did not noticeably change, the actual time to consummate transactions did decline from 2007 to 2008. Figure 2 shows the number of days to close each deal by agreement date. The downward sloping trend line is statistically significant at the 10 percent level. Another trend apparent from the table is that the time to close transactions has become less dispersed over the surveyed period. Transactions executed in 2007 closed in 38 to 526 days with two deals requiring more than a year. In contrast, transactions executed in 2008 closed in 34 to 209 days with none taking more than nine months.¹⁶



There was no observed change in the litigation requirements over the course of the survey. Twenty-four of the thirty agreements in 2007 contained some type of litigation obligation, compared to twenty-five in 2008. Of the agreements with an express litigation requirement, there appeared to be little change as to parties' precise obligations, e.g., litigating through a preliminary injunction hearing versus litigating through an appeal on the merits. Other common risk-shifting provisions, such as the "best efforts" clause, also showed little variation over time.

Regulatory Expediting Covenants. The surveyed agreements contain a variety of provisions designed to expedite the antitrust review process. The frequency of these provisions did not change noticeably over the period of our survey, suggesting that both buyers and sellers continue to see value in these provisions.

¹⁶ Abandoned transactions were excluded from this part of the survey. Two transactions signed in the second half of 2008 have not yet closed and could affect the upward range of closing times for 2009.

Two merger agreements in our survey contain a deadline for compliance with a second request, if issued. In Delta/Northwest, the deadline was three months;¹⁷ in Plains Exploration/Pogo, the deadline was two months.¹⁸ The second request covenant appears to have had its intended effect in the Delta/Northwest transaction, which moved through the regulatory process rapidly. That merger agreement was signed on April 14, 2008. Just over three months later, on July 23, 2008, Northwest announced in an earnings call that the parties had already complied with the second request.¹⁹ On October 29, 2008, six-and-a-half months after the parties entered into the transaction, the Antitrust Division closed its investigation—a quick review considering the scrutiny given to airline mergers.²⁰

A number of surveyed agreements set a deadline for all non-U.S. competition filings. These clauses have become more popular as the number of countries with premerger notification regimes has expanded. The agreements require the parties to make all non-HSR competition filings within fifteen business days on average, with a range of seven to thirty business days.²¹ This compares to an average of thirteen days to submit the HSR filing in the same agreements. Some agreements take a slightly different approach by setting a deadline for the parties to compile a list of all required competition filings but without specifying when the filings must be made. In the Alpha/Cleveland Cliffs merger, for example, the parties' counsel were required to compile "a definitive list" of all suspensive merger filings outside the United States within seven days.²²

A number of the surveyed agreements specify which party has the right to direct the antitrust strategy and discussions with the antitrust agencies. These provisions are designed to prevent disputes between antitrust counsel, notwithstanding the standard practice, in which buyer's counsel takes the lead role. There is some variation in exactly what the lead party is entitled to direct, for instance, taking the lead on "the [antitrust] strategy of the parties,"²³ taking the lead on "pro-

¹⁷ Agreement and Plan of Merger by and among Delta Air Lines, Inc., Nautilus Merger Corporation and Northwest Airlines Corporation (Form 8-K) § 5.3(e) (Apr. 14, 2008) [hereinafter Delta/Northwest Merger Agreement] ("Each party will certify substantial compliance with respect thereto as promptly as possible, but in no event more than three months after the date of the Second Request.").

¹⁸ Agreement and Plan of Merger by and among Plains Exploration & Production Company, PXP Acquisition LLC and Pogo Producing Company (Form 8-K) § 5.6(a) (July 17, 2007) (parties required to "certify substantial compliance with any request for additional information (also known as a 'second request') issued pursuant to the HSR Act within 60 days of such request"). An analysis of the effectiveness of the Plains/Pogo covenant is not possible because the transaction apparently did not result in a second request.

¹⁹ Northwest Airlines Corp. Second Quarter 2008 Earnings Call Transcript (July 23, 2008) (CEO stating: "We have hit all the milestones so far, including in our view, compliance with the second request under the Hart-Scott-Rodino statute . . .").

²⁰ Statement of the Department of Justice's Antitrust Division on Its Decision to Close Its Investigation of the Merger of Delta Air Lines Inc. and Northwest Airlines Corporation (Oct. 29, 2008), available at <http://www.usdoj.gov/opa/pr/2008/October/08-at-963.html>.

²¹ Only one of the agreements extends the deadline in the event that one party is dilatory in supplying information to the other party. See Agreement and Plan of Merger among Basell AF, BI Acquisition Holdings Limited and Huntsman Corporation (Form 8-K) § 5.4(b) (June 26, 2007) [hereinafter Basell/Huntsman Merger Agreement] (twenty business day filing requirement assumes that "the parties to this Agreement have received from the other party all of the information required to make all of their premerger notification filings").

²² Agreement and Plan of Merger by and among Cleveland-Cliffs, Inc., Daily Double Acquisition, Inc. and Alpha Natural Resources, Inc. (Form 8-K) § 5.3(g) (July 15, 2008). See also Agreement and Plan of Merger by and among Invitrogen Corporation, Atom Acquisition, LLC and Applera Corporation (Form 8-K) § 5.9(b) (June 11, 2008) (parties required to "determine and agree upon, as soon as practicable" a list of jurisdictions requiring competition filings).

²³ Delta/Northwest Merger Agreement, *supra* note 17, § 5.3(f).

ceedings or negotiations” with the antitrust agencies,²⁴ or taking the lead on “all matters” related to antitrust approvals.²⁵ Each of these agreements contains language ensuring that the other party is afforded an opportunity to provide input and to stay apprised of developments. All but one of the agreements—that being Delta/Northwest, a merger agreement between equals that designated Northwest as the leader in obtaining antitrust approval—state that the buyer shall play the lead role.

Over a dozen agreements in the survey include provisions prohibiting the parties from intentionally taking steps that might delay antitrust approvals. For example, several agreements prohibit a party from unilaterally extending any antitrust waiting period or agreeing not to close the transaction at the behest of an antitrust authority.²⁶ Other agreements prohibit the parties from taking “any action” that could reasonably be expected to delay or prevent antitrust clearance or consummation,²⁷ or forbid the parties from entering into transactions that would “materially delay” antitrust clearance or consummation.²⁸

One transaction in our

survey involved what

may be a new antitrust

risk-shifting device:

a “ticking fee.”

One transaction in our survey involved what may be a new antitrust risk-shifting device: a “ticking fee.” In June 2008, Republic Services entered into a stock purchase agreement to acquire Allied Waste Industries. The companies were the third and second largest waste hauling and disposal companies in the United States, respectively. One month later, Waste Management, the largest competitor, sent an acquisition proposal to Republic, which rejected the proposal in part because of the greater regulatory complexity and the additional time required to close the deal. Waste Management revised its proposal on August 11, 2008, and included, among other sweeteners, a ticking fee, which would increase the “per share price by an interest component . . . in

²⁴ Agreement and Plan of Merger among Basell AF, Bil Acquisition Holdings Limited and Lyondell Chemical Company (Form 8-K) § 5.4(b) (July 16, 2007); Agreement and Plan of Merger among Hexion Specialty Chemicals, Inc., Nimbus Merger Sub Inc. and Huntsman Corporation (Form 8-K) § 5.4(b) (July 12, 2007); Basell/Huntsman Merger Agreement, *supra* note 21, § 5.4(b). *See also* Agreement and Plan of Merger by and among Siemens Corporation, Belfast Merger Co. and Dade Behring Holdings, Inc. (Form 8-K) § 6.09 (July 25, 2007) [hereinafter Siemens/Dade Behring Merger Agreement] (“Parent and its counsel shall have the primary lead role in any discussions and negotiations with any Antitrust Authorities”); Agreement and Plan of Merger among CME Group Inc., CME NY Inc., NYMEX Holdings, Inc. and New York Mercantile Exchange, Inc. (Form 8-K) § 6.5(a) (Mar. 17, 2008) (“CME Group shall take the lead in determining strategy for and conducting” meetings with the government).

²⁵ Agreement and Plan of Merger by and among Anheuser-Busch Companies, Inc., InBev N.V./S.A. and Pestalozzi Acquisition Corp. (Form 8-K) § 6.5(b) (July 13, 2008); Agreement and Plan of Merger among Philadelphia Consolidated Holding Corp., Tokio Marine Holdings, Inc. and Merger Sub (Form 8-K) § 6.5(b) (July 22, 2008); Agreement and Plan of Merger by and among Philips Holdings USA Inc., Moonlight Merger Sub, Inc. and Respiroics, Inc. (Form 8-K) § 6.6(a) (Dec. 20, 2007). *See also* Agreement and Plan of Merger by and among ChoicePoint Inc., Reed Elsevier Group PLC and Deuce Acquisition Inc. (Form 8-K) § 6.6(f) (parent “shall make all decisions, lead all discussions, . . . and coordinate all activities” related to any governmental entity, including litigation strategy).

²⁶ *See, e.g.*, Siemens/Dade Behring Merger Agreement, *supra* note 24, § 6.09 (“Each of the parties shall . . . not extend any waiting period under the HSR Act and other applicable Antitrust Laws, rules or regulations or enter into any agreement with any Antitrust Authorities not to consummate the transactions contemplated by this Agreement, except with the prior written consent of the other parties hereto.”).

²⁷ *See, e.g.*, Agreement and Plan of Merger among Fresenius SE, Fresenius Kabi Pharmaceuticals Holding, LLC, Fresenius Kabi Pharmaceuticals, LLC and APP Pharmaceuticals, Inc. (Form 8-K) § 6.6(a) (July 6, 2008) (“Parent and its Subsidiaries shall not take or agree to take any action that would reasonably be expected to delay or prevent consummation of the Merger.”).

²⁸ *See, e.g.*, Agreement and Plan of Merger by and among News Corporation, Ruby Newco LLC, Dow Jones & Co., Inc., and Diamond Merger Sub Corporation (Form 8-K) § 5.5(a) (July 31, 2007) (“[N]one of the parties shall . . . acquire, purchase, lease or license (or agree to acquire, purchase, lease or license) any business or collection of assets of any kind or nature if doing so would reasonably be expected to materially delay consummation of the Merger”).

the event our transaction does not close on or before a mutually acceptable date due to delays in antitrust clearance.”²⁹

A few days later, Republic’s board rejected Waste Management’s revised offer. In a letter to Waste Management, Republic explained that “[w]hile your ‘ticking fee’ proposal may address the financial impact of a delay in closing, it does not address operational issues and additional contingencies that would result from a protracted delay.”³⁰ Waste Management withdrew its offer in October 2008, citing the state of the credit markets. While the ticking fee does not appear to have been much of an enticement to Republic, this example demonstrates yet another way in which a buyer attempted to ensure a rapid and successful regulatory review as the financial crisis worsened.

Conclusion

The survey results are consistent with buyers having greater bargaining power than sellers due to less competition from other buyers, particularly private equity funds.

The survey results are consistent with buyers having greater bargaining power than sellers due to less competition from other buyers, particularly private equity funds. This is evident from the lower reverse breakup fees and reduced divestiture obligations. That the termination periods have not become shorter—which sellers ordinarily would demand in an unstable market—is also consistent with a buyer’s market.

The survey results are also consistent with both buyers and sellers becoming more concerned about lengthy closings—most likely due to financing risk. This is evident from the consistent use of provisions intended to speed the regulatory process. Given that these provisions are on balance more favorable to sellers, their continued use in a buyers’ market suggests that buyers recognize the importance of a quick regulatory review in the current economic environment. As noted earlier, parties are in fact closing transactions faster since the financial crisis hit.

How long these trends will continue is unclear. One would expect to see more balance in antitrust risk-shifting covenants between buyers and sellers once credit becomes more available and more firms emerge as potential bidders. But because of the many other variables that can affect antitrust covenants, making accurate predictions is difficult. For example, uncertainty created by the change in government administrations may already have made some potential buyers more hesitant to strike deals.³¹ If, as many expect, merger enforcement is more actively pursued by government officials now than it was under the previous administration, antitrust covenants undoubtedly will adjust to reflect the closing and timing risks the new enforcement approach presents. Therefore, even assuming more stability in the credit and equity markets, other factors will continue to affect the allocation of antitrust risks in merger agreements. ●

²⁹ Press Release, Waste Management, Waste Management Improves All-Cash Proposal for Republic Shares (Aug. 11, 2008), available at [http://www.wm.com/wm/press/pr2008/20080811_WMI__Improves_All-Cash_Proposal_For_Republic_Services_\(WMI_08-15\).pdf](http://www.wm.com/wm/press/pr2008/20080811_WMI__Improves_All-Cash_Proposal_For_Republic_Services_(WMI_08-15).pdf).

³⁰ Press Release, Republic Services, Republic Services Declines to Enter into Discussions with Waste Management Following Review of Revised Merger Proposal (Aug. 14, 2008), available at <http://phx.corporate-ir.net/phoenix.zhtml?c=82381&p=irol-newsArticle&ID=1187661&highlight=>.

³¹ See de la Merced, *supra* note 3 (quoting a transactions partner: “Until people get a good read on what this administration is going to do on the antitrust side, it’s hard to allocate risk.”).

Antitrust in a Financial Crisis—A Canadian Perspective

Mark Katz, Anita Banicevic, and Jim Dinning

The global economic downturn has created new challenges for governments and regulatory authorities around the world. One important issue raised is the appropriate interplay between antitrust policy and macroeconomic recovery imperatives. That is, what role, if any, should be afforded to competition law and policy considerations in responding to the current crisis?

On the one hand, it could be argued that competition principles should be subordinated to macroeconomic imperatives and thus should not be applied to interfere with measures that are necessary for economic stability, even if such measures are inconsistent with promoting competition. On the other hand, it is possible to contemplate a more significant role for competition law and policy in shaping and perhaps even monitoring recovery initiatives (particularly where significant mergers or other economic initiatives are proposed). The approach taken to this apparent dichotomy can have significant implications, particularly (although not exclusively) for merger review.

To date, the approach to the financial crisis by antitrust agencies worldwide has been anything but uniform. Several agencies have addressed the issue head on. In Korea, for example, the Federal Trade Commission has announced that it will allow competitors to form temporary cartels to deal with the country's worst financial crisis in decades.¹ In the European Union, the European Commission has demanded an active role for itself both with respect to merger review and the review of state aid proposals.² In the UK, John Fingleton, head of the Office of Fair Trading (OFT), recently gave a speech in which he acknowledged that competition authorities will have to "display a degree of pragmatism in recognising times when other policy interests may over-ride competition policy," but warned against the wholesale abandonment of competition principles in dealing with the fallout of the economic downturn.³ These statements followed on the heels of the UK government's quick approval of the merger between Lloyds TSB and HBOS as being in the public interest, despite the OFT's concerns.⁴

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¹ H. Stephen Harris, Jr., Peter Wang & Shinya Watanabe, *China: Korea Considers Antitrust Exemptions for Certain Cartels to Assist Economic Recovery* (Jan. 16, 2009), available at <http://www.mondaq.com/article.asp?articleid=72396>.

² See Neelie Kroes, European Commissioner for Competition Policy, *The Role of State Aid in Tackling the Financial and Economic Crisis*, Introductory Remarks at Press Conference (Dec. 8, 2008), available at <http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/08/683&format=HTML&aged=0&language=EN&guiLanguage=en>; Neelie Kroes, European Commissioner for Competition Policy, *Dealing with the Current Financial crisis*, Speech to the Economic and Monetary Affairs Committee, European Parliament (Oct. 6, 2008), available at <http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/08/498&format=HTML&aged=0&language=EN&guiLanguage=en>.

³ John Fingleton, *Competition Policy in Troubled Times*, Speech at the Charles River Associates Conference (Jan. 20, 2009), available at http://www.of.gov.uk/shared_of/speeches/2009/spe0109.pdf.

⁴ See Decision by Lord Mandelson, the Secretary of State for Business, not to refer to the Competition Commission the merger between Lloyds TSB Group plc and HBOS plc under Section 45 of the Enterprise Act 2002 (Oct. 31, 2008), available at <http://www.berr.gov.uk/files/file48745.pdf>; see also *Lloyds TSB's HBOS Deal Is Cleared*, BBC News, Oct. 31, 2008, available at <http://news.bbc.co.uk/2/hi/business/7702809.stm>.

Other agencies have been less proactive in stating their intentions, the Canadian Competition Bureau among them. In part, that is because Canada has yet to see as many business failures or mergers precipitated by the financial crisis as may be the case in other jurisdictions. Nonetheless, the issue of the application of competition principles during this global slowdown is as relevant in Canada as it is elsewhere: Will the Bureau continue to operate in a “business as usual” fashion or will it adjust its enforcement standards in order to accommodate broader economic concerns that may be inconsistent with the strict application of competition law? As discussed below, this issue is of particular relevance for merger review under Canada’s Competition Act.⁵ It also has implications for the government’s review of acquisitions by non-Canadians under the Investment Canada Act.⁶

Implications for Merger Review Under the Competition Act

Pursuant to recent amendments to the Competition Act’s merger review process, transactions that exceed certain financial thresholds and, in the case of share acquisitions, that exceed an additional voting interest threshold, cannot be completed before the expiration of a statutory waiting period of thirty days.⁷ Before that thirty-day period expires, the Competition Bureau may issue a “second request” for information, in which case the proposed transaction may not be completed until thirty days after the requested information is provided to the Bureau.⁸ The statutory test that the Bureau applies in reviewing transactions is whether the merger prevents or lessens, or is likely to prevent or lessen, competition substantially in a relevant market.⁹ If the Bureau decides to challenge a merger, and an agreement with the parties as to an appropriate remedy cannot be reached, the matter is referred to the Competition Tribunal for a hearing.

Role of Public Interest Considerations. As a general matter, there is no formal role for extrinsic, non-competition considerations in the Competition Bureau’s merger review process. The Bureau also prides itself on its independence and imperviousness to political pressure.

⁵ Competition Act, R.S.C., ch. C-34 (1985).

⁶ Investment Canada Act, R.S.C., ch. 28 (Supp. I 1985).

⁷ Bill C-10, Budget Implementation Act, 2009, 2d Sess., 40th Parl., 2009, § 439 (Can.). The purpose of these amendments is to more closely align the Canadian merger review process with that in the United States. Under the prior Canadian merger review regime, transactions could not be completed before the expiration of a statutory waiting period of either 14 or 42 days following the filing of a notification containing the prescribed information. The duration of the statutory waiting period depended on whether the acquirer elected to make a short form filing (14-day waiting period) or a long form filing (42-day waiting period). The Competition Bureau’s substantive review of transactions, however, ran on a different non-statutory timetable, based on the complexity of the transaction. According to the Bureau’s non-binding “service standard” periods, it aimed to complete its substantive review of “non-complex” transactions within two weeks; of “complex” transactions within ten weeks; and of “very complex” transactions within five months. COMPETITION BUREAU, FEE AND SERVICE STANDARDS HANDBOOK (Dec. 2003), available at [http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/vwapi/ct02530e_a.pdf/\\$FILE/ct02530e_a.pdf](http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/vwapi/ct02530e_a.pdf/$FILE/ct02530e_a.pdf) [hereinafter *Fee and Service Standards Handbook*]. According to Draft Merger Regulations recently issued, the Bureau will “continue to make every effort to provide a response to merger notifications within the current 14-day service standard period for non-complex transactions and anticipates that the vast majority of mergers will continue to be cleared within a 30-day period.” Competition Bureau, Canada, Draft Enforcement Guidelines on the Revised Merger Review Process (Mar. 24, 2009), available at <http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/02986.html>.

⁸ Bill C-10, *supra* note 7, § 439. Concerns have been raised about the adoption of a “second request” process in Canada. See, e.g., Letter from the Canadian Bar Association to Ron Parker, Senior Assistant Deputy Minister, Industry Canada (Feb. 3, 2009), available at <http://www.cba.org/cba/submissions/pdf/09-04-eng.pdf>. The Canadian Bar Association letter notes that the “second request” process amounts to a “substantial tax on merger activity,” imposing a lengthy and expensive review process on merging parties, and questions the wisdom of such an amendment, particularly in light of the current economic climate.

⁹ Competition Bureau, Merger Enforcement Guidelines, Part 2 (Sept. 1, 2004), available at <http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/01245.html>.

Nonetheless, there are two key industries where parallel “public interest” reviews are required in addition to the standard merger review process, i.e., banking and transportation. In both of these areas, one can envision a scenario where public-interest considerations could trump any antitrust analysis and thereby allow otherwise anticompetitive mergers to be approved.

BANK MERGERS. The question of the appropriate interaction between antitrust policy and other public interest considerations likely would be front and center in any merger between major Canadian financial institutions proposed as a result of the global economic crisis.

In the case of mergers between banks (as well as mergers between certain other financial institutions), the Competition Bureau’s review is clearly subordinate to the ultimate decision-making authority of the federal Minister of Finance. The Minister of Finance’s authority to override competition issues is incorporated in section 94(b) of the Competition Act, which specifically provides that a bank merger cannot be blocked, regardless of its effect on competition, if the Minister certifies that it is “in the public interest.” Alternatively, the Minister of Finance also has the ability to block a merger that is not in the public interest even if it does not raise competition concerns (or if those concerns could be resolved).

... a bank merger cannot be blocked, regardless of its effect on competition, if the Minister certifies that it is “in the public interest.”

In 1998, the Minister of Finance’s power was exercised when two proposed mergers between four of Canada’s five leading banks (that would have seen their overall numbers reduced to three) were vetoed. At the time, the banks took the position that it was necessary for them to become larger in order to compete more efficiently internationally and in Canada. Specifically, the large banks contended that larger foreign institutions had significant cost advantages and that these foreign financial institutions, as well as those using electronic technology to deliver financial services, were becoming an increasing threat to the competitiveness of Canadian financial institutions. The merging banks also contended that significant cost savings and efficiencies would arise out of the proposed mergers.

While the Competition Bureau independently reviewed the proposed mergers and issued letters to the parties indicating several areas of concern,¹⁰ the Minister of Finance at that time, Paul Martin, placed a particular emphasis on broader competition and prudential policy concerns in his decision to disallow the proposed mergers.¹¹ In particular, he referred to the need for Canadian businesses and consumers to have sufficient choice and access to a variety of lending facilities, access which he felt could be compromised if the financial sector were allowed to consolidate further. In what now appears to be an almost prescient statement, Martin expressed the following concern: “If circumstances were to lead to large dominant institutions having to restrain lending, the resulting withdrawal of bank credit could lead to a ‘credit crunch,’ with adverse consequences on the economy as a whole.”

As a result of Minister Martin’s decision, the 1998 mergers were abandoned. Indeed, he imposed a temporary moratorium on major bank mergers, stating that the government would not consider any merger among major banks until a “new policy framework” to assess large bank

¹⁰ Specifically, the Bureau performed a detailed analysis of the areas of overlap between the merging parties and concluded that the proposed mergers would “lead to a substantial lessening or prevention of competition that would cause higher prices and lower levels of service and choice for several key banking services in Canada.” See Letter from the Competition Bureau to the Royal Bank and the Bank of Montreal (Dec. 11, 1998), available at <http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/01612.html>; Letter from the Competition Bureau to the CIBC and TD Bank (Dec. 11, 1998), available at <http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/01601.html>.

¹¹ Statement by the Honourable Paul Martin, Minister of Finance, on the Bank Merger Proposals (Dec. 14, 1998), available at <http://www.collectionscanada.gc.ca/webarchives/20071122063125/http://www.fin.gc.ca/news98/98-124e.html>.

mergers was in place.¹² Even then, Martin explained, merging parties would have to “demonstrate, in the light of the circumstances of the day, that [the proposed mergers] do not unduly concentrate economic power, significantly reduce competition or restrict our flexibility to address prudential concerns.”¹³

The policy framework referred to by Minister Martin took a number of years to develop and, in fact, has never been formally finalized. In June 2000, the government released guidelines setting out a merger review process for any proposed merger of banks with equity of more than CDN \$5 billion (large banks). In February 2001, Minister Martin released revised guidelines that clarified that the Standing Senate Committee on Banking, Trade and Commerce, in addition to the Standing House Committee on Finance, would be asked to review the public interest impact assessments and hold public hearings on proposed bank mergers. In October 2002, following a request from stakeholders for clarification of the public interest tests, then-Minister of Finance John Manley asked the two Committees for their views on the considerations that should apply in determining whether major bank mergers were in the public interest. In June 2003, the Department of Finance released its response to the recommendations of the House of Commons Standing Committee on Finance and the Standing Senate Committee on Banking, Trade and Commerce on the public interest considerations in reviewing merger proposals between large banks.¹⁴ The response laid out a set of suggested public interest considerations for large bank mergers.¹⁵ The criteria were initially intended to be subject to public commentary and further refined or developed based on responses received.¹⁶ However, a revised set of guidelines was delayed on a number of occasions and a “finalized” set of criteria or revised guidelines on large bank mergers has not yet been issued.¹⁷

Based on the 2003 government response, the criteria that the Minister would consider in assessing the “public interest” under the foregoing process are: (1) access to financial services by Canadian consumers; (2) continued access to sufficient choice by Canadian consumers; (3) impact of the merger upon international competitiveness and long-term growth prospects for the merging parties; (4) contribution of the merger to the “deepening and broadening” of Canadian

¹² *Id.* That said, the Minister did approve the merger of TD and Canada Trust in January 2000, even though the requisite policy framework was not in place at that time. Press Release, Dep’t of Finance, Federal Government Approves Acquisition of Canada Trust by The Toronto-Dominion Bank (Jan. 31, 2000), available at <http://www.collectionscanada.gc.ca/webarchives/20071122055018/http://www.fin.gc.ca/news00/00-006e.html>.

¹³ Statement by the Honourable Paul Martin, *supra* note 11.

¹⁴ DEPARTMENT OF FINANCE, RESPONSE OF THE GOVERNMENT TO LARGE BANK MERGERS IN CANADA: SAFEGUARDING THE PUBLIC INTEREST FOR CANADIANS AND CANADIAN BUSINESSES AND COMPETITION IN THE PUBLIC INTEREST: LARGE BANK MERGERS IN CANADA 5–12 (Jun. 23, 2003), available at http://www.fin.gc.ca/activity/pubs/mergers_e.pdf. No separate guidelines have been released for mergers involving banks with less than CDN \$5 billion in equity. Accordingly, it is unknown whether mergers involving these “smaller” banks would be subject to the same “public interest” review process and criteria as “large banks.”

¹⁵ *Id.*

¹⁶ In a press release announcing the government’s response, Minister Manley stated that the government would accept comments on its approach until December 31, 2003, and would release its policies on these issues and revised merger review guidelines by June 2004. In this same press release, Minister Manley also stated that the government would not accept or consider mergers involving large banks until after the revised guidelines had been released and a three month transition period had expired. See Press Release, Dep’t of Finance, Minister Manley Releases Response to Commons and Senate Committee Reports on Bank Mergers and the Public Interest (Jun. 23, 2003), available at <http://www.collectionscanada.gc.ca/webarchives/20071120132726/http://www.fin.gc.ca/news03/03-031e.html>.

¹⁷ After a number of delays, in September 2005, then-Minister of Finance Ralph Goodale issued a press release stating that it was not an appropriate time to bring forward revised guidelines on large bank mergers. See Statement by the Minister of Finance on Guidelines for Large Bank Mergers (Sept. 26, 2005), available at http://www.fin.gc.ca/n05/05-061_2-eng.asp.

capital markets; and (5) transition of employees displaced by the merger.

Certain of these criteria, such as the impact of the merger upon the overall competitiveness of the merging entities, are clearly aligned with the goals of any antitrust assessment. However, other public interest considerations, such as the impact of the merger upon employees and access to financial services, would clearly diverge from Canadian antitrust law goals. Canadian antitrust law purposely disregards the impact of mergers upon employment levels, and, furthermore, shutting down branches may be part of the merging parties' plan to achieve significant efficiencies.

Another example of the tension between public interest and antitrust goals could be seen where a merger of two large banks were proposed to ensure the ongoing stability of Canada's financial sector, or the overall economy. Although ensuring the stability of the economy does not fit squarely within any of the listed criteria, presumably it would nonetheless qualify a merger as being in the "public interest." Here, the tension between public interest and antitrust considerations and, indeed, differing public interest considerations is especially acute given the previously expressed concerns regarding the negative impact of increased concentration upon consumer choice and access to financial services.

While there has been continued debate about whether major bank mergers might or should be approved, there has been little political momentum to raise the issue of large bank mergers anew.¹⁸ Despite the fact that Canada's banks are currently heralded as some of the world's most stable financial institutions, it is clear that the full scope of the current financial crisis is still unknown. Furthermore, there have been repeated calls for Canada's banks to be allowed to merge to realize significant economies of scale.¹⁹ These facts, together with the consolidation that is rapidly occurring in other jurisdictions, suggest it is within the realm of possibility that two or more of Canada's leading banks will again float the possibility of a merger. A major merger in this area could crystallize the potential conflict between competition and other public interest considerations.

TRANSPORTATION SECTOR MERGERS. Public interest considerations are also part of the review of certain mergers in the transportation industry. In June 2007, the Canada Transportation Act (CTA) was amended to allow the federal Minister of Transport to review mergers "involving trans-

. . . it is within the realm of possibility that two or more of Canada's leading banks will again float the possibility of a merger.

¹⁸ See, e.g., Jeffrey S. Graham, *Did Paul Martin Really Ban Bank Mergers?*, FIN. POST, Jul. 22, 2008, available at <http://network.nationalpost.com/np/blogs/fpcomment/archive/2008/07/22/what-bank-ban.aspx>; *Lift Canada bank, insurance merger limits: Manulife*, EDMONTON J., Jan. 28, 2008, available at <http://www2.canada.com/edmontonjournal/news/business/story.html?id=2ebd7c67-bca4-4034-8279-9d46bbb8fd1a&k=95054>.

¹⁹ In June 2008, a panel assembled by the federal government to conduct an independent review of Canada's competition policy and legislation recommended that the de facto prohibition on bank mergers be lifted. The reason cited was the need for Canada's banks to become more competitive in the global arena. COMPETITION POLICY REVIEW PANEL, *COMPETE TO WIN: FINAL REPORT 50-52* (June 2008), available at [http://www.ic.gc.ca/eic/site/cprp-gepmc.nsf/vwapj/Compete_to_Win.pdf/\\$FILE/Compete_to_Win.pdf](http://www.ic.gc.ca/eic/site/cprp-gepmc.nsf/vwapj/Compete_to_Win.pdf/$FILE/Compete_to_Win.pdf). On the other hand, some individuals (most notably Canada's former Prime Minister, Jean Chrétien) have credited the relative strength and stability of Canada's financial institutions to the moratorium on bank mergers. See Sinclair Stewart, *Lucky or Prescient? Chrétien Takes Credit for Stronger Banks*, GLOBE & MAIL, Oct. 8, 2008, available at <http://business.theglobeandmail.com/servlet/story/RTGAM.20081008.wrbankschretien08/BNStory/Business>. Supporters of the moratorium argue that this decision prevented Canadian institutions from playing a more significant international role and, consequently, becoming more intertwined with their international peers. This relative independence, it is argued, decreased the exposure of Canadian financial institutions to the U.S. sub-prime mortgage meltdown. *Id.*

portation undertakings” that fall under federal jurisdiction.²⁰ Pursuant to the amended CTA, any such mergers that are subject to the Competition Act’s merger notification requirements must also be notified to the Minister of Transport, who will determine whether the proposed transaction should be subject to review on public interest grounds (i.e., whether it affects the public interest as it relates to national transportation). The Competition Bureau will report to the Minister any concerns it has regarding any potential prevention or lessening of competition that may occur as a result of the transaction. Ultimate approval, however, rests with the federal Cabinet, acting on the Minister of Transport’s advice, including with respect to public interest considerations.

The Minister of Transport released draft guidelines in July 2008, which set out a list of public interest factors relevant to determining whether a proposed transaction raises public interest issues relating to national transportation.²¹ These include economic (e.g., the transaction’s impact on prices and employment), social (e.g., the transaction’s impact on low-income workers and Canadian sovereignty), environmental, security, and safety factors. Many of the economic factors overlap with the Competition Act (e.g., impact on prices, service quality, and Canadian competitiveness). However, the draft guidelines do not clarify whether the Minister of Transport will refrain from reviewing a proposed merger where it raises only public interest issues that relate to competition.²²

As with bank mergers, the public interest review process under the CTA opens the possibility that the Minister of Transport may recommend approval for mergers even if they raise competition issues. This authority may turn out to be of particular importance in the current economic downturn. In gauging potential attitudes in this regard, it is worth noting that when Canadian Airlines initially sought to acquire Air Canada in 1999, section 47 of the CTA, which allows the federal Cabinet to address extraordinary disruptions to the national transportation system, was invoked by the Cabinet to suspend application of the Competition Act for ninety days.²³

Exceptions/Defenses.

FAILING FIRM. While there may not be a “public interest” override for most industries, Canadian competition law itself incorporates other forms of exceptions or defenses that may be relevant in difficult economic times.

²⁰ The predecessor to the CTA, the National Transportation Act, 1987, also contained a public interest review provision, requiring the then-National Transportation Agency to review the acquisition of a transportation undertaking if any person objected to it. National Transportation Act, R.S.C., ch. 28 (Supp. III 1985), §§ 251–58. When the National Transportation Act, 1987 was replaced by the CTA in 1996, the public interest review provisions were omitted. Canada Transportation Act, 1996 S.C., ch. 10 (Can.). Following Air Canada’s acquisition of Canadian Airlines in 1999, the CTA was amended to allow public interest review of mergers involving “air transportation undertakings.” S.C. 2000, c. 15, § 2 (Can.). The 2007 amendments extend this review process to all mergers involving federally regulated transportation undertakings. S.C. 2007, c. 19, § 13 (Can.).

²¹ See Transport Canada, Guidelines for Mergers & Acquisitions Involving Transportation Undertakings (June 2008), available at <http://www.tc.gc.ca/pol/en/acg/acgb/mergers/guidelines-draft.htm>.

²² See *id.* While there have been a number of mergers “involving transportation undertakings,” we are not aware of any transaction to date having been subjected to a full public interest review under the CTA, let alone having been turned down or re-structured because of these concerns.

²³ Konrad von Finckenstein, Commissioner of Competition, Opening Remarks, Press Conference Regarding the Restructuring of Canada’s Airline Industry (Dec. 19, 1999), available at <http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/00901.html>. The section was invoked to allow parties to discuss and consider restructuring options for the airline industry. Although the initial proposal for Canadian to acquire Air Canada did not succeed, as discussed in greater detail below, Air Canada’s acquisition of Canadian was later reviewed (once the ninety-day period had expired) and ultimately cleared by the Competition Bureau. See also, Letter from Konrad von Finckenstein to David Collette (Oct. 22, 1999), <http://strategis.ic.gc.ca/pics/ct/coll-e.pdf>.

For example, one potential argument of obvious relevance is set out in section 92 of the Competition Act, which provides that it is appropriate to consider whether the target of a merger “has failed or is likely to fail” when assessing a transaction’s effect on competition. In other words, if it is likely that the target of a merger will exit the market even in the absence of the merger (due to extreme financial difficulties), any reduction in competition as a result of the “failing firm’s” acquisition is not attributed to the merger.

According to the Bureau’s Merger Enforcement Guidelines, a firm will be considered to be “failing” for these purposes if: (1) it is insolvent or is likely to become insolvent; (2) it has initiated or is likely to initiate voluntary bankruptcy proceedings; or (3) it has been or is likely to be petitioned into bankruptcy or receivership. The Competition Bureau will typically require financial information from the firm (such as projected cash flows and credit information) to support its claims that it is failing or is likely to fail.²⁴

Before the Competition Bureau accepts a failing firm argument, it also will consider whether any preferable alternatives to the merger exist and are likely to result in a materially greater level of competition. In particular, the Bureau will consider whether there are any “competitively preferable purchasers” that are willing to pay a price for the failing firm that, net of transaction costs, is greater than the net proceeds that would be received in a liquidation. A purchaser is considered “competitively preferable” if an acquisition by it would be likely to result in a materially higher level of competition in a substantial part of the market. In assessing the availability of competitively preferable purchasers, the Bureau must be satisfied that a thorough search has been conducted (referred to as a “shop” of the failing firm). If not, the Bureau will require an independent third party (such as an investment dealer, trustee, or broker) to conduct the shop.²⁵

The Competition Bureau also will consider whether the retrenchment or restructuring of the failing firm (e.g., restructuring with more focused or narrower operations) or liquidation would lead to a materially greater level of competition than if the proposed merger proceeds. For example, liquidation may facilitate entry or expansion in certain cases by enabling (potential) competitors to compete for the failing firm’s assets to a greater degree than if that firm merged with another.

The “failing firm” criteria are quite onerous on their face. However, it remains to be seen whether, given the significant time pressures to clear such transactions, the Competition Bureau will show greater flexibility in the current environment, particularly with respect to the “shop” requirement.²⁶

... if it is likely that
the target of a merger
will exit the market
even in the absence
of the merger
(due to extreme
financial difficulties),
any reduction in
competition as a result
of the “failing firm’s”
acquisition is not
attributed to the
merger.

²⁴ Merger Enforcement Guidelines, *supra* note 9, at 38–41.

²⁵ *Id.* The U.S. Merger Guidelines contain a similar failing firm defense. Dep’t of Justice and Fed. Trade Comm’n, Horizontal Merger Guidelines (1992, revised 1997), available at http://www.usdoj.gov/atr/public/guidelines/horiz_book/hmg1.html. Specifically, Part 5.1 states:

A merger is not likely to create or enhance market power or facilitate its exercise if the following circumstances are met: 1) the allegedly failing firm would be unable to meet its financial obligations in the near future; 2) it would not be able to reorganize successfully under Chapter 11 of the Bankruptcy Act; 3) it has made unsuccessful good-faith efforts to elicit reasonable alternative offers of acquisition of the assets of the failing firm that would both keep its tangible and intangible assets in the relevant market and pose a less severe danger to competition than does the proposed merger; and 4) absent the acquisition, the assets of the failing firm would exit the relevant market.

²⁶ It may be noted in this regard that the OFT recently published a restatement of its position regarding acquisitions of failing firms in order to ensure that businesses in financial difficulty because of the current economic downturn understand their options and how the OFT will assess acquisitions of failing firms. The OFT also stated that it will take into account prevailing economic and market conditions when assessing the merging parties’ evidence with respect to issues such as the likelihood of exit and the realistic availability of alternative purchasers. The OFT also expressed its willingness to allow “meritorious ‘failing firm’ cases . . . to proceed relatively swiftly through clearance . . .” See Office of Fair Trading, Restatement of OFT’s Position Regarding Acquisitions of ‘Failing Firms’ (Dec. 2008), available at http://www.of.gov.uk/shared_of/business_leaflets/general/of1047.pdf.

There is some precedent to indicate that the Bureau will follow an expedited process when confronted with exigent circumstances. For example, in 1999 the Bureau relied on failing firm grounds when it decided not to challenge Air Canada's acquisition of Canadian Airlines (which was in dire economic straits at the time), notwithstanding that the merged airline would account for 90 percent of domestic passenger revenues. Following only a month-long formal review under the prior merger review process, which was much shorter than normal for mergers raising "complex issues,"²⁷ the Bureau determined that there was not likely to be a competitively preferable purchaser and that the acquisition as proposed (which included a set of significant undertakings for the acquirer) was preferable to the liquidation of Canadian Airlines.²⁸

EFFICIENCIES. In addition to the "failing firm" argument, Canadian competition law explicitly provides for an "efficiency defense," which allows anticompetitive mergers to be cleared if they are likely to generate gains in efficiency that "will be greater than, and will offset the effects of any prevention or lessening of competition" and if they would not likely be attained in the absence of the merger.²⁹ The Competition Bureau does not take efficiencies into account as part of its competitive assessment of a transaction. Instead the defense is considered separately after the competitive assessment.³⁰ This differs from other jurisdictions, such as the United States, where efficiency gains form part of the calculus of whether a transaction is likely to lessen competition.

The Competition Act's efficiencies defense has not been relied upon very frequently. The only case to have successfully invoked the defense, *Superior Propane*, was litigated extensively.³¹ The major issues in *Superior Propane* focused on which cost savings were efficiency gains and which were not; how deadweight losses to producers should be addressed; and, perhaps most controversially, how wealth transfers (that are neither gains nor losses) from consumers to producers should affect the analysis.

Given the current economic climate, and the likely consolidation that will result, it can be expected that parties will seek to increase their reliance on the efficiencies defense in appropri-

²⁷ The parties' merger pre-notification filing was made on November 19, 1999, and approved on December 21, 1999. See Letter from the Commissioner of Competition to Lawson A.W. Hunter (Dec. 21, 1999), Proposed Acquisition by Air Canada and 853350 Alberta Ltd. (the "Offeror") of Canadian Airlines Corporation, available at <http://strategis.ic.gc.ca/pics/ct/ac2199e.pdf>. As noted previously, under the prior merger review regime, the Bureau aimed to complete its substantive review of "complex" transactions within ten weeks (and of "very complex" transactions within five months). See *Fee and Service Standards Handbook*, *supra* note 7.

²⁸ See Letter from the Commissioner of Competition to Lawson A.W. Hunter (Dec. 21, 1999), available at <http://strategis.ic.gc.ca/pics/ct/ac2199e.pdf>. There are only a few additional examples on the public record of mergers being approved on failing firm grounds. See News Release, Director of Investigation and Research, CCAC No. 189 10234 E 89-04, Information Document on the Proposed Acquisition of Wardair Inc. by PWA Corporation (Apr. 14, 1989) (on file with author); COMPETITION BUREAU, ANNUAL REPORT OF THE DIRECTOR OF INVESTIGATION AND RESEARCH FOR THE YEAR ENDED MARCH 31, 1989, at 14 (on file with author) (discussing the acquisition of substantially all the assets of Noranda Metal Industries Ltd. by Wolverine Tube (Canada) Inc.).

²⁹ Competition Act, R.S.C., ch. C-34 (1985).

³⁰ The Bureau's approach has been criticized by the Canadian Bar Association, among others. The Association believes that consideration of efficiencies should not be foreclosed at the competitive assessment stage. See Canadian Bar Ass'n, Submission on Draft Bulletin on Efficiencies in Merger Review 3 (Sept. 2008), available at http://www.cba.org/CBA/sections_competition/pdf/bulletin.pdf.

³¹ The Competition Tribunal initially upheld the efficiencies defense and allowed the transaction in question to proceed. The Tribunal's decision was subsequently reversed by the Federal Court of Appeal, on the basis that the Tribunal had incorrectly applied the test and the matter was remanded to the Tribunal for re-determination. The Tribunal then re-confirmed its decision, using the test mandated by the Federal Court of Appeal. The Commissioner again appealed to the Federal Court of Appeal on the basis that the Tribunal had not followed the directions given by the Federal Court of Appeal in its first decision. The Commissioner's second appeal was dismissed. See *Canada (Commissioner of Competition) v. Superior Propane Inc.*, 2000 Comp. Trib. 16 (2002), *aff'd*, 3 F.C. 529. See also *Canada (Commissioner of Competition) v. Superior Propane Inc.*, [2001] 3 F.C. 185, *rev'g* 2000 Comp. Trib. 15 (2000), *leave to appeal to S.C.C. refused*, [2001] 2 S.C.R. xiii.

ate cases. Unfortunately, the exact scope of the defense, as well as the Bureau's approach to a number of critical factors, remains unclear.³² Recently, the Bureau issued an "information bulletin" on the efficiencies defense in an attempt to address these issues.³³ However, the general reaction is that the bulletin still does not provide sufficient clarification.³⁴

POST-CLOSING INTERVENTION. There are also several avenues in Canadian competition law whereby the Competition Bureau can bring proceedings following an acquisition, if necessary. These "safety valves" may give the Bureau the comfort it needs to allow a questionable merger to proceed, knowing that it could bring proceedings at a later stage if competition problems crystallize.

For example, section 97 of the Competition Act authorizes the Bureau to challenge a transaction up to one year following closing (recently decreased from three years following closing).³⁵

Given the current economic climate, and the likely consolidation that will result, it can be expected that parties will seek to increase their reliance on the efficiencies defense in appropriate cases.

Although the Bureau has almost never sought to challenge a transaction post-closing³⁶—and it is clearly the Bureau's preference to deal with potential problems up front—difficult economic times may persuade the Bureau to rely on this option as a matter of practical expediency rather than seek to prevent a merger from closing.

More generally, the Competition Bureau also has the authority to bring applications against dominant parties for abuse of that dominant position.³⁷ While the Bureau has not brought an abuse of dominance case to the Competition Tribunal in over six years, it has in the past commenced proceedings in industries that have undergone significant restructuring. For instance, although Air Canada's acquisition of Canadian Airlines was allowed in 1999, the Competition Bureau subsequently brought an abuse of dominance case against Air Canada in 2000 for predatory pricing on certain routes.³⁸

³² For instance, in its Bulletin on Efficiencies in Merger Review, the Bureau has stated that it will "generally follow the direction given by the Competition Tribunal in *Superior Propane* by applying the balancing weights standard when considering the trade-off analysis" required for application of the efficiencies defense. COMPETITION BUREAU, BULLETIN ON EFFICIENCIES IN MERGER REVIEW (Mar. 2, 2009), available at http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/h_00170.html. However, the Bureau has also stated that "a different approach to weighing efficiency gains against the anti-competitive effects may be appropriate in a specific case." Thus, it remains unclear what other approaches the Bureau would view as acceptable methods to complete this analysis. See Competition Bureau, Draft Bulletin on Efficiencies in Merger Review (Aug. 7, 2008), available at [http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/vwapi/Draft_Efficiencies_Bulletin_Eng.pdf/\\$FILE/Draft_Efficiencies_Bulletin_Eng.pdf](http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/vwapi/Draft_Efficiencies_Bulletin_Eng.pdf/$FILE/Draft_Efficiencies_Bulletin_Eng.pdf).

³³ COMPETITION BUREAU, BULLETIN ON EFFICIENCIES IN MERGER REVIEW, *supra* note 32.

³⁴ See Canadian Bar Association, *supra* note 30. The Association's submission was made on the Competition Bureau's draft version of the Bulletin; however, the final Bulletin is substantially similar to the draft version and only addresses a limited number of the Association's concerns.

³⁵ The recent Competition Act amendments reduced this *ex post* review period from three years following closing to one year. Bill C-10, *supra* note 7, § 430.

³⁶ Circumstances in which this authority may be exercised include where the competitive environment has changed after the issuance of a "no-action" letter to the merging parties by the Bureau (or where the information in a no-action letter changes or is incorrect). See *Canada (Director of Investigation and Research) v. Southam Inc.*, [1991] 38 C.P.R. 68 (Competition Trib.). Additionally, the Bureau must commence an inquiry upon an application by six persons resident in Canada under § 9(1) of the *Competition Act*, *supra* note 5. See Director of Investigation and Research, Annual Report of the Director of Investigation and Research for the Year Ended March 31, 1992 at 11 (Ottawa: Min. of Supp. and Svcs. Canada, 1989) (discussing the opening of an inquiry into the previously consummated acquisition of substantially all the assets of Noranda Metal Industries Ltd. by Wolverine Tube (Canada) Inc. Following its inquiry, the Bureau did not make any application to the Competition Tribunal.) It is also possible that the Bureau could exercise this authority where a merger had not been previously notified to the Bureau because it did not meet the notification thresholds.

³⁷ Competition Act, R.S.C., ch. C-34 (1985).

³⁸ *Canada (Commissioner of Competition) v. Air Canada*, [2003] 26 C.P.R. (4th) 476 (Comp. Trib.).

Implications for Review Under the *Investment Canada Act*

In addition to the Competition Bureau's merger review, it is appropriate to consider the possible impact of the economic crisis on merger review under the Investment Canada Act (ICA).

Foreign investors whose acquisitions of Canadian businesses are subject to review under the ICA must satisfy the Minister of Industry (or the Minister of Canadian Heritage in acquisitions of "cultural businesses") that the acquisition is likely to be of "net benefit to Canada."³⁹ Although transactions rarely have been refused approval under the ICA, foreign investors are usually obliged to provide binding undertakings to the responsible Minister in order to obtain approval. These can involve commitments to undertake capital expenditures, maintain employment levels and ensure Canadian participation in management of the business, among other things.

In terms of potential impact, the declining economy may make it difficult to require the same types of undertakings that have been demanded of foreign acquirers in the past to meet the "net benefit to Canada" test, such as maintaining jobs and investment expenditures in Canada. If the alternative is downsizing or bankruptcy, acquisitions of Canadian businesses in financial distress by foreign investors may be afforded more generous and flexible undertakings than could be negotiated in better economic times.⁴⁰

Additionally, it is very likely that the current economic situation will make it more difficult for acquirers to satisfy their obligations in existing undertakings. It would not be at all surprising, therefore, if there were a noticeable increase in the number of requests to renegotiate undertakings in light of the drastic changes to the economy.

Industry Canada, the government department responsible for foreign investment review, already recognizes that circumstances beyond the control of foreign investors may make it difficult to comply with undertakings. In this regard, procedural guidelines issued by Industry Canada note that "plans and undertakings are based to some extent on projected circumstances and the monitoring of an investor's performance will recognize this factor. Where inability to fulfill a commitment is clearly the result of factors beyond the control of the investor, the investor will not be held accountable."⁴¹ Even where the inability to perform an undertaking is the result of factors beyond the investor's control, the Minister may require the investor to provide new undertakings in place of the original undertakings. Indeed, the changes to the ICA specifically authorize the Minister to ask for new undertakings where the investor has failed to comply with its original undertakings.⁴²

³⁹ There are a variety of different thresholds that apply to determine if a transaction is reviewable under the ICA. Broadly speaking, most transactions that are reviewable involve direct acquisitions of businesses in Canada whose value exceeds the prescribed limit. According to the ICA provisions now in force, the most commonly applied threshold is CDN \$312 million, based on the book value of the business's assets in its most recent fiscal year. Pursuant to the amending legislation discussed above (Bill C-10), this review threshold will be increased to CDN \$600 million based on the "enterprise value" of the business, with the threshold to increase to CDN \$1 billion within five years of enactment and increases thereafter tied to a prescribed formula. See Industry Canada, *Investment Canada Act—Thresholds for Review*, available at http://www.ic.gc.ca/eic/site/ica-lic.nsf/eng/h_lk00050.html; Bill C-10, *supra* note 7, § 448. The increase will come into effect at a date to be determined by the federal Cabinet, which is expected to be sometime in summer 2009. The apparent objective of the increase in threshold is to make fewer foreign acquisitions subject to review. Unfortunately, guidance has yet to be provided with respect to the definition or calculation of "enterprise value." As such, the full implications of the increased threshold remain to be seen.

⁴⁰ An alternative view is that the responsible minister may seek to impose even tougher undertakings so as not to be accused of accelerating unemployment and the outflow of investment.

⁴¹ Industry Canada, *Guidelines—Administrative Procedures*, available at <http://www.ic.gc.ca/eic/site/ica-lic.nsf/eng/lk00064.html>.

⁴² Bill C-10, *supra* note 7, § 461.

In addition to the “net benefit” test and its associated review process, the recent legislative amendments have introduced a new “national security” review process.⁴³ Under this process, the Minister of Industry may review any acquisition by a non-Canadian of an interest in a Canadian business (regardless of whether it would be otherwise reviewable under the ICA) where he has reasonable grounds to believe that the acquisition “could be injurious to national security.” If the Minister is satisfied that the acquisition could be injurious to national security, the federal Cabinet, on the recommendation of the Minister, then may refuse to allow the acquisition to proceed or may approve the acquisition conditionally, subject to undertakings by the foreign acquirer or terms imposed by Cabinet.

At this point, very little guidance has been provided with respect to the scope of the new “national security” review process. For instance, no definition of “national security” has been issued and the standard of review (“could be injurious to national security”) seems to place a great deal of discretion in the hands of government officials. Although government officials have indicated in conversations with the bar that the intention is to limit the circumstances in which the national security review process will be invoked, it is quite possible that pressures to protect Canadian businesses in the current economic climate will persuade the Canadian government to exercise this authority more robustly than originally intended.

Conclusion

The credit crunch and associated economic downturn have created new challenges for economic policy around the world. As governments struggle to fashion remedies to prime the global economic pump, they may also be tempted to ignore or downplay antitrust concerns in favor of mergers that offer a “fast fix.”

Canadian competition law already contains elements that could smooth the way for more lenient application. However, one also expects that if today’s resolutions truly raise significant antitrust issues (such as excessive concentration), then it will only be a matter of time before antitrust concerns (in one form or another) rise to the forefront again, albeit perhaps at odds with macroeconomic recovery imperatives.

Apart from the possible antitrust/macroeconomic trade-off and the specific merger review factors discussed in this article, the Canadian situation may be influenced by the fact that a new Commissioner of Competition will be appointed at some point in the next few months. Since the previous Commissioner was criticized for a lack of enforcement initiatives, absent other circumstances, it would be expected that the new Commissioner would face pressure to reverse this course and bring more proceedings. One possible indicator of the mindsets of the government and Competition Bureau is the fact that the government recently has passed significant amendments to the Competition Act that enhance the Bureau’s enforcement powers.⁴⁴ The passage of these amendments may suggest that there is no intention to relax enforcement standards even during these hard economic times. ●

⁴³ *Id.* § 453.

⁴⁴ Bill C-10, *supra* note 7. For example, apart from introducing the new (and arguably more enforcement friendly) merger review process, the amendments replace the existing conspiracy provisions in the Competition Act with a per se criminal offense for cartel-like agreements between competitors; increase the penalties for violations of the cartel prohibition; broaden the scope of the bid-rigging offense; grant the Competition Tribunal the power to order significant administrative monetary penalties for contravention of the abuse of dominance provisions of the Competition Act; and increase the penalties for various other offenses.

Paper Trail: Working Papers and Recent Scholarship

Editor's Note: In this edition of the Paper Trail, editor John Woodbury reviews an EAG Working Paper that looks at the antitrust agencies' merger review of firms in financial distress. Should the agencies be more willing to allow firms to take advantage of the failing-firm defense in the face of today's severe economic downturn? Send suggestions for papers to review, and your comments, to: page@law.ufl.edu or jwoodbury@crai.com.

—WILLIAM H. PAGE AND JOHN R. WOODBURY

Recent Papers

Ken Heyer & Sheldon Kimmel, Merger Review of Firms in Financial Distress, EAG Working Paper (EAG 09-1) (Mar. 2009)

<http://www.usdoj.gov/atr/public/eag/244098.pdf>

As Congress, policy makers, and policy wonks struggle with identifying and implementing mechanisms that will pull or push the U.S. and perhaps the world out of this Great Recession, should antitrust enforcement reflect the sudden, deep, and widespread decline in the demand for goods and services? Should the antitrust agencies be more willing today to allow merging firms to take advantage of the failing-firm defense than they might have been three to five years ago? In this EAG working paper, Justice Department economists Ken Heyer and Sheldon Kimmel argue that the current requirements satisfying the failing-firm defense are just fine, thank you.

The working paper begins with the conditions under which the agencies will rely on the failing firm defense to clear a merger that might otherwise be anticompetitive. Paraphrasing, those conditions are that the firm demonstrate its inability to meet its near term financial obligations; that it could not be successfully reorganized under Chapter 11 of the Bankruptcy Act; that it made good-faith efforts to find a competitively preferred buyer; and that absent the acquisition, the assets of the failing firm would exit the industry.

After reprising the benefits of competition and the notion that most horizontal mergers generate efficiencies (and so are never challenged), Heyer and Kimmel note that the fact of financial distress itself has no implications for antitrust enforcement policy. If the firm can be successfully reorganized under Chapter 11, then the merging parties cannot use the failing firm defense. If the firm cannot be so reorganized, then a rival firm might want to acquire the failing firm for one of two reasons—because the acquirer could choose to shut the firm down and so enable the acquiring firm to raise price (or prevent price from falling as far as it otherwise might) or because the acquiring firm “understands and can, perhaps uniquely, help release the potential of the currently [financially distressed] firm.” Viewed from that perspective, “financial distress works as a failing firm defense because there is an underlying efficiency defense.” (p.6).

Heyer and Kimmel note that if there is an alternative bidder who would purchase the assets for use in another industry but whose bid is lower than that of the incumbent firm, then the authors conclude that the incumbent's bid must be driven by efficiency since otherwise “it should be

happy to see those assets exit the market.” Yet that doesn’t seem quite right—if the assets can be redeployed at low cost, then the outside bidder’s acquisition of the assets would serve as a competitive constraint on the incumbent even if the assets were used outside of the industry. The “right” condition to satisfy the exiting asset prong of the failing-firm defense would seem to be that the exiting assets could not be easily redeployed in the market they are exiting.

The paper notes that if a lower bidder is another industry incumbent who might otherwise be competitively preferred by the agencies, then the agencies must evaluate the acquisition of the financially distressed firm by, in effect, treating the assets as being currently owned by the lower-bid firm, which would be the “but for” world. In this scenario, the agencies would evaluate the merger as if the higher-bid firm were acquiring the assets from the lower-bid firm. As the paper notes, the need to predict the competitive significance of the assets when controlled by the lower-bid firm will (or should) greatly complicate the antitrust analysis. A complete antitrust analysis requires evaluating the effect of two mergers, not one.

The authors acknowledge the possibility that in a “severe economic downturn,” there may be no alternative bidders for the assets. Curiously, the paper provides no answer as to how to proceed in these circumstances, except to observe that both firms might continue to operate. If the firm cannot be successfully reorganized under Chapter 11 and if the assets would otherwise exit the industry via liquidation and in the absence of any alternative, “competitively-preferred” bidder, it would seem to me that the financially distressed firm has satisfied the requirements for the failing firm defense.

The penultimate section of the paper (finally) addresses the issue of whether in severe economic downturns, the failing firm standards should be relaxed. The authors first point to a recent paper that finds that New Deal policies that encouraged cartel formation (or at least did not discourage that formation by enforcing the antitrust laws) weakened the recovery from the Great Depression because the cartels restricted output.¹

Against that backdrop, the authors identify the criteria for relaxing the application of standards as whether “the costs of wrongly finding a firm to be viable exceed the costs of wrongly finding a firm to be failing.” (p.11). In their view, determining where the scale tilts in tough economic times is a mission impossible, and so the agencies should be agnostic. Although if anything, the authors note the New Deal experience may suggest an even tougher policy to reduce the likelihood of merger-related output restrictions.

Unfortunately, the authors spend virtually no time on what really is the 800 lb. elephant in the antitrust room: The inability to quickly redeploy the assets of the failed firm (both capital and labor) in a severe economic downturn may make the firm’s failure more costly than in “normal” periods of economic activity, when redeployment would occur more quickly. That may be the case because the Chapter 7 liquidation of one firm leads to the failure of its suppliers, which in turn has a cascading effect moving down the supply chain.

But they also note that “on the other hand . . . the cost of allowing a merger to create market power is greater during a downturn (since entry may be likelier during a boom). As usual, the competition authorities have to weigh all of these possibilities.” (p.11). This conclusion may be the most important component of this too-short discussion in that it seems to acknowledge that the timing of asset redeployment is a bona fide consideration for antitrust enforcement. Thus, while the

¹ See Harold Cole & Lee Ohanian, *New Deal Policies and the Persistence of the Great Depression*, 112 J. Pol. Econ. 779 (2004).

paper concludes that there is no reason for “looser standards” for meeting the efficiency defense, the paper seems to suggest one reason that in “normal” economic times we don’t consider.

To sum up, the authors note the recent evidence that the New Deal policy of at least looking the other way as cartels were being formed slowed the pace of recovery from the Great Depression. But in fact, even if true, I am unaware of anyone suggesting the adoption of such a policy—the issue here is whether we should be willing to tolerate a “bit more” risk of anticompetitive outcomes during times of severe downturn, which (if the world is linear) would have a much smaller effect on harming consumers than a cartel.

When we talk about relaxing the standards for satisfying the failing firm defense, it’s worth considering what that doesn’t mean. Suppose in normal times, the agencies tend to conclude that 1 in 20 failing firm defenses satisfy the Guidelines requirements. The authors note that more firms will “pass” simply because there are more firms that will mount that defense in economic downturns even if only 1 in 20 continue to pass the failing firm test.

But more than 1 in 20 will likely be able to successfully mount that defense and, as a result, there may be an “automatic relaxation” of the policy even if the same standard of review is maintained during the Great Recession as before. First, one would expect that the probability of reorganizing under Chapter 11 is less, perhaps considerably less, than in more stable economic periods. Second, the likelihood of finding an alternative buyer may be diminished as prospective buyers themselves are adversely affected by the economic downturn. Assuming that the firm has demonstrated its inability to satisfy its financial obligations, the final, more difficult question is whether the assets would exit the industry absent the merger. If there is little prospect that firms either inside or outside the industry would bid for the use of these assets, it must mean that the value of the assets is so low that their next best use might be scrap. As scrap, those assets would exit the industry absent the merger. In short, the likelihood that firms can satisfy the failing firm defense is greater during the Great Recession than in normal times, and that increased likelihood occurs “automatically,” i.e., without any change in the standard of review. What has changed are the facts—a widespread and substantial decline in economic activity—to which the standards are applied.

But should agencies go further by relaxing the standards themselves? Should we tolerate a “bit” more anticompetitive risk by being more permissive about the application of the failing firm standards to offset the risk of creating cascading failures because of the inability to redeploy assets quickly when there is a severe economic downturn? And, to extend the argument a bit, because the cost of redeployment is likely to be greater the greater is the “interconnectedness” of the industry in which the failing firm operates.² Right or wrong, this is a key reason for the bailout of the large banks and GM and Chrysler, i.e., that their failure would lead to “millions” of lost jobs through a cascade of failures down the supply chain and ultimately leaking into the general economy.

At the level of economic principle, there is no reason why antitrust policy could not account for a slower redeployment of assets in a time of severe economic downturn. A single failure or collection of “small” failures may generate a substantial negative externality resulting from sluggish asset redeployment, including increased unemployment. There is no reason to believe that the costs and benefits of antitrust enforcement are invariant to changes in underlying economic conditions. In effect, the risk of anticompetitive harm might increase a bit as a result of some relax-

² It’s not at all obvious how one might operationalize the concept of “interconnectedness,” but economists have historically used tools like input-output tables to trace the economywide reverberations of changes in demand.

ation of standards, but the benefits from the looser standards would be the costs saved by what would otherwise be a slow and painful redeployment of assets of the failed firm as well as the assets of those suppliers to the failed firm.

On the other hand (and there must always be another hand), there may be an issue of whether this opens a Pandora's Box. First, having started down this path, is the direction easily reversible once economic activity returns to "normal" levels? Would the agencies have to define "normal" economic activity? There will always be some industries where the ability to redeploy assets even in "normal" times is difficult. Should this factor become a more permanent fixture of antitrust enforcement? Should the agencies consider the "disruptive effects" of a merger on small towns where asset redeployment may take a substantial amount of time?

This is obviously a slippery slope. One standard answer to whether the standards for antitrust enforcement should be broadened to encompass factors such as the timeliness of asset redeployment or small-town effects is that federal and state governments have alternative policy instruments that directly and more efficiently target these concerns. These instruments would include low-cost loans, extended unemployment benefits, and worker retraining. One can interpret the Congressional stimulus package as an effort to restore the "normal" timeliness of asset redeployment combined with policies to ease transitions during the interim. Is there a reason why the agencies should in effect go beyond what Congress has done? Don't federal and state governments have more targeted tools to address the impact of a merger on a small town or declining industries? Put differently, given both the availability and the use of these alternative policy instruments to target the timeliness of asset deployments, the marginal gain from any relaxation of the failing firm standards may be small.

In short, while the scope of antitrust enforcement can be expanded to encompass the scope of these additional objectives, it's not obvious why antitrust enforcement has a comparative advantage in addressing issues that are not directly antitrust-centric. Thus, the paper's conclusion of "no change" may be appropriate, but deserved more discussion than a reader might have expected, given the paper's title.

While the paper disappointed on addressing the implications of the Great Recession for the application of the failing firm standard, it nonetheless is an informative read on the application of the standard in more normal times. ●

—JRW