

## Interview with David Vladeck, Director, FTC Bureau of Consumer Protection

**Editor's Note:** In June 2009, David Vladeck became Director of the FTC Bureau of Consumer Protection. Prior to his appointment, Mr. Vladeck was a Professor of Law at Georgetown University Law Center. At Georgetown, he taught federal courts, government processes, civil procedure, and First Amendment litigation. In addition, Mr. Vladeck co-directed the Center's Institute for Public Representation, a clinical law program for civil rights, civil liberties, First Amendment, open government, and regulatory litigation. Under Mr. Vladeck's direction, the Institute has urged the FTC to strengthen regulations in order to ensure that consumers are protected from unlawful business practices. At the start of his legal career, Mr. Vladeck spent almost thirty years with Public Citizen Litigation Group, including ten years as Director. Public Citizen Litigation Group is the litigating arm of Public Citizen, which is a national, nonprofit consumer advocacy organization established by Ralph Nader to represent consumer interests in Congress, the executive branch, and the courts. The Litigation Group specializes in cases involving health and safety regulation, consumer rights, access to the courts, open government, and the First Amendment, including Internet free speech.

This interview was conducted for The Antitrust Source on March 19, 2010, by John Villafranco, a partner at Kelley Drye.

—JOHN VILLAFRANCO



**David Vladeck, Director,  
FTC Bureau of Consumer  
Protection**

**ANTITRUST SOURCE:** Do you consider yourself a consumer advocate?

**DAVID VLADECK:** Yes. If one looks at the trajectory of my career, I have spent most of my time handling or supervising litigation that is intended to benefit consumers, workers, other participants in the market. So I don't think my career path has been atypical compared to my predecessors in the position of Bureau Director.

**ANTITRUST SOURCE:** Well, it certainly hasn't been typical. You've had an impressive career as a litigator and as a professor, primarily in the area of representing consumer interests. Was there a particular event or a specific advertising campaign that pushed you in this direction? Was there a moment, for example, when you saw an ad and thought, "This can't be true and I need to do something about it?"

**VLADECK:** I don't think I could point to any event like that. I think like most people of my generation, who lived through the tumult of the Vietnam War era and the trauma of Watergate, I saw law as an instrument for social change. But if you had asked me thirty-five years ago, when I was law student, would my ideal job be to work at the Federal Trade Commission, I probably wouldn't have said, "Yes." Watergate soured many of us on government service.

**ANTITRUST SOURCE:** You spent nearly thirty years with Public Citizen Litigation Group. During your ten years as Director of Public Citizen, you brought a number of cases relating to health and safety regulation, consumer rights, access to the courts, open government, and the First Amendment, including Internet free speech. What do you consider your greatest achievement while at Public Citizen?

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**VLADECK:** It is too hard to isolate one accomplishment, but in relation to our current work at the Federal Trade Commission, I would point to Public Citizen's litigation in the area of commercial speech. I arrived at Public Citizen just as we were wrapping up *Virginia Pharmacy Board*, which many would cite as the capstone case that gave rise to the commercial speech doctrine. I think the intellectual groundwork for it was laid in *Bigelow*, where we played quite an active role. So I came to Public Citizen just as we were concluding *Pharmacy Board* and I began to work on a series of other commercial speech cases. For instance, I did most of the briefing in *Zauderer*. I handled, while I was the Director, *Edenfield v. Fane*, a case I decided to take on based on a handwritten letter I got from Scott Fane who was then a CPA in Florida. Scott had then recently moved to Florida and wanted to establish a practice advising small businesses. But Florida law barred him from going to businesses to introduce himself and explain the services he could offer. After a six year odyssey, the Supreme Court ruled in Scott's favor and struck down Florida's ban on in-person solicitation by accountants. We did a lot of commercial speech litigation. I tried, for several weeks a case called *Schwartz v. Welch*, which was an attack on Mississippi Bar Association rules essentially banning lawyer advertising on the television. I represented the lawyers challenging the restrictions, and we won at trial. The Bar did not appeal.

So I did a lot of work on commercial speech. It was intellectually challenging and exciting litigation. But also I think it helped shape my views on the proper role of government in mediating between the advertiser's interest in selling products and the public's right to ensure that the flow of commercial speech flows cleanly as well as freely, which of course is the Court's great line in *Pharmacy Board*.

Those cases were a treat to work on. And they were very important to consumers, who benefit tremendously from a steady and reliable flow of information about the price and quality of the goods and services they are thinking of buying. But those cases also recognized the perils of an unregulated market rife with false and deceptive claims, and thus laid the intellectual groundwork for the work that we continue to do here at the Federal Trade Commission.

Another chain of cases I am particularly proud of are the ones challenging the failure of health and safety agencies to take reasonable steps to protect workers. For example, in 1981, we brought a case to force OSHA to issue a standard to protect health and hospital workers from ethylene oxide—a gas used to sterilize heat-sensitive medical equipment in hospitals. And we ultimately won. It took seven years, three trips to the court of appeals, but in the end we forced OSHA to issue a tough standard that protects over 100,000 workers from grave risk of harm.

I handled many similar cases. For awhile my docket sounded like a bad chemistry course, including challenges to the Department of Labor's failure effectively to regulate formaldehyde, benzene, cadmium, hexavalent chromium, and radon daughters, the radioactive byproduct of radon gas in mines. I also handled cases involving other safety risks, including the risks of explosion in grain storage facilities and the hazards of failing to lock-out electrical and hydraulic machinery during maintenance operations.

Those cases all had a common thread. They were focused on harnessing the power of government to protect those who were not capable of protecting themselves. And we have a similar objective in a lot of the fraud work that we're doing here.

We are spending the lion's share of our resources these days focusing on what we call, "Last dollar frauds"—frauds that are aimed to take the last dollars out of the pockets of people rendered economically vulnerable by the economic downturn. We have been conducting sweep after sweep of mortgage rescue scams, bogus debt consolidation services, and job and business opportunity scams, in an effort to safeguard the economically vulnerable. And so I see a lot of parallels in my earlier work and the work we're doing today.

**ANTITRUST SOURCE:** You just ran through some impressive achievements while at Public Citizen. What was your greatest frustration while there?

**VLADECK:** We did many great cases, but all the while we were doing triage. I have exactly the same frustration at the FTC. At Public Citizen, we were really the lawyers of last resort. When every other institution—including government—had failed them, people would send letters to us or Ralph. And Ralph would send anything involving a legal matter on to the Litigation Group.

Early in my career at Public Citizen, I took on what my colleagues thought was the short-end-of-the-stick assignment of looking through these letters to see whether they presented good cases that we could take on. And I responded to every letter. I spent a lot of time writing letters to people saying, “I’m sorry, there’s nothing we can do for you.” We had to decline many good cases—cases that should have been brought—because we didn’t have the resources to handle them. And I found that very frustrating.

I don’t think that I’m exposing any secret by acknowledging that the Bureau does not have the capacity to do every case that we ought to do. And so a lot of my job, and a lot of the work of my colleagues, is doing triage: deciding which are the best cases to bring in what I would say is a target rich environment.

**ANTITRUST SOURCE:** Early in your career, you worked on the initiative known as Kid-Vid, a rule-making with the objective of restricting the promotion of highly sugared foods to children in television advertising. Three years after the notice of the proposed rule, the FTC staff recommended that the Commission terminate the rulemaking proceeding. At that time, did you disagree with that recommendation? And has your opinion remained the same or has it changed over the years?

**VLADECK:** Well let me correct the record, just a little. The clinical program at Georgetown where I worked right out of law school—before I joined Public Citizen Litigation Group—was working on Kid-Vid while I was there. I didn’t work directly on that issue; I worked exclusively on litigation matters. Nor can I say that I followed the controversy as closely then as I’ve now looked at it retrospectively. I think, in hindsight, I understand both the reasons why people were pushing regulation and the reason why the regulatory effort struck such a discordant note.

To be clear, I don’t look on that episode as an opportunity lost. I do think that there are lessons to be learned from that episode, and for good or ill, the dispute still casts a shadow on the agency.

**ANTITRUST SOURCE:** How so?

**VLADECK:** In two ways. One is that Congress clipped the Agency’s wings as a result, and we are now hobbled with a byzantine, Rube Goldberg-like rulemaking system that is close to useless. So one important regulatory tool that would allow us to better do our job has been taken from us. The other is that folks are understandably wary about taking action that might be portrayed as paternalistic. We want to protect consumers, but we don’t want to be America’s nanny.

**ANTITRUST SOURCE:** You have stated that you were chosen by FTC Chairman Jon Leibowitz to run the Bureau in part because of your experience as a litigator with a background in bringing test case litigation. How would you define the term “test case?” And what sort of test case should we expect you to bring during your tenure?

**VLADECK:** I think that the quote is likely accurate, but it would be interesting to hear Jon's version of the story.

Before I took this job, I looked at the litigation output of the Bureau of Consumer Protection over the last three years. And two things became apparent. One is, we didn't lose a case—not a single case. And my reaction then, and my belief now, is that part of our job is to be stewards of the statutes that we have to implement. And if we think the law says X, but there isn't a case that establishes X and people are not conforming their conduct to our belief about how the law ought to work, then we should look for a good case to establish X as a governing legal principle.

I would define the term "test case" as a case in which the facts directly and clearly support the legal theory that you are advocating, even if the legal theory has not been accepted by a court prior to that time. And you bring a test case to see whether you can persuade the court to adopt your reading of the law.

If the court agrees, then the hope would be that people would conform their conduct to that norm. And if they don't, then you have grounds for further litigation. Of course, if the court disagrees, you add that to the list of things that you may ask Congress to rectify. Often in the course of test case litigation you bring a number of cases based on the same legal theory and see whether you can make some progress. When the *Pharmacy Board* case was filed my colleagues at the Litigation Group were looking at other cases as well. To be sure, given the facts, they thought that *Pharmacy Board* would make an especially good vehicle for establishing the principle that commercial speech is entitled to some level of constitutional protection. But other cases might have worked as well.

Perhaps a better example was our strategy to overturn the legislative veto—a strategy that culminated with a win in *INS v. Chadha*. *Chadha* was one of six or seven cases we filed challenging the use of the legislative veto to overturn important administrative action. *Chadha* just happened to be the one that made it up to the Supreme Court. But we were filing a number of cases, including, if I recall correctly, one against the FTC over the veto of the used car rule—each of which we thought perfectly illustrated our concerns about the veto.

Using test cases to move the law better to protect consumers is one tool that we have and will continue to use. As you know, the FTC has a very broad mandate from Congress that includes enforcing a number of consumer protection statutes. And there are areas where we will look for cases to establish legal principles that we believe are important to fulfill our consumer protection mandate.

**ANTITRUST SOURCE:** You have mentioned *Pharmacy Board* a few times now. As I understand your general thesis, the commercial speech doctrine was originally directed at the importance of truthful information to consumers, and the focus has moved toward protection of commercial speakers' rights. Given that the constitutional analysis requires an assessment of the truthfulness of the commercial message, how in your view has the balance shifted in favor of the commercial speakers' rights?

**VLADECK:** I think in two ways: first, if you look at the early cases, there is no hint that the constitutional protection was being accorded to facilitate the speaker's own interests. The locus of the Court's concern was in dismantling state restrictions that interfered with consumers receiving information that may be relevant to their purchasing decision. If one looks at the Court's early decisions, there's a real emphasis on sending a signal to states that prohibitions on the provision of truthful speech relating to the price and availability of goods and services to consumers would be

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looked at skeptically by the Court. For the first twenty years or so of the commercial speech doctrine, the Court's sole focus is protecting consumers' interest in the free flow of commercial information that might be germane to consumer choice. It was not until *Lorillard* that the Court began to talk in terms of protecting the speaker's independent First Amendment right.

In my view, I think that a close reading of the Court's commercial speech decisions shows that, over the years, the nature of the right has been transformed, albeit not formally. Instead of a right of the listener to receive information that may be material to his or her purchasing decision, the right now appears to have expanded to embrace the speaker's, that is, the seller's right to convey information of its choosing to consumers.

Apart from the transformation of the nature of the constitutionally protected right, there has also been a transformation in the stringency of the review triggered under the commercial speech doctrine. Again, if one looks at the briefing in *Pharmacy Board*, and indeed the briefing in most of the cases until *Central Hudson*, there was no effort to equate commercial speech with pure speech, let alone to argue that the rigorous "strict scrutiny" test for restraints on pure speech should apply to restraints on commercial speech. The briefs and the decisions all presupposed that the antifraud frameworks that preexisted the commercial speech doctrine—state laws, and federal laws like the Federal Trade Commission Act, that give the government tools to go after false, deceptive or misleading speech—would be in place.

Ironically, I would trace this transformation to one of my cases, *Edenfield v. Fane*. There, Justice Kennedy's opinion for the Court certainly goes beyond the brief that I wrote in terms of placing a significant burden on government to justify speech restraints and to demonstrate a material connection between the restraint and the deception or fraud the government wants to prevent.

Again, over the years the "intermediate" standard of review the Court established in *Central Hudson* has changed, although again the Court has not said so. While there has been no formal alteration of the *Central Hudson* standard, the Court's review is much more searching now than it was twenty years ago. The standard now used makes it harder for the government to enforce restraints on truthful speech the government may want to suppress for important public health reasons (such as protecting kids from advertising of tobacco products) and on speech that may not be demonstrably false, but is deceptive and misleading.

**ANTITRUST SOURCE:** As a litigator, your background is different than that of your predecessors who have served as Bureau Director. In fact, I believe that you recently argued the FTC's position in a case in federal court in New Jersey, which is something that a Bureau Director would not typically do.

**VLADECK:** I appeared before a judge for an all-day settlement conference; it was not merits argument. I should add that the case (*United States v. Civic Development Group*) was settled on the terms we proposed.

**ANTITRUST SOURCE:** Do you expect to make any merits arguments as Bureau Director? Or are you going to leave that to other staff attorneys?

**VLADECK:** I've been thinking about that. There have been some cases that I really have been tempted to argue myself.

But thus far I've resisted the temptation. One of the wonderful things about my job, and I credit my predecessors for this, is that I inherited a Bureau that was in terrific shape. We have excel-

lent managers. The caliber of lawyering in the Bureau is top-notch. I'd certainly be interested in arguing a case or two. But I would not want to push aside an attorney who has spent his or her time getting the case ready. So we'll see. I may exercise my prerogative at some point. What I'd really like to do is persuade FTC General Counsel Will Tom to let me argue one of our cases in the Court of Appeals. That way his lawyers would forfeit the argument and not one of mine.

**ANTITRUST SOURCE:** Turning to social media, when the revised Endorsement and Testimonial Guides were issued, one of their effects was to cause, a great deal of anxiety among bloggers and others who enter into an endorsement arrangement with advertisers. The concern was that, by the language of the Guides, bloggers would be exposed to potential FTC enforcement actions.

In October, Mary Engle, who is the Director of the Bureau's Advertising Practices Division, assured these individuals that the FTC is not planning on investigating individual bloggers, and will be focusing any enforcement actions on advertisers, not individual endorsers. What is the rationale for a hands-off approach to individual bloggers? Especially given the more general focus on expanding the circle of responsibility for false advertising?

**VLADECK:** First of all, let me assure our readers that BCP has not created a Division of Blogging. And second, there's nothing new about our position that material connections between advertisers and endorsers should be disclosed. As always, our main concern is with the folks sponsoring these endorsements. But we haven't said that endorser-bloggers are free to ignore the law. What Mary Engle was underlining is our general approach to enforcement. We try to go after the entity most responsible for the misconduct. Typically, if an advertising agency is using viral or word of mouth marketing to sell a product, the agency is not just enlisting a single blogger to spread the word. There generally is a broader, orchestrated campaign. Our concern will rarely be an individual blogger; rather, it will be the advertisers who are hiring or compensating a number of bloggers, and others, to hawk their products.

And so the message that Mary was trying to convey, and I think she did it quite well, is, "If you're an advertiser and you're going to use bloggers and other viral marketing, don't think you can insulate yourself from liability simply by having the blogger do your work for you."

I would say, in hindsight—and this is no criticism of Mary, this is more a criticism of me—that we did not do a good job with the rollout of the Endorsement Guides. I think we should have explained more clearly at the outset why we needed to modernize the Guides. Indeed, the references to bloggers are actually just a clarification of longstanding FTC policy; after all, the Guides were originally issued in 1980 before there was an Internet, and before there were bloggers. The Guides didn't change Commission policy, they just clarified that endorsements by bloggers will be treated as any other endorsement. But in retrospect I wish we had done a better job explaining this at the time the Guides were updated. Your question just is symptomatic of the fact that the updated Guides engendered more concern, anxiety, and confusion than they needed to.

**ANTITRUST SOURCE:** How would you have done the roll-out differently?

**VLADECK:** That's a fair question. First, neither Mary nor I were available for comment the day the Guides were issued. As a result, the initial press accounts were sensational, and sensationally wrong. The major Associated Press story that was widely circulated wrongly said that the FTC would target bloggers and then, also wrongly, said that the FTC could impose fines up to \$16,000 on bloggers who failed to disclose material connections. So a number of things went wrong. We

didn't affirmatively get our story out; we didn't have business education pieces ready to go; and we hadn't set in motion an outreach program to accompany the Guides' release.

**ANTITRUST SOURCE:** Turning now to alternative remedies for data breaches, last summer in an interview in the *New York Times*, you suggested that it may be time to move beyond an economic and tangible harm-based model for redress in data security cases, to one that also recovers for intangible harms, such as harm to a consumer's dignity. This may, for example, include situations involving disputed online behavioral advertising practices, or data breaches where personal information is potentially compromised but consumers are not financially harmed. What is the rationale for this initiative, and what kind of concrete guidance might be offered to marketplace participants to minimize such non-economic losses?

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**VLADECK:** Let's distinguish between two separate but related questions embedded in your question. The question that I'd like to tackle first is a question that we wrestle with all the time which is, "What do you do when there's a data breach?"

So, so far we've brought between 25 and 30 cases involving data breaches which have resulted in the disclosure of personal information of consumers in one form or another. But that number is dwarfed by the number of investigations we have conducted into data breaches. The fact is that data breaches are common. One question we are wrestling with is, "How do we do a better job deterring these breaches? Would some form of civil penalty be appropriate?"

As you know, Congress is considering whether to give us civil penalty authority. And one area we've suggested we might want to exercise that authority is in the area of data security. We are concerned that the remedies available to us under current law are inadequate to force companies that store sensitive data to take reasonable precautions to safeguard the data.

But it's not only the deterrence issue that is troublesome. Another difficulty in these cases is that it is often hard to quantify the injury the consumers suffer as a result of data breaches. Sometimes the injury doesn't take a tangible form in the sense of, for instance, ID theft that results in financial loss. Sometimes the consumer injury resulting from the breach is anxiety and the time and burden of ensuring that one's finances are in order. Sometimes there has been an ID theft but the money drained from a bank account has been returned by the bank, but the consumer nonetheless spends hours and hours and hours putting his or her financial house back in order. These are all injuries, even if they can't be measured in dollars and cents. And we think that, in some cases, there is a good argument for consumer redress.

Data security is a big issue for us. And it is only becoming more complicated as increasing amounts of personal information is being stored in the cloud, where questions of responsibility become more diffuse. And data security has become more problematic with the proliferation of file-sharing and spyware programs that can often be difficult to detect. As you know, we just announced a major P2P Sweep, where we found an alarming amount of very sensitive information about individuals available on the Internet as a result of peer-to-peer file sharing data breaches. So the issue of data breaches—and how to prevent them—is one that occupies a fair amount of our time and energy.

Data security, however, is just one part of the broader question I think you were asking, which is, "Where are we heading on privacy generally, and on online behavioral advertising more specifically?" And if that's your second question, let me address that.

**ANTITRUST SOURCE:** Please.

**VLADECK:** As you know, we have just concluded a series of three workshops to take a fresh look at how we address privacy, especially with respect to evolving technology. And this is the point I was trying to make in *The Times* interview: the problem that we face is that the privacy frameworks that have served us well in the past don't promise to serve us well in the future. One of the many lessons we learned during the workshops is that there is widespread agreement that we need to develop a set of principles to guide us as we move forward, especially given the dynamic and evolving nature of the media, the transition to mobile computing, the broad dispersion of data storage, the integration of online and offline information, and the erosion of the distinction between anonymous and individually identifiable information.

Historically, the FTC has put a lot of emphasis on a regime that focuses on notice and then consent or choice by consumers. Today both facets of that framework are problematic.

Notice is typically given in privacy policies, which are rarely read. They're written by lawyers so they're incomprehensible to ordinary consumers. And they don't really convey clearly what the consumer needs to know. Instead, they are chock full of legal disclaimers designed to protect the company, not inform consumers.

And second, questions of choice and how consumers can exercise choice effectively have now become very difficult. For one thing, the concept of "choice" generally presupposes that the consumer has read the privacy policy, which we know rarely happens. And the means provided to consumers to exercise choice are often troublesome as well. We have gotten bogged down in what I consider to be a rather sterile debate between opt-in and opt-out, as if those were well-defined terms with accepted meanings. But they are not. Some opt-in methods can provide consumers a clear and effective way of making a choice, while some "opt-out" programs are so confusing that they are counter-productive. The real challenge is to make the process transparent and enable consumers to make an informed and meaningful choice. And whatever system is adopted, it is going to have to work not just on computers, but also on cell phones, PDAs and other devices that have screens that display as few as 140 characters.

The "harm" model used by the Commission at times also is problematic. For one thing, it has been applied mainly where consumers suffer economic harm. And the point I was trying to make in the *Times* interview is that our conception of privacy reaches harms that cannot be expressed in terms of dollars lost. For another, the "harm" approach provides little guidance. It is aimed at redressing consumer injury but not at providing companies and consumers with clear principles that guide conduct going forward. So it too is a model with serious limitations.

So we've held a series of roundtables to explore the question of where we ought to go. We are considering questions about how to make the data collection process more transparent and to provide consumers with meaningful controls over the use of their information. We have been thinking about ways to ensure that data is not kept beyond the time it is needed for its expected use. And, as I've mentioned, we are exploring ways to encourage companies to enhance data security measures.

There is also the related question of whether there are areas that merit special protection. For example, I think that there is a consensus that an individual's health records should be subject to heightened protection. But even where there may be general agreement, there are serious definitional questions. For instance, is information about a skin cream someone uses to combat dry skin health information? How about a cream for psoriasis? How about a cream used to treat skin cancer?

Congress has already required additional protection for information relating to children thirteen and under. HIPAA requires special protection for certain health records. And Gramm-Leach-Bliley requires certain protections for financial records.

But we need to start thinking about privacy issues more systematically. With respect to online behavioral advertising, we've been crystal clear that our current effort intends to build upon, not displace or supplant, the principles that we set out in February 2009. We think that those principles provide meaningful guidance to people engaged in online behavioral advertising and we appreciate the considerable self-regulatory efforts that are geared towards putting those principles into operation.

But those principles only go so far. We left a number of questions open in that report; one question concerns how to give clearer and more timely notice to consumers. As I said, the industry has been engaged in self regulatory efforts to address those concerns.

The report also stops short of addressing what we think is a major issue coming up in the future, which is, what do you do about secondary uses of consumer data? What do you do about data that is collected for online behavioral advertising but has value elsewhere? Do you let the advertising network sell that information even though that sale and the uses the buyer may make of that information may not be within the consumer's reasonable expectation? Do you restrict secondary uses, absent explicit consent from the consumer? What sort of rules should govern?

We left those questions open last February. We need to try to start providing answers to them. And I think that the roundtable discussions that we've held provide us with a platform for starting to think about those issues going forward.

Let me be clear about this: Our goal is a modest one here. We've now spent four months intensively gathering information. It's going to take us a while to digest it all. But we'll be in constant discussions with stakeholders as we do so.

My hope is, and this may be optimistic, my hope is that by the end of the summer or early fall, we'll be able to publish something that looks like a report and maybe some recommendations, which we will distribute in tentative or draft form. We will then invite public comment—and I suspect we will get a lot of comments. And then we'll try to issue a final report and recommendations or principles, as we did with online behavioral advertising. But this is not an area in which we want to set strict or binding regulations or inflexible norms. Some folks have suggested that the FTC is looking to set out formal regulations on privacy. Let me be clear about this: That is not our aim. We are addressing technologies that are evolving so quickly that it would be, in my view, foolhardy to try to set rules in place knowing that two or three years later they would be rendered obsolete.

For example, we are spending a lot of our time now thinking about mobile applications because the reality is, within five years, mobile smart phones, iPads, and PDAs are going to dominate the marketplace, and laptops may be an anachronism.

**ANTITRUST SOURCE:** The Administration and both the House and Senate have made establishing a Consumer Financial Protection Agency a centerpiece of regulatory reform. Is this legislation necessary? Particularly as many are arguing that the FTC's regulatory role has been sufficient in this area and should continue, rather than be transferred to a new agency.

**VLADECK:** Well, let me start with an observation, I'm not sure I hear a lot of people arguing that our role has been sufficient, and that is a justification for not creating this new agency.

**ANTITRUST SOURCE:** Fair enough. Let me ask the question differently. Would it be more efficient to expand the FTC's role, rather than to create a new agency?

**VLADECK:** Well, I think that there's room for both actually. The FTC does not have, and we have not

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asked for, the capacity to engage in any examination function. And one insight that the legislation has made clear is that for certain market players, some form of examination role is useful.

I don't know that we need examination authority to police the pay-day lenders, mortgage brokers, or credit reporting agencies over which we have regulatory authority. But as you move up the food chain in lending institutions and financial institutions, examination authority is essential. The Commission has come out in support of a new consumer protection agency in the financial products and services arena, and I agree with that assessment. We need more resources in this area, not just for the financial service providers under FTC jurisdiction, but for the full-range of financial institutions.

We do a very good job with the resources we have, but as I said earlier, part of my job is to do triage. Anything that places the spotlight on enhancing consumer protection in the financial products realm is a good idea. As you know, we had some problems with the bill as originally proposed by Treasury, but we were happy with the bill that emerged from the House.

Now that the debate has shifted to the Senate, I don't know where the process will end up. But I have two observations: first, the FTC could use more resources in this area. If you look at our docket over the last year or so, we have done everything we can to bring cases against phony mortgage rescue firms, bogus debt settlement companies, and job and business opportunity scams. I think we've been effective. I think we've made progress here, but there is always more to do, and additional resources would help.

Second, we could have used rulemaking authority at an earlier stage. Because the FTC lacks general APA rulemaking authority, we had to wait until Congress gave us rulemaking authority in the mortgage area. By the end of this year we'll probably have finalized a series of rules that regulate the advance fees mortgage rescue companies can charge and mortgage advertising and servicing for non-banks. Had we had general rulemaking authority, we likely would have been done with those rules by now, if not earlier. That, in my view, is a serious opportunity lost. Without rules in place, we had to proceed against companies one-by-one. With a rule, we could have effected reform on a wholesale basis, sparing many consumers the tragedy of losing thousands of dollars in scams while facing foreclosure.

**ANTITRUST SOURCE:** Another issue before Congress, or actually it seems to be before Congress annually, is the potential repeal of the Common Carrier Exemption. I know a number of commissioners have urged Congress to repeal the exemption over the years, particularly as phone and Internet services continue to expand. Have you given any thought to the types of cases that you might bring if the exemption were repealed?

**VLADDECK:** I have not focused on your "what if" question relating to the possible repeal of the common carrier exemption. I have, however, focused on the problems that the Common Carrier Exemption causes us in areas where there is a jurisdictional gap with the FCC. For instance, we bring phone card and cramming cases, but the scope of those cases is limited because our authority to go after deceptive advertising does not extend to matters that the FCC regulates. Fortunately, we are now working closely with the FCC to better coordinate our enforcement efforts, and I think that we can resolve some of the difficulties we've encountered in the past.

As for the Internet, we exercise authority over Internet providers and users in several ways—privacy, data security, and anti-fraud—to name a few. I understand that the Broadband Plan that has been announced by the FCC would clarify the FCC's authority over the Internet. We are working closely with our FCC colleagues to ensure that the FTC's consumer protection mission remains

unimpaired while the FCC moves ahead to implement its Broadband Plan and ensure net neutrality.

**ANTITRUST SOURCE:** Is there any effort to increase the interaction with the Federal Communications Commission? Historically, there's been some criticism, not from the Federal Trade Commission of course, but there's been some criticism of the FCC's efforts to protect consumers who are purchasing phone and Internet services. And I know that there has been some success of interagency cooperation in the past, and I'm thinking about the Truth in Billing efforts that occurred not long ago. Is there currently any effort to increase that sort of interaction with the FCC?

**VLADECK:** Yes, I don't want to comment on past efforts, but I would say that certainly in the last nine months we have established very good working ties with the FCC. We are working on matters of common interest. We meet regularly with our counterparts there. And we look forward to deepening our collaboration.

**ANTITRUST SOURCE:** You've written extensively on the subject of administrative law, and in particular federal agency preemption. In Congressional testimony, you've generally argued against broad federal preemption of state laws. In particular you've stated that "recent assertions of preemption of State law by Federal regulatory agencies are in the main nothing less than an effort by the Executive Branch to arrogate power that properly belongs to Congress." Given that your position envisions the state as an active participant in protecting consumers, how do you see the Bureau of Consumer Protection increasing its collaboration with the various states during your tenure, in particular the offices of the attorneys general?

**VLADECK:** Let me make two quick points; one is, that quote in context refers to assertions of preemption by agencies, not in regulations or other formal statements of agency policy, but simply in Federal Register preambles and other informal statements, which I saw as an arrogation of authority. The FTC has not and would not do that. I think that the Supreme Court's ruling in *Wyeth v. Levine*, which sharply criticized the FDA for attempting to exercise preemptive power through a statement in a regulatory preamble, took the same view as I did. And I think that practice has come to a halt.

But the more pertinent answer is, yes, I believe that the FTC and State Attorneys General, as well as legal service providers, are natural partners. Getting back to the resource question—none of these entities has resources sufficient to do its job. And one thing I feel strongly about is working collaboratively with states and other important partners, like legal services providers, to optimize the use of our resources.

We recently settled a case against LifeLock, which billed itself as a company that could prevent ID theft. Thirty-five State Attorneys General participated in that settlement, along with the FTC. I don't know if that's a record for the Federal Trade Commission, but it was emblematic of what I want to accomplish in terms of FTC-state collaboration.

Collaborations serve important purposes. They conserve scarce resources. They facilitate settlements with companies facing the possibility of multiple enforcement actions. And they build working relationships that have value going forward.

I recently spent two days in Chicago meeting in our Midwest Regional Office with nearly 100 lawyers from the offices of State Attorneys General and legal service providers. The meeting, which we called a "Common Ground" conference, was the first one held by the FTC that brought

lawyers from states, legal service organizations, and the FTC together. It was energizing and inspiring to meet with others who are doing the same kind of high-volume anti-fraud work we're doing. We had a lot to discuss. The legal services providers often see scams before we do, but they too are under-resourced and cannot cope on their own with the flood of cases that they review. One goal of the conference was to think about allocation of responsibilities and to explore whether there are resources, including training, access to briefs and pleadings, and technical assistance that we can offer to better equip legal services providers and State Attorneys General to handle these cases. And I plan on doing these meetings at every regional office within the next year to eighteen months. So yes, I think we do want to cooperate more with our state partners.

*If you look at some of the great consumer*

*protection cases,*

*they're antitrust cases*

*dressed up in*

*other garb.*

**ANTITRUST SOURCE:** And it would occur to me that the recent confirmation of Julie Brill as FTC Commissioner will advance that objective, given Julie's great work over the years in the Office of the Vermont Attorney General and, more recently, as the Chief of the Consumer Protection Division in the Office of the North Carolina Attorney General.

**VLADECK:** I think that's right, and of course I agree with your assessment of Commissioner Brill. We're looking forward to Commissioner Brill helping us build on the foundation for a closer collaboration with states and legal services organizations that we've been laying for the past year.

This is in keeping with one of my top priorities. I am anxious to forge partnerships with the FTC's natural allies: not just state AGs and legal services providers, but also our federal partners, the FCC, as you mentioned, the Food and Drug Administration, the Department of Justice (especially the Civil Division's Office of Consumer Litigation), the EPA, and the Department of Energy.

**ANTITRUST SOURCE:** Given that most of the readership of *The Antitrust Source* is comprised of competition lawyers, many readers of this interview will be curious about your views regarding the interplay of competition and consumer protection law.

Some have commented that both are intended to remedy market distortions, in the case of consumer protection law by correcting a misimpression that a product or service has a greater value than it actually does, and by doing so preventing consumer injury. Do you agree with this characterization? Would you describe the interplay any differently?

**VLADECK:** No. I think that the observation is true. If you look at some of the great consumer protection cases, they're antitrust cases dressed up in other garb.

Consider again the early commercial speech cases. These cases were aimed at dismantling anticompetitive restraints that might have been actionable under the antitrust laws but for the fact that they were imposed by guilds operating under the protection of the state.

The Florida Board of Accountancy, which was the defendant in *Edenfield v. Fane*, was unreachable under the antitrust laws as a result of cases like *Ronwin*. But the Board was composed of practicing CPAs who wanted to retain the anti-solicitation rule to prevent CPAs from the North moving to Florida and "poaching" their clients.

The one time I got Chief Justice Rehnquist to crack up during an argument was in *Edenfield*. He asked me to describe the origins of the Florida anti-solicitation rule. When I began my answer with a description of the 1905 "Anti-Encroachment Rule," also known as the "Anti-Poaching" rule of the then Guild of Florida Accountants he interjected and said, "Did you say anti-poaching?" And I said, "Yes, your Honor, anti-poaching." He thought that was hilarious. It was the only time I got him to laugh, and I think it was the only time I got his vote.

I think it is also worth noting that BC and BCP are working together on a number of cases in which we have mutual interest.

**ANTITRUST SOURCE:** Your predecessors, as Bureau Directors—Lydia Parnes, Howard Beales, Jodie Bernstein, and others—have left very strong legacies. I'm curious as you look ahead and you someday arrive at the conclusion of your tenure, is there one thing for which you would like to be remembered?

**VLADECK:** I think I came in with a clear sense of what I wanted to accomplish here. I think we need—at least in the time of this economic downturn—to concentrate on anti-fraud work to protect those rendered vulnerable by the recession. That has been a focus of our enforcement and rulemaking efforts and I think we're making real progress in that regard.

The privacy initiative that we've launched is also essential. The current frameworks available to the Commission just aren't going to serve us well going forward. We need to construct a framework that works in a highly dynamic, constantly evolving market. And establishing a framework that provides consumers meaningful control over their personal information without stifling innovation or placing barriers on the information superhighway is a serious challenge.

I also am happy to capitalize on the successes of my predecessors. The group you mentioned is an illustrious one, and I am proud to be part of that heritage. Lydia Parnes, my immediate predecessor, should be applauded for her many accomplishments.

From my standpoint, Lydia's most important achievement was building an institution that is exceptionally high functioning and is staffed with top-flight lawyers who get the work done who have a deep commitment to the agency's mission, and who genuinely enjoy working with one another. There is a culture within BCP that is special and needs to be preserved. If I can do that, then I think that I'll have done a good job.

**ANTITRUST SOURCE:** Well, David, thank you very much for taking the time this morning.

**VLADECK:** John, it's always a pleasure to chat with you. ●

## Interview with Richard A. Feinstein, Director, FTC Bureau of Competition

**Editor's Note:** In this interview with The Antitrust Source, Richard Feinstein discusses his background, recent FTC enforcement decisions, coordination with other agencies, and proposed antitrust legislation, with a special focus on “pay for delay” pharmaceutical settlements.

Mr. Feinstein was appointed Director of the Federal Trade Commission's Bureau of Competition in May 2009. Prior to this, he was a partner at Boies, Schiller & Flexner LLP, where he focused on antitrust litigation and counseling. From 1998 to 2001, Mr. Feinstein was Assistant Director in the Bureau of Competition's Health Care Services and Products Division, concentrating on antitrust enforcement, including anticompetitive practices and mergers involving health care providers and payers, and anticompetitive conduct in the pharmaceutical industry. Mr. Feinstein also worked previously at McKenna & Cuneo, LLP, and he was a trial attorney and supervisor in the Antitrust Division of the U.S. Department of Justice. Mr. Feinstein is a graduate of Yale University and Boston College Law School.

The interview was conducted on March 11, 2010, by Editor Atleen Kaur for The Antitrust Source.

—ATLEEN KAUR



**Richard A. Feinstein,  
Director, FTC Bureau of  
Competition**

**ANTITRUST SOURCE:** You've been at the FTC previously and you've spent some time in private practice. Could you elaborate on how that experience has informed your current vision as the Director of the FTC's Bureau of Competition?

**RICHARD FEINSTEIN:** I've been practicing antitrust law in Washington for more than thirty-two years, which is frankly kind of shocking to me. But I got here in 1977 fresh out of law school and started my career in the Antitrust Division where I worked for seven-and-a-half years in a variety of positions. At the time I left the Division in 1985, I was serving as an Assistant Section Chief. I was then in private practice from 1985 to 1998.

At that point I had an opportunity to come to the FTC to serve as the Assistant Director of the Bureau of Competition in charge of the Health Care shop. I'll pause and backtrack just for a second. During the decade or so from the mid-'80s to the late '90s I had devoted a great deal of my practice to activity at the intersection of antitrust and health care, which I guess may be the reason I was asked to run the Health Care shop after Bob Leibenluft stepped down as Assistant Director. I did that from 1998 to 2001. At the end of June 2001 I left the Commission, and took a couple of months off actually. I then re-entered private practice with Boies, Schiller & Flexner here in Washington, where I practiced until May of last year, when I returned to the FTC as Bureau Director.

Over the course of my career, I have had the opportunity to do both antitrust litigation and counseling. I've had a fair amount of litigation experience, including a couple of jury trials—one of which was criminal. I also did some criminal work when I was in the Division back in the early '80s.

So I've had a fairly broad antitrust experience. And I've found the opportunities to serve in both the Division and the Commission to be particularly exciting and rewarding.

You'd probably have to ask him to confirm this, but I suspect that one of the reasons that the current Chairman of the FTC, Jon Leibowitz, thought I might be qualified to be the Bureau Director

would be because of the experience I've had in the health care sector. Certainly I've had antitrust experience with respect to many other industries as well. But to the extent that health care was a subspecialty of mine and a high priority of his, it may have made it a good fit.

I have noted on a number of occasions publicly that the very first meeting that I attended in 1998 (when I arrived at the Commission for the first time), was a meeting that led to the first of the "pay for delay" cases that the Commission brought. It was a very preliminary meeting regarding what became the *Cardizem* case, where the respondents were Hoechst and Andrx. And if somebody had said to me on that day in October of 1998, that eleven years later I would be back at the FTC where (1) I would be Bureau Director and (2) the FTC would still be worrying about pay for delay cases, I would have been very skeptical on both counts.

So it just shows you how serendipitous things can be and in some ways how one can have a sense of déjà vu in these jobs. But I'm delighted to be here. It's a very interesting time to be at the Commission, needless to say, not only with respect to the issues that we're confronting but also with respect to the quality of the Commission. In addition to a very dedicated and talented staff, I have also worked with several of the current Commissioners before—in private practice, at the Commission, or both. And I'm very grateful to have the opportunity to be here.

*[T]he very first meeting that I attended in 1998 (when I arrived at the Commission for the first time), was a meeting that led to the first of the "pay for delay" cases that the Commission brought.*

**ANTITRUST SOURCE:** Is there anything in particular that drove your interest in health care and its intersection with antitrust?

**FEINSTEIN:** Again I think that's somewhat serendipitous. When I first left the Antitrust Division back in 1985 I joined a firm where a former colleague of mine from the Division was working and was primarily doing health care work. I had not done any health care work at the Division, interestingly. But the firm I joined was looking to beef up its antitrust and white-collar horsepower, and at a time when antitrust activity was somewhat dormant or quiet in many sectors, health care was a conspicuous exception in the '80s.

That was, I think, driven in part by the very dramatic transformation in the way in which the government approached reimbursement for health care services, when it moved from essentially cost-plus reimbursement to prospective-payment reimbursement. That caused health care providers and particularly hospitals to have to worry more than they ever had before about their costs and about excess capacity and about making sure that they had a steady flow of patients. And that led in turn to all kinds of changes in the marketplace and to a lot of hospital mergers. It also led to vertical relationships between hospitals and physicians and physician groups, and to vertical relationships between hospitals and ancillary services providers, such as durable medical equipment firms and that sort of thing.

It was a time when things were changing very rapidly in health care and that led to a fair amount of antitrust activity, both in terms of government enforcement—relatively speaking—and also private litigation and counseling.

I found myself at a firm that was doing a lot of that work and I had an opportunity to experience that. The firm was then called Casson, Calligaro & Mutryn. It later became the Washington office of the Proskauer firm, but by the time that happened I had actually departed and was at the firm that is now McKenna Long & Aldridge. Back then it was called McKenna & Cuneo.

I spent twelve years at the McKenna firm—from 1986 until 1998—where I was ultimately in charge of their antitrust practice and their health care practice.

I had not had much exposure at that point to the pharmaceutical industry. But when I arrived at the FTC in 1998, responsibility for enforcement arising from conduct issues in the pharmaceu-

tical industry had been reassigned to the Health Care Division within the Bureau of Competition. And so I found myself presiding over a group of lawyers who were dealing not only with physicians and hospitals, but also with non-merger issues in the pharmaceutical sector. One of the matters that we brought while I was there was the *Mylan* case, in which the Commission sought and obtained disgorgement, and it was also during that time that we initiated the pay for delay activity. I actually had the opportunity, while I was the Assistant Director, to be the lead attorney on the *Mylan* case in federal court, which was both very challenging and very gratifying.

I certainly didn't go to law school knowing that I was going to be an antitrust lawyer when I got out. I had a summer job in the Antitrust Division in 1976 which influenced that. And I certainly didn't become an antitrust lawyer knowing that I would spend a fair amount of my career in the health care sector. But I've also, as I said, had a variety of experiences in other industries over the years.

**ANTITRUST SOURCE:** Once again you are at the FTC at a time when there is much debate about the health care system in the country. Is the FTC playing any role in the health care debate on the Hill? In addition to merger enforcement, what ways can the FTC contribute to ameliorating the health care crisis?

**FEINSTEIN:** I assume that what you're referring to is the health reform debate. The FTC has been very involved in one portion of that, which is the effort to see the passage of legislation that would address the pay for delay problem that has been confounding the FTC for several years.

More broadly, I would say that (and obviously I don't speak for the Commission here; I'm speaking for myself) the goals of health reform are fundamentally consistent with the goals of the antitrust laws and the goals of competition with respect to the delivery of health care products and services. To oversimplify a bit, I would summarize the goals of health reform, broadly speaking, as being related to promoting quality, promoting access, and promoting efficiency in terms of the delivery of health care goods and services. To my mind, all of those goals are fundamentally consistent with the goals of the antitrust laws. I haven't been at all involved in the details of the health reform debate on the Hill. But I view our role as making sure that the value of competition in serving the goals of health reform isn't overlooked.

And after the passage of the legislation, I would hope and expect that there will be an ongoing role for competition policy and antitrust enforcement in relation to health reform.

The Chairman has, of course, been very active in pursuing a legislative solution to the pay for delay issue. And we are still hopeful that legislation to address that problem may emerge from the current Congress.

**ANTITRUST SOURCE:** Just to follow up on the legislative solution—is there a consensus at the FTC that a legislative solution is actually required, given the recent court decisions on pay for delay settlements?

**FEINSTEIN:** I'm only going to speak for myself on that. We have several matters pending in federal court. We also have a number of investigations underway, but in recent years our view on that issue has not prevailed at the appellate level, either in actions that we brought or in actions brought by private parties teeing up the same issue. We are continuing to fight the good fight in the courts, and we recently received good news when the District Court in Philadelphia denied the motion to dismiss our *Cephalon* case.

While we have made no secret of our desire to get this issue to the Supreme Court, another

approach which, if successful, will almost certainly be faster, is a legislative solution that would at a minimum address the issue prospectively. Ultimately, the judicial and legislative approaches are not mutually exclusive. In my view, regardless of the outcome of the judicial initiative, a legislative solution is highly desirable, particularly to address the ongoing harm (in the form of higher costs) that consumers are experiencing as a result of these arrangements.

**ANTITRUST SOURCE:** In addition to the areas of health care and pay for delay pharmaceutical settlements, are there other areas that are priorities for you during your time at the FTC? Are there other goals that you would like to achieve at the FTC?

*[T]here are*

*investigations*

*underway in the*

*conduct area that*

*involve exclusionary*

*practices as to which*

*Section 2 could easily*

*be invoked, perhaps*

*Section 5 as well.*

**FEINSTEIN:** Well, certainly there are other areas that are receiving a lot of attention with respect to our resources. We have a number of matters in what I'll call sort of the high-tech sector for lack of a better term. The most prominent of those of course would be the *Intel* matter that was voted out in December. We've had some activity in the standard-setting area. I think that continues to be an important area. We are of course active in the energy sector. All of our shops are busy. With respect to mergers, of course, our activity is inherently reactive. By that I mean that we confront mergers as they happen rather than having an agenda to address a particular form of conduct, for example.

But there are also a fair number of investigations underway—and obviously there is some litigation in the works—addressing exclusionary conduct that may violate Section 2.

In terms of process as opposed to substance, it's also one of my goals to try to make sure that the Bureau operates efficiently and keeps things moving. That's an ongoing goal, and I'm not the first Bureau Director to want to achieve that, I'm sure. But, that is something that we are spending time on as well.

The incentives for the respondents in our matters are very different depending upon the nature of the matter. If they're trying to get a deal through, and it's subject to the Hart Scott Rodino procedures, they are well motivated to move things along and give us all the information we need. That's not necessarily as much the case in our conduct investigations or with respect to consummated mergers.

And, in addition to trying to keep things moving internally, we've also devoted some resources to trying to make sure that the parties understand that we're relying on them to help us keep things moving—by cooperating with our discovery requests, for example.

**ANTITRUST SOURCE:** You mentioned that there might be a renewed interest in investigating unilateral conduct under Section 2. Should we expect more enforcement in this area?

**FEINSTEIN:** We already have one example of that in the *Intel* matter, which raises both Section 2 and Section 5 allegations. I can certainly represent to you that there are investigations underway in the conduct area that involve exclusionary practices as to which Section 2 could easily be invoked, perhaps Section 5 as well.

So the answer to your question would be I think that's likely. Obviously, all I can do is recommend actions for the Commission. I can't cause them to be voted out. It's also worth noting that we have two new commissioners, and they will form their own views on these questions. But there are certainly matters in the pipeline that implicate Section 2 as well as Section 1 and Section 7.

**ANTITRUST SOURCE:** Following up on the *Intel* complaint and its Section 5 allegations, Chairman

Leibowitz and Commissioner Rosch have made no secret that they would like to see a greater role for Section 5. Can practitioners expect to see the FTC put out guidance on Section 5 liability?

**FEINSTEIN:** If it were up to me, yes. There was a workshop held on Section 5 back in the fall of 2008. My impression is that there was an expectation and I think even some representations at that time that the FTC would issue a report on Section 5. I would like to see that happen. Obviously it hasn't happened yet. And whether it does happen will be decided by the full Commission including the new Commissioners.

*I believe personally*

But I believe personally that it would be useful for the FTC to provide some additional guidance about the considerations that it takes into account when enforcing Section 5 or that it will take into account when enforcing Section 5.

*that it would be useful*

*for the FTC to provide*

Whether you call them limiting principles or considerations (I actually prefer the term "considerations"), my personal hope is that there will be some additional guidance.

*some additional*

I also expect that in any event there will likely be additional enforcement recommendations coming from the Bureau with Section 5 as part of them. And, assuming that the Commission votes those out, then there will be guidance in the form of cases as well.

*guidance about the*

*considerations that it*

**ANTITRUST SOURCE:** Before we leave the topic of Section 5 we'd like to briefly discuss interlocking directorates, which had been a topic that had gone out of the mainstream for a while but then came back with the Google/Apple discussion.

*takes into account when*

Do you think that the FTC might consider using Section 5 to enforce the policy considerations underlying Section 8 of the Clayton Act?

*enforcing Section 5 or*

*that it will take into*

**FEINSTEIN:** Again, I can only speak for myself on that. I could imagine a circumstance where that might be possible. I wouldn't go so far as to say it's likely. But the fact that we did have the well-publicized Section 8 inquiry involving Google and Apple has already had a prophylactic effect.

*account when enforcing*

*Section 5. . . .*

A number of folks (I'm thinking of members of the Antitrust Bar) have come up to me on various occasions and said that our investigation and the resolution of it has been very useful for them in counseling their clients about paying attention to Section 8.

*there will likely be*

I don't mean to suggest that it's my view that a large proportion of our resources are likely to be devoted to Section 8 enforcement. But I think from time to time it is useful for the Bar and corporations that may have overlapping directors to be reminded that there are rules, and they're actually quite straightforward, at least under Section 8.

*additional enforcement*

*recommendations*

**ANTITRUST SOURCE:** You have said recently that sometimes parties delay investigations by not complying fully with agency subpoenas. Does the FTC have plans to address this issue? And, what methods is it considering?

*coming from the*

*Bureau with Section 5*

**FEINSTEIN:** We're addressing it already in the form of going to federal court to enforce our subpoenas where that becomes necessary. We've done that two or three times already since I've been here. I would like to think that it wouldn't be necessary very often.

*as part of them.*

And I want to be clear: it's not my view that we are unwilling to negotiate the scope of our subpoenas. That's not the point at all. But where parties are unnecessarily delaying the process or in some instances engaging in the redaction of documents on grounds other than privilege—and we've seen that a few times recently—I think we have to try to nip that in the bud. And it is particularly ironic when we confront some of these delaying tactics in the context of investigations that are focused on pay for delay issues, for example.

Another thing that the Bureau is contemplating—in addition to going to federal court to enforce our discovery requests—is to ask the Commission to issue a Show Cause Order under its rules, as to why practitioners who engage in this conduct before the Commission shouldn't be sanctioned or reprimanded. That procedure, to my knowledge, has not been used recently. And that is another tool that the Bureau may seek to have the Commission invoke going forward. The Bureau can't do that on its own; we can only make recommendations. But I would like to think that this won't be an ongoing problem if people understand that we expect them to fulfill their obligations.

I have been on both sides of FTC subpoenas and I certainly understand that there is room for reasonable accommodation and reasonable disagreement. And those aren't the instances where, in my judgment, we will be going to federal court. I would like to think that this problem will not be a persistent one, but time will tell.

**ANTITRUST SOURCE:** Regarding the FTC's challenges to a number of consummated mergers: How do these mergers actually come to the FTC's attention? And how does the FTC go about deciding which ones it should challenge?

**FEINSTEIN:** They come to our attention in a variety of ways. Sometimes we receive complaints from customers or others. Sometimes we read about them. There's no single path that brings them to our attention. And typically they are mergers that were not HSR reportable.

The ultimate decision whether to challenge a consummated merger is up to the Commission, of course. So all I can do is tell you how I would decide about which ones we ought to be devoting our resources to investigating. The rules of thumb for me are impact in some sense, either in terms of direct impact on consumers or, if there isn't a substantial direct impact on consumers, you may still have a matter that tees up a legal issue that we think it will be useful to advance.

There are certainly many consummated mergers that we don't worry about for a variety of reasons. But, for example, every so often we come across one that appears to be a merger to a monopoly or something pretty close to a monopoly. And in those instances it's fairly hard to look the other way unless it's really trivial.

**ANTITRUST SOURCE:** When the FTC is evaluating efficiencies of a proposed merger how does the FTC draw the line between a reasonable prediction and speculation?

**FEINSTEIN:** That's a great question. There's a sense in which all of merger enforcement—at least with respect to a prospective merger—involves making predictions.

With respect to analyzing efficiencies as well as other potential effects, I don't know that there is a bright line between what is speculative and what is verifiable. I mean there's a continuum and we need—as much as possible—to satisfy ourselves that likely efficiencies are not speculative and are supportable.

One way of doing that is by considering the extent to which they are addressed in contemporaneous documents at the time that the deal is being considered by the parties as opposed to being developed after the fact. That doesn't mean that they may not be real if the efficiencies analysis is developed later. But if they're really driving the deal, there is likely to be some evidence of that in contemporaneous documents. That's one thing that I at least would look for.

**ANTITRUST SOURCE:** What are your views on retrospective study of the effects of previously approved mergers?

**FEINSTEIN:** I think they can be very useful. Obviously they're subject to resource constraints and we probably can't do as many retrospectives as we might like to do. And there is certainly a role for the academic community to play in retrospectives.

But in an area with which I've had a lot of experience personally (the health care sector), hospital mergers are a very good example of how retrospectives can be very useful in both informing and animating antitrust enforcement.

Back in the late '90s both the DOJ and the FTC were having a very hard time winning hospital merger cases in the courts. And to his great credit Chairman Muris commissioned some retrospectives on several hospital mergers, including of course the Evanston merger, which led to an enforcement action which I think has enabled the FTC to more confidently explain to judges why its predictions about likely competitive effects should be taken seriously.

And I think that's a good thing. So that's a sort of a textbook example of how retrospectives can be useful. But there are certainly other examples as well.

*[I]f one were starting*

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*jurisdiction.*

**ANTITRUST SOURCE:** The *Whole Foods* and the *CCC* decisions have been interpreted by some practitioner as lowering the bar for the FTC to obtain a preliminary injunction in merger cases. Is that how you see it?

**FEINSTEIN:** I don't know that I really see it as a dramatic lowering of the bar.

To some extent that perception is as much related to the reality that when the Justice Department goes into federal court to block a merger, almost inevitably the preliminary injunction proceeding is collapsed into a permanent injunction proceeding where the standard is a little different. If the Antitrust Division were to seek a preliminary injunction followed by a separate proceeding on a permanent injunction, I'm not sure that there would be the same perception, which is not to say that the standards are identical.

But ultimately if the FTC obtains a PI and then goes into Part 3 litigation, I'm not sure that the end result is terribly different depending upon which agency is challenging the merger. And I realize that there are people who may disagree with that. But I think that has been, to some degree, overblown.

**ANTITRUST SOURCE:** Many of us in private practice wondered which agency would review the Comcast/NBC merger. How has the clearance process been working since you became Bureau Director?

**FEINSTEIN:** The Antitrust Division will be reviewing that merger. I think generally the clearance process works quite well. I've said this publicly before as well. I think if one were starting from scratch to come up with an antitrust enforcement mechanism, I'm not sure that we would come up with one that looks the way it looks in the United States right now, with the overlapping jurisdiction. Or I'm not sure I would at least. But that's what we have. The clearance process has evolved as a result of that, and in my experience it works pretty well.

I think again that's an area where the notion that it's a problem of major proportions or that consideration of deals is frequently delayed by clearance disputes doesn't comport with my experience.

**ANTITRUST SOURCE:** Do you think there's a need for convergence in competition laws internationally? And can you comment a bit on the FTC's efforts to cooperate with or secure cooperation from other international agencies?

**FEINSTEIN:** Certainly there's been a lot of convergence over the years. Of course some differences remain as well. But there's a great deal of cooperation that I've observed, particularly—but not entirely—in the merger area.

Several of the major deals that we've investigated just in the time that I've been Bureau Director—I'm thinking in particular of several of the major pharmaceutical deals that led to consent orders—were also being investigated in Europe and in Canada and elsewhere. We work quite cooperatively with our international colleagues. While there's not complete convergence with respect to conduct issues, there's been movement in that direction as well.

Certainly there's a lot of cooperation, none of which directly involves the FTC, involving international cartels investigated and prosecuted by the Justice Department. And we've worked closely with our colleagues in Europe on some conduct matters as well. I don't think it's any secret, for example, that we have discussed the Intel matter with them from time to time.

While there isn't precisely the same analytical approach or statutory scheme in every jurisdiction, I think on a lot of the big issues there is a fundamental consistency.

**ANTITRUST SOURCE:** Thank you for your time. It has been a pleasure talking with you. ●

# Three Key Principles for Revising the Horizontal Merger Guidelines

**Timothy J. Muris and Bilal Sayyed**

The analytical framework of the Horizontal Merger Guidelines,<sup>1</sup> first introduced by Bill Baxter in 1982, has been adopted by numerous Assistant Attorney Generals and Federal Trade Commission Chairmen of both political parties. For example, former Assistant Attorney General Charles James called the 1982 Merger Guidelines “Giant Steps” in the development of antitrust analysis, with no other policy document “more enduring or far-reaching”<sup>2</sup> and past FTC Chairman Robert Pitofsky, stated that “the guideline process, in many ways, has had the most important influence on American antitrust policy in the last fifty years.”<sup>3</sup> We agree with these distinguished observers that the Guidelines’ influence is (rightly) considerable; this influence extends to the federal courts,<sup>4</sup> foreign competition agencies,<sup>5</sup> and state enforcement<sup>6</sup> and regulatory agencies<sup>7</sup> in the United States.

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<sup>1</sup> U.S. Dep’t of Justice & Fed. Trade Comm’n, Horizontal Merger Guidelines (1992, rev. 1997) [hereinafter Guidelines or Merger Guidelines], available at <http://www.ftc.gov/bc/docs/hmg080617.pdf>.

<sup>2</sup> Charles A. James, Assistant Att’y Gen., Antitrust Div., U.S. Dep’t of Justice, Remarks on the Occasion of the Twentieth Anniversary of the 1982 Merger Guidelines 2 (June 10, 2002), available at <http://www.justice.gov/atr/hmerger/11253.pdf>.

<sup>3</sup> Transcript of the Horizontal Merger Guidelines Review Project at 15 (Dec. 3, 2009), available at <http://www.ftc.gov/bc/workshops/hmg/transcripts/091203transcript.pdf>.

<sup>4</sup> See Hillary Greene, *Guideline Institutionalization: The Role of Merger Guidelines in Antitrust Discourse*, 48 WM. & MARY L. REV. 771 (2006); Christine Varney, Assistant Att’y Gen., Antitrust Div., U.S. Dept. of Justice, Merger Guidelines Workshops at 4–5 (Sept. 22, 2009), available at <http://www.justice.gov/atr/public/speeches/250238.pdf> (discussing lower and appellate court reliance on the Guidelines); see also Timothy J. Muris & Bilal Sayyed, Three Key Principles for Revising the Horizontal Merger Guidelines, Submitted to the Federal Trade Commission and Department of Justice Horizontal Merger Guidelines Review Project No. PO92900, at 1 n.4 (Dec. 7, 2009) [hereinafter Comment], available at <http://www.ftc.gov/os/comments/horizontalmergerguides/545095-00052.pdf> (identifying recent lower and appellate court merger decisions relying heavily on the Guidelines’ analytical framework).

<sup>5</sup> A review of the merger guidelines of other jurisdictions illustrates the influence the Guidelines have had in shaping merger policy worldwide. See, e.g., Guidelines on the Assessment of Horizontal Mergers Under the Council Regulation on the Control of Concentrations Between Undertakings (Feb. 2004), available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2004:031:0005:0018:EN:PDF>. Other competition agency guidelines that follow the U.S. Guidelines are identified at Comment, *supra* note 4, at 2 n.5.

<sup>6</sup> The National Association of Attorneys General (NAAG) also has adopted merger guidelines influenced by, but at parts in tension with, the Guidelines. Nat’l Ass’n of Att’y Gen., Horizontal Merger Guidelines § 2 (1993), available at [http://www.naag.org/assets/files/pdf/at-hmerger\\_guidelines.pdf](http://www.naag.org/assets/files/pdf/at-hmerger_guidelines.pdf). In practice, state attorneys general have largely adopted the approach of the Guidelines, perhaps because of their cooperation with the FTC and DOJ in general and in specific matters and because they do not have resources sufficient to pursue alternative relief or investigative paths. We encourage the NAAG formally to revoke their existing Merger Guidelines and formally adopt, as their policy, any revised Guidelines.

<sup>7</sup> The analytical framework of the Guidelines heavily influences the Federal Communications Commission’s (FCC) and the Federal Energy Regulatory Commission’s (FERC) review of mergers. For the FCC, see, for example, XM Satellite Radio Holdings and Sirius Satellite Radio, Inc., Memorandum Opinion and Order, MB Docket No. 07-57, FCC 08-178 (July 25, 2008); News Corp. and Liberty Media Corporation, Memorandum Opinion and Order, MB Docket No. 07-18, FCC 08-66 (Feb. 25, 2008). For FERC, see Inquiry Concerning the Commission’s

We believe the Guidelines successfully have served as “the blueprint for the architecture of merger analysis”<sup>8</sup> for more than twenty-five years because they set forth “as simply and clearly as possible . . . [a] clear statement” of the U.S. government’s merger enforcement policy to the business community, the antitrust agencies, the courts, and competition agencies around the world.<sup>9</sup> But, with “the bulk of the Guidelines . . . well over seventeen years old,” we agree with Chairman Leibowitz’s statement that “the time has come . . . to provide more accurate guidance than practitioners and the courts have been getting from the Guidelines.”<sup>10</sup> Assistant Attorney General Varney has correctly noted the importance of “explor[ing] whether and how the Agencies should update the Guidelines in light of changes in “economic learning, the development of [Section 7] case law and agency practice” and whether the Guidelines “accurately and clearly describe current agency practice.”<sup>11</sup> Thus, we support the Agencies’ recently announced effort to consider revisions to the Guidelines.<sup>12</sup>

Besides the potential substantive benefits to merger enforcement, the revision effort confirms that institutional efforts towards increased transparency and self-evaluation will likely continue. The revision project follows former FTC Chairman, and now Commissioner, Kovacic’s recognition that “periodic reassessment of existing statements of . . . enforcement intentions” and the “sys-

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Merger Policy Under the Federal Power Act: Policy Statement, Order No. 592, 61 Fed. Reg. 68,595 (Dec. 30, 1996), FERC Stats. and Regs., ¶ 31,044 (1996) (1996 Merger Policy Statement), *reconsideration denied*, Order No. 592-A, 62 Fed. Reg. 33,341 (June 19, 1997), 79 FERC ¶ 61,321 (1997). *See also* Greene, *supra* note 4, at 844–47.

We recognize that neither the FCC nor FERC follow the Guidelines slavishly. In fact, in our experience, there are significant transaction costs associated with dual agency merger review, even accounting for the different standard—a public interest standard—that the FCC and FERC must follow. (For a discussion of the limitations of application of a Section 7 standard to the public interest standard of the FCC, see Howard A. Shelanski, *Antitrust Law as Mass Media Regulation: Can Merger Standards Protect the Public Interest*, 94 CAL. L. REV. 371 (2006).) While it may be too aspirational given the regulatory structure of the FCC and FERC, we believe the DOJ, FCC, FERC, and FTC should engage in greater institutional efforts to more fully harmonize their competitive effects analysis of mergers, with an eye towards the adoption of Federal Merger Guidelines. Of course, any such guidelines should not implement a “lowest common denominator” approach. We understand that this may, and likely will, require significant procedural and perhaps statutory adjustments. The Domestic Competition Network proposed by FTC Commissioner William Kovacic presents a model for this type of discussion, substantive convergence, and procedural cooperation. *See* William E. Kovacic, *Toward a Domestic Competition Network*, in COMPETITION LAWS IN CONFLICT: ANTITRUST JURISDICTION IN THE GLOBAL ECONOMY 316 (2004).

<sup>8</sup> *See* ANTITRUST MODERNIZATION COMMISSION, REPORT AND RECOMMENDATIONS 54–55 (2007) [hereinafter AMC REPORT] (citations omitted), available at [http://govinfo.library.unt.edu/amc/report\\_recommendation/amc\\_final\\_report.pdf](http://govinfo.library.unt.edu/amc/report_recommendation/amc_final_report.pdf).

There is general consensus that the Merger Guidelines have acted as the “blueprint for the architecture” of merger analysis and, overall, provide a guide that “functions well.” The Guidelines have had a significant influence on judicial development of merger law, which is reflected in their widespread acceptance by the courts as the relevant framework for analyzing merger cases. . . . The Guidelines have also provided useful guidance and transparency to the business community and antitrust bar. Finally, the Guidelines have helped to influence the development of merger policy by jurisdictions outside the United States.

<sup>9</sup> *See* Press Release, Fed. Trade Comm’n, FTC/DOJ Announce Revised Guidelines on Efficiencies in Mergers (Apr. 8, 1997), available at <http://www.ftc.gov/opa/1997/04/effpress.shtm>.

<sup>10</sup> Jon Leibowitz, Chairman, Fed. Trade Comm’n, Introduction of Philip Lowe and Announcement of Joint FTC/DOJ Project to Modernize the Horizontal Merger Guidelines 2–3 (Sept. 22, 2009), available at <http://www.ftc.gov/speeches/leibowitz/090922mergerguideleibowitzremarks.pdf>.

<sup>11</sup> Christine A. Varney, Assistant Att’y Gen., Antitrust Div., U.S. Dept. of Justice, Merger Guidelines Workshops 4 (Sept. 22, 2009), available at <http://www.justice.gov/atr/public/speeches/250238.pdf>.

<sup>12</sup> On September 22, 2009, Federal Trade Commission Chairman Jon Leibowitz and Assistant Attorney General Christine Varney announced that the antitrust agencies would hold public workshops to consider revisions to the Guidelines. Press Release, Fed. Trade Comm’n, Federal Trade Commission and Department of Justice to Hold Workshops Concerning Horizontal Merger Guidelines (Sept. 22, 2009), available at <http://www.ftc.gov/opa/2009/09/mgr.shtm>.

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tematic reevaluation of guidelines”<sup>13</sup> is especially important for the FTC and Antitrust Division because of the “inherently evolutionary” nature of the United States’ competition policy framework.<sup>14</sup> It is, in fact, a necessary predicate of building and maintaining strong competition policy institutions.<sup>15</sup> Similarly, the effort is consistent with Kovacic’s recommendation that “the Commission . . . engage in regular, periodic consultations with external constituencies—including legislators, other public agencies, consumer groups, business organizations, academic institutions, and legal societies” to determine the proper scope of its enforcement efforts.<sup>16</sup>

The Guidelines revision project builds on significant recent efforts to increase the transparency of merger review and enforcement decisions. During the last decade both the FTC and Department of Justice began the regular practice of issuing public statements describing their rationale for closing certain merger investigations,<sup>17</sup> released data on a decade’s worth of merger enforcement efforts,<sup>18</sup> and held a three-day Merger Enforcement Workshop<sup>19</sup> that helped inform the 2006 Commentary on the Horizontal Merger Guidelines.<sup>20</sup> These continued efforts to make merger enforcement policy and practice more transparent are of significant importance to practitioners and the business community.<sup>21</sup>

For revising the Guidelines, we offer three key principles. First, the Merger Guidelines have succeeded in significant part because they do not try to do too much. Rather than complex, lengthy regulations, the Guidelines provide a flexible and durable framework that reflects the antitrust community’s consensus on how to evaluate the competitive effects of horizontal mergers. Any potential changes to the Guidelines should be evaluated in this light. Second, as economic experience and learning evolve, so too does agency practice. The Guidelines similarly should evolve to reflect actual agency practice. We identify a few areas in which agency practice and the Guidelines currently diverge. Third, evaluation of individual mergers is heavily fact specific; any changes to the Guidelines should highlight those facts that are particularly probative in making enforcement decisions.<sup>22</sup>

<sup>13</sup> See Ernest Gellhorn & William E. Kovacic, Analytical Approaches and Institutional Processes for Implementing Competition Policy Reforms by the Federal Trade Commission (Dec. 1995), available at [http://www.ftc.gov/opp/global/gmu\\_1.shtm](http://www.ftc.gov/opp/global/gmu_1.shtm).

<sup>14</sup> William E. Kovacic, *Rating the Competition Agencies: What Constitutes Good Performance*, 16 GEO. MASON L. REV. 903, 907 (2009).

<sup>15</sup> See William E. Kovacic, Gen. Counsel, Fed. Trade Comm’n, Achieving Better Practices in the Design of Competition Policy Institutions (Apr. 20, 2004), available at <http://www.ftc.gov/speeches/other/040420compmpolicyinst.pdf>.

<sup>16</sup> THE FEDERAL TRADE COMMISSION AT 100: INTO OUR 2ND CENTURY; THE CONTINUING PURSUIT OF BETTER PRACTICES, A REPORT BY FEDERAL TRADE COMMISSION CHAIRMAN WILLIAM E. KOVACIC 178 (2009), available at <http://www.ftc.gov/ftc/workshops/ftc100/docs/ftc100rpt.pdf>.

<sup>17</sup> See Ilene Knable Gotts & James F. Rill, *Reflections on Bush Administration M&A Antitrust Enforcement and Beyond*, COMPETITION POL’Y INT’L, Spring 2009.

<sup>18</sup> See, e.g., FED. TRADE COMM’N, HORIZONTAL MERGER INVESTIGATION DATA, FISCAL YEARS 1996–2003 (Feb. 2004), available at <http://www.ftc.gov/os/2004/08/040831horizmergersdata96-03.pdf> and the data releases cited *infra* notes 31 and 34.

<sup>19</sup> See Fed. Trade Comm’n & U.S. Dep’t of Justice, Announcement of a Workshop on Merger Enforcement (Dec. 18, 2003), available at <http://www.ftc.gov/opa/2003/12/mwa.pdf>.

<sup>20</sup> FED. TRADE COMM’N AND U.S. DEP’T OF JUSTICE, COMMENTARY ON THE HORIZONTAL MERGER GUIDELINES (2006) [hereinafter COMMENTARY], available at <http://www.justice.gov/atr/public/guidelines/215247.htm>.

<sup>21</sup> See, e.g., Biotechnology Industry Organization et al., Joint Submission to the U.S. Department of Justice and Federal Trade Commission for the Horizontal Merger Guidelines Review Project (Nov. 2009), available at <http://www.ftc.gov/os/comments/horizontalmergerguides/545095-00038.pdf> (“We applaud the goals of increased transparency and predictability for the business community, which will assist companies in assessing whether to undertake transactions and in presenting to the agencies the materials that will assist them in making informed decisions.”).

<sup>22</sup> The examples we provide under our second and third points are not meant to be exhaustive.

### **Principle 1: The Guidelines Should Continue to Provide a Flexible Framework That Reflects a Consensus View**

The Guidelines are widely accepted and widely used because they provide a flexible, comprehensive, and administrable approach, focusing on only the issues necessary to determine a merger's likely competitive effects. They do not, indeed could not, explain the precise analysis to be undertaken in each investigation. Antitrust analysis is highly fact dependent, and the flexibility (and generality) of the Guidelines reflects this crucial point. To be durable, law enforcement guidelines should reflect the existing consensus views of academics and professionals.<sup>23</sup>

Successful Guidelines also walk a fine line between remaining broadly applicable and providing certainty to businesses and practitioners. On the one hand, to remain broadly applicable across widely varying markets and industry settings, the Guidelines must incorporate sufficient flexibility. On the other hand, to provide significant certainty, the Guidelines must be both administrable and sufficiently constraining.<sup>24</sup> The Guidelines have largely accomplished this difficult balancing act. Absent serious deficiencies in the current Guidelines, revisions should not disrupt established practice.

### **Principle 2: The Guidelines Should Reflect Agency Practice**

As the joint FTC and DOJ 2006 Commentary made clear, current agency practice reflects both the additional experience gained from hundreds of investigations since 1992 and the further development of economic knowledge. Similar developments motivated the Guidelines' revisions in 1982 (incorporating a substantial body of new economic learning<sup>25</sup>), in 1992 (incorporating directly the concept of unilateral effects and revising the analysis of entry<sup>26</sup>), and in 1997 (advancing the treatment of efficiency claims<sup>27</sup>). Incorporating the best of the Agencies' recent learning and experience into the Guidelines will help them remain relevant into the next decade.

**A. The Agencies Should Adjust The HHI Thresholds and No Longer Characterize Certain Mergers as "Presumptively Anticompetitive."** Section 1.51 of the Guidelines identifies three concentration levels as "useful indicator[s] of the likely potential competitive effect of a merger." Markets with an HHI below 1000 are regarded as "unconcentrated"; markets with an HHI between 1000 and 1800 are regarded as "moderately concentrated"; and markets with an HHI above 1800 are regarded

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<sup>23</sup> See also J. Thomas Rosch, Commissioner, Fed. Trade Comm'n, Enforcement Priorities in the New Administration 14 (Nov. 17, 2009), available at <http://www.ftc.gov/speeches/rosch/091117enforceprioritiesremarks.pdf> ("The 1992 Guidelines have been successful in large measure due to their acceptance by both agencies and every administration since their adoption. The next version of the Guidelines will need to attain a similar level of consensus to be successful."). The search for consensus does not mean that different decision-makers will or should reach identical decisions in individual cases. There will always be close cases on which no set of guidelines can provide only one answer to a merger's legality. Moreover, decision makers differ about how they value Type I/Type II error, about the quantum of evidence necessary to settle an investigation short of litigation, and about the level of risk they should bear when challenging a merger in federal court.

<sup>24</sup> See AMC REPORT, *supra* note 8, at 29:

[S]ubstantive standards of antitrust law . . . should meet several criteria. The rules of antitrust must be economically sound and flexible enough to accommodate new economic learning and changes in the nature of competition. The rules also should be clear, predictable, and administrable, so that businesses can comply with them and courts can administer them. . . . As antitrust law has more fully incorporated economic learning into the substantive rules of antitrust, the courts and the antitrust agencies have sought to develop revised rules that combine economically sound principles and flexible analysis with clarity, predictability, and administrability.

<sup>25</sup> William F. Baxter, *Responding to the Reaction: The Draftsman's View*, 71 CAL. L. REV. 618 (1983).

<sup>26</sup> Remarks of James Rill, Assistant Att'y Gen'l for Antitrust, Introducing the 1992 Horizontal Merger Guidelines, *reprinted in* 62 Antitrust & Trade Reg. Rep. (BNA) 485 (Apr. 9, 1992).

<sup>27</sup> See Press Release, Fed. Trade Comm'n, FTC/DOJ Announce Revised Guidelines on Efficiencies in Mergers (Apr. 8, 1997), available at <http://www.ftc.gov/opa/1997/04/effpress.shtml>.

as “highly concentrated.”<sup>28</sup> The Guidelines state that mergers in unconcentrated markets are unlikely to have adverse competitive effects; mergers in, or resulting in, moderately concentrated markets may raise competitive concerns; and, mergers in, or resulting in, highly concentrated markets raise competitive concerns, that, depending on the size of the combined firm, are presumed to be anticompetitive.

*We would adjust the Guidelines’ three-tier concentration levels to reflect enforcement practice and the prevailing emphasis on a more direct analysis of likely competitive effects, and we would abandon characterization of markets as unconcentrated, moderately concentrated, or highly concentrated*

There is little support in the economic literature, however, for these tiers as indicators of likely competitive effects,<sup>29</sup> and they are no longer (although they once were<sup>30</sup>) consistent with the agencies’ enforcement efforts.<sup>31</sup> In opening the last day of the Guidelines workshops, Assistant Attorney General Varney indicated that “[r]evising the HHI thresholds to express accurately how the Agencies use HHIs seems not just appropriate but also necessary to correct what has become an affirmative misstatement.”<sup>32</sup>

We would adjust the Guidelines’ three-tier concentration levels to reflect enforcement practice and the prevailing emphasis on a more direct analysis of likely competitive effects, and we would abandon characterization of markets as unconcentrated, moderately concentrated, or highly concentrated, as reliance on the characterization can substitute for analysis. The proposed adjustments would still provide substantial guidance as highly useful screens. Based on our review of the FTC and DOJ merger challenge data, and a review of all merger complaints issued since the 1992 Guidelines,<sup>33</sup> we would adjust the tiers as follows:

<sup>28</sup> Guidelines, *supra* note 1, § 1.51.

<sup>29</sup> See Paul Pautler, *Evidence on Mergers and Acquisitions*, 48 ANTITRUST BULL. 119 (2003) (citing relevant studies); Richard Schmalensee, *Inter-Industry Studies of Structure and Performance*, in 2 RICHARD SCHMALENSEE & ROBERT D. WILLIG, HANDBOOK OF INDUSTRIAL ORGANIZATION (1989) (citing relevant studies); see also JOHN SUTTON, TECHNOLOGY AND MARKET STRUCTURE 486 (1998) (“Competition policy commonly pursues the aim of reducing or limiting the level of concentration to achieve some gain in welfare. . . . [T]he overriding conclusion for policy analysis is that the answers to most of the questions we ask may turn upon the details of the particular market involved.”); Transcript of Department of Justice and Federal Trade Commission Merger Workshop 133 (Feb. 19, 2004), available at <http://www.ftc.gov/bc/mergerenforce/040219ftctrans.pdf> (Dennis Carlton: “[T]here are some industries in which competition is naturally vigorous, all else equal. They’re just naturally more competitive for whatever reason. In game theory terms, they’re playing a more competitive game. In those industries, there is an inverse relationship between, or can be, between concentration and price. It completely reverses our usual notions of price and concentration. The more concentrated the industry, the lower the price.”)

<sup>30</sup> See Timothy J. Muris, Chairman, Fed. Trade Comm’n, *How History Informs Practice—Understanding the Development of Modern U.S. Competition Policy* 18–19 (Nov. 19, 2003) (recounting the history of merger enforcement in the Reagan Administration), available at <http://www.ftc.gov/speeches/muris/murisfallaba.pdf>; David Scheffman et al., *20 Years of Merger Guidelines Enforcement at the FTC: An Economic Perspective* 16–17 (June 2002), available at <http://www.ftc.gov/be/hilites/ftc20thanniversarypaper.pdf>.

<sup>31</sup> The FTC’s investigative and enforcement data from 1996 to 2007—covering Administrations of both political parties—show that the antitrust agencies do not find the current thresholds to predict accurately which mergers are likely to be anticompetitive. From 1996 through 2007, setting aside certain mergers among petroleum firms, the FTC did not challenge *any* mergers, or seek relief in *any* markets, when, post-merger, the market concentration level was below 2000. (We remove the FTC’s enforcements in petroleum markets for the reason discussed in note 34.) The FTC data also show that the agency did not, on a consistent or preponderant basis, allege that anticompetitive effects were likely to occur in a variety of markets with post-merger concentration levels as high as 2399 (except for mergers involving petroleum firms). See FED. TRADE COMM’N, HORIZONTAL MERGER INVESTIGATION DATA, FISCAL YEARS 1996–2007 at 10–15 tbls. 3.1 to 3.6 (Dec. 1, 2008) [hereinafter HORIZONTAL MERGER DATA 1996–2007], available at <http://www.ftc.gov/os/2008/12/081201hsrmergerdata.pdf>. We encourage the Commission to continue to release updated data every few years; the Department of Justice should follow suit. For a more detailed discussion of the FTC data release, and a discussion of the DOJ’s data release, see Comment, *supra* note 4, at 7–9.

<sup>32</sup> Christine A. Varney, Assistant Att’y Gen., Antitrust Div., U.S. Dept. of Justice, *An Update on the Review of the Horizontal Merger Guidelines* 8 (Jan. 26, 2010), available at <http://www.justice.gov/atr/public/speeches/254577.pdf>.

<sup>33</sup> See Comment, *supra* note 4, at 7–9.

- (i) Mergers resulting in markets with a post-merger HHI below 1800 are unlikely to raise competitive concerns;<sup>34</sup>
- (ii) Mergers resulting in markets with a post-merger HHI of 1800 to 2399 are unlikely to have adverse competitive effects when the merger increases the HHI by less than 300. Mergers in this tier that increase the HHI by 300 or more are likely to require detailed investigation into their likely competitive effects; and,
- (iii) Mergers resulting in markets with a post-merger HHI of 2400 or greater are unlikely to have adverse competitive effects when the merger increases the HHI by less than 150. Mergers in this tier that increase the HHI by 150 or more are likely to require detailed investigation into their likely competitive effects.

We note that our suggestions are based on the lowest level of the ranges for which enforcement data has been released and that they generally represent a lower bound on the HHI levels the agencies have found to trigger a concern.<sup>35</sup> Of course, “cases falling just above and just below a threshold present comparable competitive issues”<sup>36</sup> and should not be precluded from (or subject to) a more detailed investigation simply because they are slightly lower (or higher) than the recommended tiers.

**B. The Guidelines Should Recognize Fixed-Cost Efficiencies as Cognizable.** The Commentary makes it clear that the Agencies accept fixed-cost savings under certain circumstances.<sup>37</sup> Indeed, the Commentary notes that “under certain market or sales circumstances, fixed-cost savings

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<sup>34</sup> This number—a substantial jump from the existing “safe harbor” of 1000—is appropriate even though the Agencies have, in the seventeen years since the release of the 1992 Guidelines, occasionally sought relief in markets with a post-merger concentration level below 1800. The data released by the FTC (*see supra* note 31), and the DOJ (*see* FED. TRADE COMM’N & DEP’T OF JUSTICE, MERGER CHALLENGES DATA, FY 1999–2003 (Dec. 18, 2003), *available at* <http://www.ftc.gov/os/2003/12/mdp.pdf>), as well as a review of FTC and DOJ complaints for the fiscal years 1992–2009 (representing the tail end of the Bush I Administration, the first year of the Obama Administration, and the complete terms of the Clinton and Bush II Administrations), show very clearly that the Agencies rarely challenge transactions in “moderately concentrated” markets. Agency challenges to mergers in moderately concentrated markets have largely been limited to transactions combining the wholesale and retail gasoline marketing assets (and related terminal assets) of large petroleum firms. These challenges derive from the FTC’s practice in large petroleum firm mergers (e.g., British Petroleum Company p.l.c. and Amoco Corporation, Exxon Corporation and Mobil Corporation) to seek relief at lower concentration levels (as low as 1400) as an alternative to a comprehensive, but substantially longer, investigation. *See* FED. TRADE COMM’N, BUREAU OF ECONOMICS, THE PETROLEUM INDUSTRY: MERGERS, STRUCTURAL CHANGE, AND ANTITRUST ENFORCEMENT 27–29 (Aug. 2004) [hereinafter PETROLEUM INDUSTRY REPORT], *available at* <http://www.ftc.gov/os/2004/08/040813mergersinpetrolberpt.pdf>. This practice is an accommodation to the realities of a modern merger investigation—in particular the time and expense—and the merging parties’ interest in consummating their transaction in a reasonable time. *Id.* at 27–28. When the parties desire to consummate their acquisition prior to, or without, a detailed investigation, it is proper that they bear the risk of over-enforcement. *Id.*

There is little basis for distinguishing wholesale and retail gasoline markets from the many other markets where price is transparent and products are homogenous. *See* Timothy J. Muris, Chairman, Fed. Trade Comm’n, Statement Concerning FTC Merger Enforcement in the Oil Industry (June 2, 2004), *available at* <http://www.ftc.gov/speeches/muris/040602response.shtm>. Unsurprisingly, for petroleum mergers raising issues in fewer markets, in which an investigation was more manageable, the Commission did not seek relief in markets with a post-merger HHI below 2000. PETROLEUM INDUSTRY REPORT, *supra*, at 28 n.33. The FTC’s data also reveal non-enforcement in many petroleum markets with HHIs above 2000. *See* Table 3.3, HORIZONTAL MERGER DATA, 1996–2007, *supra* note 31 (showing no action taken in 16 petroleum markets where the post-merger HHI ranged from 2000 to 3999, for the period FY 1998 through 2007).

<sup>35</sup> The choice of a 150 delta for mergers in the highest tier represents a midpoint of the published data. The data as published are in ranges and thus do not allow for precise delineation of the appropriate lower and upper bounds. The Agencies should use the more precise, non-public, data to properly adjust the thresholds.

<sup>36</sup> GUIDELINES, *supra* note 1, § 1.50.

<sup>37</sup> COMMENTARY, *supra* note 20, at 58 (the Agencies “consider merger-specific, cognizable reductions in fixed costs, even if they cannot be expected to result in direct, short-term, procompetitive price effects because consumers may benefit from them over the longer term even if not immediately”).

*We believe that the Guidelines should explicitly reject different burdens of proof for procompetitive and anticompetitive effects; this would support consistent treatment within (and across) each agency.*

may result in lower prices in the short term.”<sup>38</sup> A recent study of 186 FTC merger investigations found “staff was as likely to accept fixed-cost savings as they were to accept claims of variable-cost savings.”<sup>39</sup> Additionally, the economic literature and experience suggests that many companies price based on total cost or some other cost measure that includes at least some fixed costs; thus, as fixed costs change for these companies, so will prices.<sup>40</sup>

To reflect the actual practice of the Agencies and the economic literature, the Guidelines should be revised (1) to acknowledge that fixed-cost savings may result in lower prices in the short term; and, (2) to state that the Agencies will consider as cognizable those fixed-cost savings that are likely to provide some benefit to consumers.

**C. The Guidelines Should Confirm that the Evidentiary Burden on the Parties to Demonstrate Efficiencies Is No Greater than the Agencies’ Burden to Show Anticompetitive Effects.** The Guidelines should make clear that the merging parties are not, in supporting their efficiency claims, held to a higher standard of proof than the one to which agency staff is held in showing anticompetitive effects. In our experience, agency leaders do not apply different levels of proof, but some (not all) investigating attorneys appear more skeptical of efficiency claims than they do of potential anticompetitive effect claims.<sup>41</sup> We believe that the Guidelines should explicitly reject different burdens of proof for procompetitive and anticompetitive effects; this would support consistent treatment within (and across) each agency. If agency practice is to apply different burdens, any revisions should justify such an extraordinary position.

### **Principle 3: The Guidelines Should Reflect the Importance of “Actual Evidence” and Merger-Specific Highly Probative Facts**

Although it is clear that agency practice is to rely heavily on case-specific facts, not all facts are created equal. Here we discuss five facts whose presence provides especially reliable information for guiding agency decisions. We also discuss one issue—innovation markets—in which the lack of reliable data about how to analyze mergers is a fact calling for caution in agency action.

**A. The Guidelines Should Recognize that Firm and Industry Experience Are Highly Reliable for Determining the Merged Firm’s Ability to Capture Cost Savings or Other Efficiencies.** In determining whether merging parties are likely to obtain efficiencies, such as successfully implementing cost savings or production enhancing processes, the Agencies should give substantial weight to

<sup>38</sup> *Id.* The Commentary includes two examples of fixed-cost savings passed on to consumers: (i) where contracts are “cost based,” and (ii) where contracts require fixed-cost savings to be passed through to the customer.

<sup>39</sup> Malcom B. Coate & Andrew J. Heimert, *Merger Efficiencies at the Federal Trade Commission 1997–2007* at vi (Feb. 2009), available at <http://www.ftc.gov/os/2009/02/0902mergerefficiencies.pdf>. Efficiency claims were raised and evaluated in 147 of the 186 matters. *Id.* at 6–7.

<sup>40</sup> See, e.g., Comment of David T. Scheffman, Director, Bureau of Economics, Fed. Trade Comm’n, Transcript of Roundtable Sponsored by the Bureau of Economics, Understanding Mergers: Strategy & Planning, Implementation and Outcomes at 228 (Dec. 10, 2002), available at <http://www.ftc.gov/be/rt/xscriptpanel4.pdf> (“[E]conomists have known . . . forever . . . that actual business decisions are often made in part based on average costs rather than incremental costs.”); Remarks of David Painter, Chief Accountant, Federal Trade Commission, *id.* at 232–52; Comment of Gabe Dagen, Assistant Dir., Accounting and Fin. Analysis, Fed. Trade Comm’n, *id.* at 263 (“Having come from industry, I know that fixed costs are involved in pricing decisions.”); and various studies, including Eric W. Noreen & David Burgstahler, *Full-Cost Pricing and the Illusion of Satisficing*, J. MGMT. ACCT. RES. 239, 252 (1997) (“[I]t is common to hear some variation of the assertion that ‘of course, full costing is necessary for long term pricing decisions.’”); Eunsup Shim & Ephraim F. Sudit, *How Manufacturers Price Products*, MGMT. ACCT., Feb. 1995, at 37 (finding that 70 percent of large manufacturing companies set prices by marking up some version of full costs); V. Govindarajan & R.N. Anthony, *How Firms Use Cost Data in Price Decisions*, MGMT. ACCT., July 1983, at 30 (finding that 41 percent of companies responding to the author’s survey based their prices on total costs (production and non-production) and another 41 percent based prices on total production costs (which contain certain elements of fixed cost)).

<sup>41</sup> In litigation, however, the Agencies remain unduly hostile toward efficiency claims.

the past experiences and successes (or failures) of the firm, or similarly situated firms in the same or similar markets. Just as the Agencies rightly dismiss unsubstantiated efficiency claims, they should accept as presumptively valid those claims based on the best evidence possible: the resulting efficiencies, or lack thereof, in recent mergers involving one of the merging companies or others in the relevant industry.<sup>42</sup> Moreover, such evidence may include improvements in product quality, not just reductions in cost.

**B. The Guidelines Should Not Assume a Form of Competition Among Firms, but Conduct a Fact Specific Inquiry of Industry Competitive Dynamics.** Firms compete in different ways, including by bargaining (in auctions), by using promotions and advertising, by setting capacity, and by managing revenue or “yield.”<sup>43</sup> The Guidelines’ framework searches for ways in which market power may be exercised successfully; this analysis depends highly on the particular industry at issue.

Changing the Guidelines to assume a specific form of competition—e.g., that firms compete by simply setting price—would make it more difficult for the Guidelines both to characterize existing competition accurately and to predict any post-merger loss of competition. More than fifteen years of using various models to estimate the price effects of mergers “has led to a greater appreciation of the complexity and variety of competitive processes, and clearer understanding that differing modeling assumptions can amplify or attenuate merger price increases.”<sup>44</sup> While a model can “usefully complement a fact-intensive analysis of consumers, competitors, and the institutional setting of an industry, it cannot substitute for such an analysis.”<sup>45</sup> As the Guidelines move away from reliance on structural presumptions, it is unnecessary and inconsistent to incorporate models that do not reflect real-world competition. Specifying the form that competition takes, independent of the industry particulars, risks serious error: simulation models are highly sensitive to assumptions about costs, efficiencies, and demand variables.<sup>46</sup>

**C. The Guidelines Should Recognize that Merging Firms Have an Incentive to Pass on Marginal Cost-Savings, Regardless of the Number of Remaining Competitors.** The Guidelines should correct the mistaken view that a firm’s incentive to pass on merger-specific efficiencies is positively cor-

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<sup>42</sup> Benefits that arise in non-merger settings may also produce meaningful evidence of successful efficiencies. For example, experience may reveal lower costs from improved production techniques that one of the merging firms uses or increased product quality associated with increases in output.

<sup>43</sup> See, e.g., COMMENTARY, *supra* note 20, at 31–36 (discussing auction and bargaining models); Fed. Trade Comm’n, Statement Concerning Google/DoubleClick, FTC File No. 071-0170, (Dec. 19, 2007) (advertising), available at <http://www.ftc.gov/os/caselist/0710170/071220statement.pdf>; United States v. Exelon, No. 1:06CV01138 (D.D.C. 2006) (Complaint) (bidding of capacity into same-day and day-ahead markets), available at <http://www.justice.gov/atr/cases/f216700/216785.pdf>; Fed. Trade Comm’n, Statement Concerning Royal Caribbean Cruises, Ltd./P&O Princess Cruises plc and Carnival Corp./P&O Princess Cruises plc, FTC File No. 021 0041, (Oct. 4, 2002) (yield management), available at <http://www.ftc.gov/os/2002/10/cruisestatement.htm>.

<sup>44</sup> Gregory J. Werden, Luke M. Froeb & David T. Scheffman, *A Daubert Discipline for Merger Simulation*, ANTITRUST, Summer 2004, at 89, 91.

<sup>45</sup> *Id.*; see also Remarks of Dan Rubinfeld, former Deputy Assistant Att’y Gen., Antitrust Div., U.S. Dep’t of Justice, Transcript of Horizontal Merger Guidelines Review Project 182 (Jan. 14, 2010), available at <http://www.ftc.gov/bc/workshops/hmg/transcripts/100114transcriptstanford.pdf> (“[W]e don’t have very much evidence as to how accurately these models predict. I like to use them not so much as predictors but as sort of ways to evaluate robustness of results.”).

<sup>46</sup> See Werden, *supra* note 44; Remarks of Jeremy Bulow, former Director, Bureau of Economics, Fed. Trade Comm’n, Transcript of Horizontal Merger Guidelines Review Project 73 (Jan. 14, 2010), available at <http://www.ftc.gov/bc/workshops/hmg/transcripts/100114transcriptstanford.pdf> (“When you are trying to model a particular industry or analyze a particular industry, sometimes one kind of model is appropriate or relatively easy to use. Sometimes it’s not.”).

related with the number of post-merger competitors.<sup>47</sup> The economic literature establishes, with little or no disagreement, that merger-specific marginal cost savings will, at least in part, be passed on to consumers whenever the merged entity will face a downward sloping demand curve, as do almost all real-world firms.<sup>48</sup> A recent study of FTC staff treatment of efficiency claims, however, suggests that investigating lawyers frequently express concerns that merger-generated cost reductions may not be passed on to consumers.<sup>49</sup> To avoid error, and to correct the mistaken view that firms only pass-on cost savings because of competitive pressures, the Guidelines should be revised to recognize that marginal-cost savings will lower prices.

***D. The Guidelines Should Reflect The Importance of Customer Views in Agency Determinations of Likelihood of Anticompetitive Effects.*** An important variable in the agencies' decision to challenge a merger is the volume and strength of customer complaints. The merger data that the FTC released in 2004, subsequently updated twice, demonstrate that strong, consistent complaints from customers almost always lead to a government challenge.<sup>50</sup> Although the data do not permit testing the point, our experience is that strong support from sophisticated customers generally does, and should, lead to a merger's approval. Unfortunately, in *Heinz*, *Arch Coal*, and *Oracle*, courts were dismissive of customer opinions.<sup>51</sup>

The Agencies rely substantially on the opinions of customers to implement the Guidelines: customer opinions provide important, perhaps unparalleled, evidence for defining the relevant product and geographic markets by identifying: (a) the firms that participate in those relevant markets and their competitive strengths, and (b) the firms that may be credible entrants. Nevertheless, some judges appear to want customers to do empirical or econometric analysis to understand fully how a merger may affect them.<sup>52</sup> Such judicial criticism can easily be extended to suggest that failure to perform a critical loss analysis of the ability of a hypothetical monopolist test to raise price profitably, or do an analysis of the economic requirements of entry, would render suspect customer testimony on market definition and entry.

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<sup>47</sup> Compare Nat'l Ass'n Of Att'ys Gen., *supra* note 6, at 4 (“[T]o the extent that a merger increases market power, there is less likelihood that any productive efficiencies would be passed on to consumers.”), and Guidelines on the Assessment of Horizontal Mergers Under the Council Regulation on the Control of Concentrations Between Undertakings, *supra* note 5, ¶ 84 (“[T]he incentive on the part of the merged entity to pass efficiency gains on to consumers is often related to the existence of competitive pressure from the remaining firms in the market. . . .”), with Michael Vita & Paul Yde, Merger Efficiencies and Pass-Through Analysis: Comment on Testimony of George Cary to the Antitrust Modernization Commission 1 (Mar. 16, 2005), available at [http://govinfo.library.unt.edu/amc/public\\_studies\\_fr28902/merger\\_pdf/060316\\_Vita\\_Yde.pdf](http://govinfo.library.unt.edu/amc/public_studies_fr28902/merger_pdf/060316_Vita_Yde.pdf) (“[E]nforcement agency standards and legal commentary reflect[] the mistaken view that static competition is what causes a company to “pass on” efficiencies achieved through merger. . . . [T]he extent to which a firm passes on firm-specific marginal cost reductions is determined by the shape of the demand curve it faces, and . . . the pass through rate for such merger efficiencies is directly related to the merged firm’s market power.”).

<sup>48</sup> See, e.g., Luke Froeb et. al., *Pass-Through Rates and the Price Effects of Mergers*, 23 INT’L J. INDUS. ORG. 703 (2005); Paul L. Yde & Michael G. Vita, *Merger Efficiencies: Reconsidering the “Passing-On” Requirement*, 64 ANTITRUST L.J. 735, 736 (1996) (“A reduction in marginal cost invariably increases the firm’s incentive to expand output. And if the firm faces a downward sloping, firm-specific demand curve . . . then the firm also will reduce its price.”).

<sup>49</sup> Coate & Heimert, *supra* note 39, at 27 (“Pass-through issues were much more likely to be a concern to [the Bureau of Competition] than [the Bureau of Economics]”).

<sup>50</sup> HORIZONTAL MERGER DATA 1996–2007, *supra* note 31, at 26, 28 (tbls. 7.1 and 8.1). To be reliable, the evidence must reflect a substantial volume of customer experience and, for similarly situated customers, be largely consistent.

<sup>51</sup> FTC v. H.J. Heinz Co., 116 F. Supp. 2d 190 (D.D.C. 2000) (rejecting strong customer testimony in support of merger), *rev’d on other grounds*, 246 F.3d 708 (D.C. Cir. 2001); United States v. Oracle Corp., 331 F. Supp. 2d 1098 (N.D. Cal. 2004); FTC v. Arch Coal, Inc., 329 F. Supp. 2d 109 (D.D.C. 2004).

<sup>52</sup> *Oracle*, 331 F. Supp. 2d at 1131.

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We believe that the Agencies correctly recognize the importance of opinions from experienced customers; courts should grant similar deference to those opinions, both positive and negative. In assessing customer testimony, the courts (and the Agencies) should acknowledge the policy judgment that underlies the Business Judgment Rule that figures so prominently in corporate law.

The Business Judgment Rule creates a rebuttable presumption that “in making a business decision the directors of a corporation act on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company.”<sup>53</sup> Moreover, it explicitly recognizes the difficulties judges face in distinguishing business judgments that are or are not in the corporation’s or shareholders’ best interests, and the many factors that weigh in business decisions that may be unknown or unclear to the court. The Rule essentially requires judicial abstention from second-guessing corporate decisions based in part on the relative expertise of businesses versus judges and courts. Substantive due care requires directors exercise “care and prudence.”<sup>54</sup> Procedural due care is concerned with process: decisions that are “unintelligent or unadvised” are not entitled to the Rule’s presumption.<sup>55</sup>

The rationale for the Business Judgment Rule applies with equal force to customer testimony on mergers. Once the Agencies or courts have screened customers to ensure their testimony is reasonably informed, offered in good faith, and not prompted by conflicting or anticompetitive incentives, the decision makers should give great weight to customers’ views on a merger’s likely effects. Customers will most directly experience the effects of a merger. Customers’ self-interest, combined with their experience in the industry ensures that their views will provide crucial evidence. We believe most antitrust lawyers—on both sides of the table—agree that “customers remain the most objective marketplace participants . . . the decisions they make in the ordinary course of business frequently provide a better window onto how the market actually functions than an economist’s model or the court’s intuition.”<sup>56</sup>

To encourage greater court (and agency) deference to customer testimony, while increasing transparency and consistency, any Guidelines revisions should include a discussion of how the agencies ensure that customer testimony is informed, in good faith, representative, and not prompted by conflicting or anticompetitive incentives. The Guidelines also should recognize that customer testimony is not credited on only one side of the ledger: customer support for a merger, if well-founded, is as relevant, and entitled to as much weight, as customer concern. Indeed, customers may be able to provide more specificity about the merged firm’s ability to increase competition than about the potential decreased competition from mergers that customers oppose.<sup>57</sup>

<sup>53</sup> *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984).

<sup>54</sup> *Litwin v. Allen*, 25 N.Y.S.2d 667 (N.Y. Sup. 1940); *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 361 (Del. 1993) (A decision by a “loyal and informed board will not be overturned by the courts unless it cannot be attributed to any rational business purpose.”).

<sup>55</sup> *Smith v. Van Gorkom*, 488 A.2d 858, 872 (Del 1985). The Rule’s presumption disappears, and liability inures, only if a court finds a corporation’s directors or officers acted without good faith, loyalty (e.g., acts based on fraud or self-dealing), and due care. *Cede & Co.*, 634 A.2d at 360; see also *Panter v. Marshall Field & Co.*, 646 F.2d 271, 293 (7th Cir. 1981) (“In the absence of fraud, bad faith, gross overreaching or an abuse of discretion, courts will not interfere with the exercise of business judgment by corporate directors.”).

<sup>56</sup> Thomas O. Barnett, Deputy Assistant Att’y Gen., Antitrust Div., U.S. Dept. of Justice, *Antitrust Enforcement Priorities: A Year in Review 14* (Nov. 19, 2004), available at <http://www.justice.gov/atr/public/speeches/206455.pdf>.

<sup>57</sup> We note that our reliance on the expressed view of customers reflects a different, albeit related, policy judgment than the so-called “power buyer” doctrine. A number of courts recognize the ability of large purchasers to discipline markets. See, e.g., *Chicago Bridge & Iron Co. v. FTC*, 534 F.3d 410, 440 (5th Cir. 2008) (“courts have found that the existence of power buyers can be considered in their evaluation of an anti-trust case. . . .”). The Guidelines, *supra* note 1, § 2.2, do recognize that the ability of large purchasers to swing large volumes of purchases to different sellers can undermine the ability of firms to coordinate their output decisions. But, if the Guidelines are revised to include

**E. The Guidelines Should Reflect the Importance of Post-Merger Evidence in Consummated Merger Transactions.** With consummated mergers, the Agencies may be able to use fundamentally different facts than are available in the normal HSR process: evidence of the merger's actual competitive impact. When reliable evidence of that impact is available, it should trump the normal predictive analysis used in the standard HSR process. The relevant analogy is to judicial decisions regarding the superiority of direct evidence of competitive impact in Sherman Act cases.<sup>58</sup>

Of course, post-merger evidence must be reliable. The Agencies need to be confident that the measurements are accurate and merger specific. Obviously, lawyers and economists may disagree regarding the evidence and its correct interpretation, and, as is often the case, decision makers will need to adjudicate the conflicting positions. Moreover, in at least two instances, reliable measurement of the merger's impact will likely be impossible. The first involves transactions for which too little time has passed post-merger to measure the effects. The FTC's challenge to Chicago Bridge's acquisition of certain assets of Pitt-Des Moines provides a good example: lumpy sales and little elapsed time post-merger rendered post-merger evidence of limited probative value.

The second instance when measurement of the merger's impact likely will be unreliable occurs when the merging parties have manipulated the post-acquisition evidence. Here, we would reject the Fifth Circuit's dictum in *Chicago Bridge* to ignore post-merger evidence, that "could arguably" be manipulated.<sup>59</sup> Because the Agencies have access to the merging parties' internal records and deliberations, making a judgment about whether the merging parties likely have manipulated the post-acquisition evidence is no more difficult than the myriad other judgments the Agencies and the courts must make.<sup>60</sup>

**F. Any Discussion of How A Merger Affects Innovation Should Recognize the Lack of Evidence Supporting Structural Presumptions.** Innovation is crucial for an economy's long-term economic growth. The Antitrust Modernization Commission noted the "broad agreement . . . that research and development is a major source of economic growth."<sup>61</sup> The Agencies recognize that "research and development by individual firms, especially basic research, has contributed significantly to increases in their productivity, and at the macro level, technical progress has been

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a power buyer defense, they should recognize explicitly that competitive pressures on a seller can come not only from its competitors but from customers who can credibly threaten to switch to alternative sources of supply by: (i) vertically integrating to the upstream market; (ii) sponsoring entry (including through increased imports), or expansion by committing to do sufficiently large business with a potential entrant; and (iii) refusing to buy other products produced by the merged supplier.

<sup>58</sup> See *FTC v. Indiana Fed'n of Dentists*, 476 U.S. 447, 460–61 (1986) ("[G]enuine adverse effects on competition, proof of actual detrimental effects, such as a reduction of output can obviate the need for an inquiry into market power, which is but a surrogate for detrimental effects.") (internal quotation marks omitted).

<sup>59</sup> *Chicago Bridge*, 534 F.3d at 435.

<sup>60</sup> The view expressed in *Chicago Bridge* also obscures the requirement that, at least in coordinated effects cases, it is not only the merging parties who are refraining from anticompetitive conduct—it is some or all firms operating in the relevant market. Although detailed analysis of the circumstances in which Agencies should even investigate consummated mergers are beyond the scope of this article, we note that such investigations should hardly be the norm for mergers otherwise subject to the HSR process. For investigating consummated mergers, the agencies need compelling factual or policy reasons to deviate from the certainty that the process provides. For mergers that the agencies allowed to proceed only pursuant to a legally enforceable agreement with the parties, violation of that agreement should be the sole basis upon which additional government action against the merger should occur.

<sup>61</sup> AMC REPORT, *supra* note 8, at 59 (citations omitted).

estimated to have accounted for as much as three-quarters of the economic growth in major industrialized countries.”<sup>62</sup>

In practice, innovation concerns play a central role in antitrust enforcement. Former FTC Chairman Majoras observed:

Competition’s role in spurring innovation . . . has secured a central position in antitrust analysis . . . . [Not] so long ago, antitrust largely focused only on static efficiencies. The learning of recent decades, however, has made it clear that a broader lens, reaching issues of innovation and progress over time, is essential. Today, we care enormously about innovation and the competitive forces that drive it.<sup>63</sup>

Given this importance, some argue the Guidelines should be revised to include a discussion of how the Agencies evaluate the competitive effects of a merger on innovation. Although we think the Agencies should provide additional guidance regarding this issue, we do not think the current state of knowledge and experience with innovation markets supports their inclusion in the Guidelines. In practice, the Agencies’ experience with innovation markets is quite limited and largely derived from investigations of mergers in the pharmaceutical industry, which has regulatory features that make identifying market participants, and determining likelihood of competitive effects, relatively tractable.

A firm facing aggressive competition in existing product markets has an incentive to develop new products to defend its position. As mergers remove product rivals, this incentive may be dulled, and a concern about cannibalizing sales of existing products may grow. Yet, firms with many rivals may be unable to recoup sufficient returns to make investments worthwhile. Similarly, a business competing with one or more firms to be the first to patent a new technology or drug has an incentive to move quickly lest it lose the race. An acquisition of a rival “runner” may slow or increase its pace. The increased certainty that a merged firm will obtain a monopoly patent may cause the firm to devote more resources to obtaining a patent or technological breakthrough, thereby increasing incrementally the probability of achieving a breakthrough. Moreover, a merger of two previously competing firms may combine complementary assets (including intellectual property), increasing the chances of success and decreasing the time required to achieve that success. But the dynamics of the integration and the loss of a competitor also may slow the pace of innovations. These determinations remain intensely fact specific.

Thus, if the Guidelines include a section on innovation, they should recognize that the competition-innovation link is neither settled nor supportive of a causal relationship between the number of firms and amount of (successful) innovation.<sup>64</sup> Any guidance should make clear that the examination of a merger’s effect on innovation is “presumption” free. Theoretical and empirical work in economics has not found a conclusive relationship between concentration levels and the pace or

*[W]e do not think the current state of knowledge and experience with innovation markets supports their inclusion in the Guidelines.*

<sup>62</sup> ORGANIZATION FOR ECONOMIC COOPERATION AND DEVELOPMENT, DYNAMIC EFFICIENCIES IN MERGER ANALYSIS 248 (2007), available at <http://www.oecd.org/dataoecd/53/22/40623561.pdf>.

<sup>63</sup> Deborah Platt Majoras, Chairman, Fed. Trade Comm’n, Competition Policy, Patent Law, and Innovation: Welcoming Remarks for the Patent Reform Conference 3 (June 9, 2005), available at <http://www.ftc.gov/speeches/majoras/050609comppolicy.pdf>. See also Robert Kramer, Chief, Litigation II Section, Antitrust Div., U.S. Dep’t of Justice, Antitrust Considerations in International Defense Mergers 3 (May 4, 1999) (“As important as price competition is to us, a second major and possibly even greater concern is maintaining competition for innovation.”).

<sup>64</sup> Thus, we have included innovation markets in the section of our comment about agency reliance on “actual” evidence. Here the evidence is the *lack* of reliable data on how to address the underlying issues.

amount of innovation.<sup>65</sup> In accord with agency practice and the economic literature, any revised Guidelines should make clear that innovation inquiries must be even more factually intensive than product market investigations, and subject to case-by-case analysis.<sup>66</sup>

## Conclusion

The 1982 Horizontal Merger Guidelines represent one of the most useful and important steps in antitrust's long history. Because previous changes to the Guidelines adhered to the three principles for revision we have discussed, the Guidelines continue to be pivotal in merger analysis for both the agencies and the courts. Attention to these three key principles for revision will help ensure the Guidelines continued utility. We also encourage the Agencies to continue their recent history of transparency and consultation by releasing the Guidelines in draft form, for public comment. ●

<sup>65</sup> See, e.g., Michael Katz & Howard Shelanski, *Mergers and Innovation*, 74 ANTITRUST L.J. 1, 12–31 (2007); Richard Gilbert, *Looking for Mr. Schumpeter: Where Are We in the Competition-Innovation Debate?* in 6 INNOVATION POLICY AND THE ECONOMY 159 (Adam B. Jaffe ed., 2006); Timothy J. Muris, Chairman, Fed. Trade Comm'n, Statement In the Matter of Genzyme Corporation/Novazyme Pharmaceuticals, Inc. 2–3 (Jan. 13, 2004), available at <http://www2.ftc.gov/os/2004/01/murisgenzymestmt.pdf> [hereinafter Muris Genzyme Statement] (discussing the economic learning in the FTC's 1996 Report, ANTICIPATING THE 21ST CENTURY: COMPETITION POLICY IN THE NEW HIGH-TECH GLOBAL MARKETPLACE). The Muris Genzyme Statement observes that “the Commission properly has been cautious in using innovation market analysis” and that the 1996 Report “acknowledged that ‘economic theory and empirical investigations have not established a general causal relationship between innovation and competition.’” Muris Genzyme Statement, *supra*, at 2–3. Consequently, the 1996 Report suggested that a “careful, intense factual investigation is necessary” to “distinguish between procompetitive and anticompetitive combinations of innovation efforts.” *Id.* at 3–5. (In Genzyme/Novazyme, the FTC's investigation focused on whether the combination of the only two firms known to be pursuing a treatment for Pompe disease would slow the introduction of a first- or second-generation treatment or increase the likelihood (and speed) of bringing a treatment to market. We note that Genzyme has successfully brought a product to market; on April 28, 2006, the Food and Drug Administration approved the use of Myozyme in the treatment of Pompe disease. Myozyme was also granted Orphan Drug status; the Orphan Drug Act provides a seven-year period of exclusive marketing to the first sponsor who obtains marketing approval for a designated orphan drug. See Press Release, Food and Drug Administration, FDA Approves First Treatment for Pompe Disease (Apr. 28, 2006), available at <http://www.fda.gov/NewsEvents/Newsroom/PressAnnouncements/2006/ucm108645.htm>).

FTC Commissioner Tom Rosch has also recognized that “there is not yet a universally accepted consensus as to the kind of market structure that best facilitates innovation.” J. Thomas Rosch, Commissioner, Fed. Trade Comm'n, Antitrust Regulation of Innovation Markets, Remarks before the ABA Antitrust Intellectual Property Conference 10 (Feb. 5, 2009), available at <http://www.ftc.gov/speeches/rosch/090205innovationspeech.pdf>. See also Remarks of Professor David Teece, Transcript of the Horizontal Merger Guidelines Review Project 234–35 (Jan. 14, 2010), available at <http://www.ftc.gov/bc/workshops/hmg/transcripts/100114transcriptstanford.pdf> (“The evidence . . . that links concentration to innovation, notwithstanding the frequent reference to it, is weak. . . . Market concentration is only one of many, many factors that affects the rate and direction of innovation at the enterprise level.”).

<sup>66</sup> In their important article, *Mergers and Innovation*, *supra* note 65, Katz and Shelanski recognize the weakness of structural presumptions, retaining a presumption only in “mergers to monopoly.” We disagree that a presumption is appropriate even in this context. In product markets, mergers to monopoly are almost never justified. In innovation markets, the evidence does not support such an overwhelming conclusion. See references cited *supra* note 65. The FTC's 1996 Report noted that while “there are a number of theoretical models that suggest when a monopolist may have a disincentive to invest in research and development[,] [a]ntitrust enforcers can examine whether the facts of a specific matter are generally consistent with a particular theoretical description.” 1 FED. TRADE COMMN, STAFF REPORT, ANTICIPATING THE 21ST CENTURY: COMPETITION POLICY IN THE NEW HIGH-TECH GLOBAL MARKETPLACE ch. 7, at 19 (1996), available at [http://www.ftc.gov/opp/global/report/gc\\_v1.pdf](http://www.ftc.gov/opp/global/report/gc_v1.pdf). See also COUNCIL OF ECONOMIC ADVISERS, ECONOMIC REPORT OF THE PRESIDENT 176 (1999):

To the extent there is consensus, it is that neither the presence of many competitors nor pure monopoly correlates systematically with optimal levels of innovation. But even in such polar cases, predictions about R&D activity are hard to make. The determination requires looking at the facts in each case, because market factors other than concentration, as well as a firm's regulatory status and the nature of its products and technologies, also affect innovation.

Katz and Shelanski appear to recognize these concerns, and suggest that the effect of their presumption in mergers-to-monopoly should be relatively insignificant, by approving of the intensive factual investigation the Commission undertook in the Genzyme/Novazyme matter—characterized as a merger to monopoly—and by disapproving of the strong presumption favored by Commissioners Thompson and Harbour. Katz & Shelanski, *Mergers and Innovation*, *supra* note 65, at 85.

# Unilateral Effects for Differentiated Products: Theory, Assumptions, and Research

**David Scheffman and Joseph Simons**

One focus of the potential revision of the Department of Justice and Federal Trade Commission Horizontal Merger Guidelines is unilateral effects analysis in markets with differentiated products.<sup>1</sup> Unilateral effects analysis was first introduced to the Guidelines in the 1992 revisions. The reliability of the predictions of post-merger prices arising from the economic models underlying that unilateral effects analysis, however, has been the subject of substantial controversy. Specifically, it has long been well known that these models<sup>2</sup> predict that *any* merger between sellers of competing differentiated products will lead to a price increase absent offsetting efficiencies.<sup>3</sup>

There has been considerable discussion, including recently, of what role these underlying economic models should have, including potentially superseding market definition and providing a presumption of anticompetitive effects.<sup>4</sup> In our view, reliance on these models for either purpose is not justified. We will explain in this article that the theoretical economic models underlying the Guidelines unilateral effects analysis for differentiated products make a subtle, but strong and critical mathematical assumption that is not likely to be satisfied in real world situations. Without this

<sup>1</sup> U.S. Dep't of Justice & Fed. Trade Comm'n Horizontal Merger Guidelines § 2.211 (1992, rev. 1997), available at <http://www.justice.gov/atr/public/guidelines/hmg.htm#22>.

<sup>2</sup> One uncontroversial assumption in the models is that (incremental) price-cost margins are positive.

<sup>3</sup> In order to avoid this extreme outcome with respect to differentiated products, the 1992 Guidelines included language suggesting that either a substantial percentage of consumers view the merging parties as their first or second choices or that the two firms have at least a 35 percent share in a properly defined relevant market in order to establish the likelihood of a unilateral effects concern. See Guidelines, *supra* note 1, § 2.211. Nevertheless, the federal antitrust enforcement authorities still bore the burden of demonstrating that the merger eliminated sufficient constraints from the merging parties to allow them to profitably increase price.

<sup>4</sup> See, e.g., Fed. Trade Comm'n & U.S. Dep't of Justice, Horizontal Merger Guidelines: Questions for Public Comment, Question 10 (Sept. 22, 2009), available at <http://www.ftc.gov/bc/workshops/hmg/hmg-questions.pdf>. Also, Assistant Attorney General Christine Varney stated in a recent speech:

[T]he Agencies, courts, merging parties, and commentators have all struggled with assessing unilateral effects in markets with differentiated products. This important concept was first introduced into the Guidelines in 1992. Since then, the Agencies and private practitioners have gained extensive experience in analyzing unilateral effects, and a large body of academic and economic learning has grown around the treatment of unilateral effects. This appears to be an area where practice has evolved and where revisions to the Guidelines could be very helpful.

Christine Varney, Assistant Att'y Gen., Antitrust Div., U.S. Dep't of Justice, Speech at the Third Annual Georgetown Law Global Antitrust Enforcement Symposium (Sept. 22, 2009), available at <http://www.justice.gov/atr/public/speeches/250238.htm>. A relatively recent prominent and widely discussed paper by Joseph Farrell and Carl Shapiro advocates a modified version of the typical model. Joseph Farrell & Carl Shapiro, *Antitrust Evaluation of Horizontal Mergers: An Economic Alternative to Market Definition*, B.E. J. THEORETICAL ECON.: POLICIES AND PERSPECTIVES, Vol. 10, Issue 1 (2010), <http://www.bepress.com/bejte/vol10/iss1/art9>. See also Serge Moresi, *The Use of Upward Price Pressure Indices in Merger Analysis*, ANTITRUST SOURCE, Feb. 2010, at 1–12, <http://www.abanet.org/antitrust/antitrust-source/10/02/Feb10-Moresi2-25f.pdf>; Steven C. Salop & Serge Moresi, *Updating the Merger Guidelines: Comments* (2009), available at <http://www.ftc.gov/os/comments/horizontalmergerguides/545095-00032.pdf>. These models make the same mathematical assumption that we explain is not likely to be satisfied in real world situations.

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assumption, the prediction of price increases based on margins and diversion ratios or simulations, as suggested by these models, is not justified.<sup>5</sup>

This critical mathematical assumption requires that the relevant demand, cost, and competitor response relationships be very “smooth,” that is, they must be differentiable. This will be explained further below. The models make this assumption, not on a factual basis, but rather for technical convenience as it allows the mathematical modeling to be based on the use of calculus. In fact, as discussed below, there is considerable published research indicating that this mathematical assumption is not likely to be factually justified.

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*Guidelines unilateral*

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### **Intuition Underlying Unilateral Effects Analysis**

In order to explain the critical role of the technical mathematical assumption of differentiability and its implications, it is first necessary to briefly discuss the basic intuition underlying the unilateral effects analysis.

Suppose that pre-merger, there are two products, X, which is produced by Firm X, and Y, which is produced by Firm Y. Suppose further that X and Y are differentiated.<sup>6</sup> In the differentiated products models at issue here, Y is a substitute for X in the sense that an increase in the price of X leads to an increase in the units sold of Y, holding all else equal. These assumptions, alone, do not *require* that the demands for X and Y have any specific additional mathematical properties. They require only that, for any price of X above the current price, other things held constant, the number of units sold of Y are higher. In the usual terminology, sales are *diverted* from X to Y when the price of X is increased from the current level.

Suppose now that the sellers of X and Y merge. An increase in the price of X for the merged company is more profitable than it is for the company that sold only X because the merged company obtains additional profits from the increased sales of Y that result when consumers switch from product X to product Y. This result does not depend on any specific economic modeling. It requires only the assumption that Y is a substitute for X.

The assumption that an increase in the price of X increases sales of Y implies that a merger of the sellers of X and Y *may* make it profitable for the merged firm to raise the price of X.<sup>7</sup> However, constraints on the price of X posed by substitutes other than Y may nonetheless make price increases of X, *on net*, unprofitable. The fact that Y is a substitute for X does not, without much more, tell us whether Y uniquely constrains the price of X.

Consider the following example: Some purchasers of product X consider product Y to be their only substitute for X. However, other purchasers of X consider products A, B, C, and D to be substitutes for X. Competition from A, B, C, and D could prevent a merger of the sellers of X and Y from increasing profitably the price of X post merger. Suppose that a significant number of very price sensitive consumers would shift to C if the price of X increased. If the sales that are diverted to C are large enough, it would not be profitable for the merged firm to increase the price of X,

<sup>5</sup> For a summary of the analyses based on diversion ratios, see, for example, Carl Shapiro, Dep. Assistant Att’y Gen., U.S. Dep’t of Justice, Mergers with Differentiated Products, Speech Before the ABA and IBA (Nov. 9, 1995), available at <http://www.justice.gov/atr/public/speeches/shapiro.spc.htm>.

<sup>6</sup> Examples of differentiated products include breakfast cereals and beer.

<sup>7</sup> The merged firm may instead find it profitable to raise the price of Y (or raise the price of both products).

even with the increased profits derived from the diversion of sales from X to Y.<sup>8</sup> All of the basic economic models of unilateral effects for differentiated product mergers, including “differentiated Bertrand,”<sup>9</sup> various simulation models,<sup>10</sup> or the recent “Upward Pricing Pressure” (UPP) model of Farrell and Shapiro,<sup>11</sup> rule out the preceding example only because these models make the critical *mathematical* assumption of differentiability.

As discussed below, there is a substantial body of research that indicates that this technical mathematical assumption is likely to be inconsistent with real world markets. We stress here that it is not just that there can be situations in which the “standard” unilateral effects models may not be valid; rather it is the case generally that the “standard” unilateral effects models are not likely to be valid. This does not mean that a whole new analysis is required in order to consider the potential for unilateral effects arising from mergers of differentiated products. Rather, as with mergers involving products that are not assumed to fit into the differentiated products models, the analysis must focus on what constrains the prices of the parties to the proposed merger. Diversions and margins are only one part of the analysis, and thus, it is not appropriate that they provide a basis for a presumption of anticompetitive effects.<sup>12</sup>

### The Lerner Equation and Its Implications

The mathematical assumption of differentiability leads to what is known as the “Lerner Equation,” which, as will be explained below, underlies the prediction that any merger between two substitute products will lead to a price increase. For a single-product firm, the Lerner Equation says: A firm’s profit-maximizing mark-up (price minus marginal cost divided by price) is equal to (minus) one divided by the price elasticity of demand for the firm’s product.<sup>13</sup>

Thus, the Lerner Equation states an exact relationship between the profit-maximizing price-cost margin and the own-price elasticity of demand for a firm’s product. If the Lerner Equation is satisfied, then the own-price elasticity of demand can be inferred from information on price and marginal cost. Specifically, you know, at least for small price increases, approximately how much unit sales of X will change after an increase in the profit-maximizing price of X.

That demand elasticity facing a given company’s product can be found simply from price-cost margins any time products are differentiated is, empirically, a “curious” result. Cost comes entirely from the producer side. Demand elasticity comes entirely from the consumer side.<sup>14</sup> But according to the Lerner Equation, you can determine demand elasticity from cost and price, i.e., without

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<sup>8</sup> A potentially important source of competition in consumer differentiated products is private label “versions” of the leading brands. There may be many consumers who consider a specific major brand and its private label “version” good substitutes for one another. For example, one significant constraint on Kellogg’s Corn Flakes may be private label corn flakes.

<sup>9</sup> See, e.g., ROBERT L. PINDYCK & DANIEL S. RUBINFELD, *MICROECONOMICS* 438–41 (2009); JEFFREY PERLOFF, *MICROECONOMICS* 462–64 (2008); Gregory J. Werden, *Unilateral Competitive Effects of Horizontal Mergers I: Basic Concepts and Models*, in 2 ABA SECTION OF ANTITRUST LAW, *ISSUES IN COMPETITION LAW AND POLICY* ch. 55, at 1319 (2008).

<sup>10</sup> See, e.g., Gregory J. Werden, *Simulating the Effects of Differentiated Products Mergers: A Practical Alternative to Structural Merger Policy*, 5 *GEO. MASON L. REV.* 363 (1997).

<sup>11</sup> See, e.g., Farrell & Shapiro, *supra* note 4.

<sup>12</sup> The same is true of the “UPP” analysis discussed by Farrell & Shapiro, *id.*, which depends on the Lerner Equation for its results.

<sup>13</sup> Mathematically:  $(p_X^* - c)/p_X^* = -1/\epsilon^*$ , where  $c$  is the marginal cost of X and  $\epsilon^*$  is the own-price elasticity of demand for X at the profit-maximizing price ( $p_X^*$ ) of X. This condition comes directly from profit maximization *assuming differentiability*, i.e., that the derivative of X’s profits with respect to the price of X is zero at the profit-maximizing price.

<sup>14</sup> As will be discussed below, “residual” demand reflects the reaction functions for substitute products.

knowing anything about demand, characteristics of the product, etc. This curious relationship set forth by the Lerner Index was questioned by the judge in the FTC's preliminary injunction litigation of the *Swedish Match* matter:

Moreover, Dr. Simpson's [one of the FTC's economic experts] use of the Lerner Index in this case is at least questionable. The FTC's own expert, Dr. Orley Ashenfelter, testified at the hearing that if price and quantity data are available, as they are here, he normally would use econometrics, not the Lerner Index, to estimate demand elasticity.<sup>15</sup>

In all the relevant economic models of unilateral effects, satisfying the Lerner Equation leads to the conclusion that a merger between two competing differentiated products, X and Y, always leads to a price increase absent offsetting efficiencies. The basic intuition is this: as discussed above, in order for a post-merger increase in the profit-maximizing price to be profitable, the increased profits on Y caused by diversion from X to Y must outweigh the reduced profits on X. If the Lerner condition is satisfied at the pre-acquisition profit-maximizing price, then, for a very small increase in the price of X, the change in profits on X is close to zero, but the change in profits on Y is positive, so, on net, the profits of X increase for at least small increases in the price of X. The proof of this requires the use of calculus, which requires the assumption of differentiability.

### **The Lerner Equation Requires Differentiability**

Differentiability, as it relates to the Lerner Index, requires three components. First, the own-price elasticity of demand for X must exist (i.e., have a specific value). Second, the own-price elasticity of demand for X must be about the same for small price increases as for equally small price decreases. Third, the elasticity of the incremental cost curve must be about the same for small output increases as for equally small output decreases.<sup>16</sup>

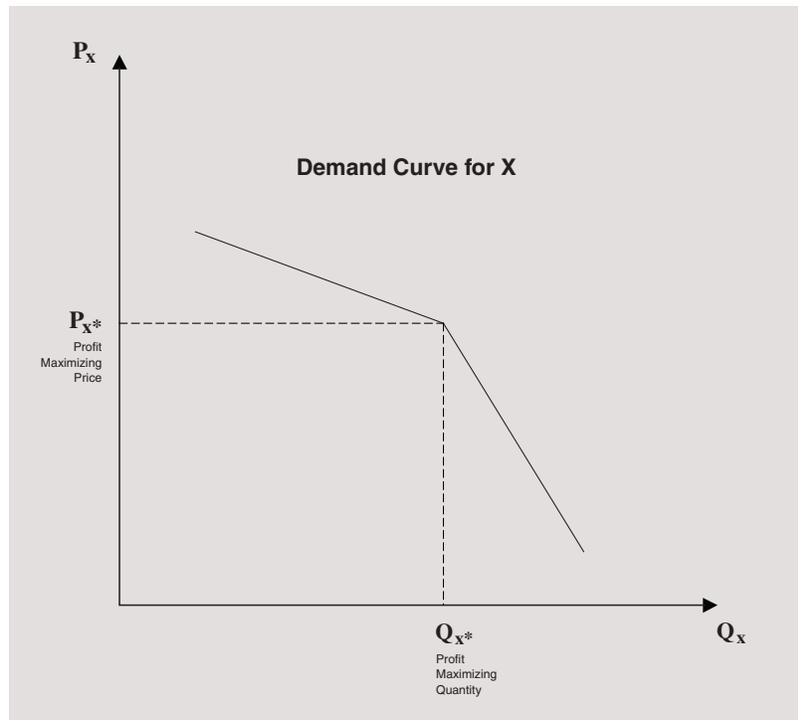
The second condition is the basis of a common criticism of "Critical Loss Analysis," i.e., that estimates of demand elasticities that are larger than that required for a given price increase to be profitable cannot be correct. The basis of the argument is that the demand elasticity is about the same for price increases as for price decreases—i.e., the basis of the argument is an assumption that arises from the assumption of differentiability. Thus, this critique is only valid if the Lerner Equation holds, and specifically, the second condition, at current prices, and in the case of market definition, over the range of output reduction necessary to bring about the small but significant and transitory increase in price called for by the market definition algorithm of the Guidelines.

For a number of reasons, demand functions for differentiated products are not likely to be differentiable. One situation in which the Lerner Equation will not hold is if the relevant own-price elasticity of demand is significantly larger for price increases than for price decreases. Consider the following diagram of a hypothetical demand curve facing X before an acquisition of Y.

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<sup>15</sup> *FTC v. Swedish Match*, 131 F. Supp. 2d 151, 161 (D.D.C. 2000).

<sup>16</sup> Technically, the second and third requirements are that the demand curve and the incremental cost curves are differentiable.



As shown in the figure, there is a kink in the demand curve at the profit-maximizing price  $P_X^*$ . Notice that the demand curve is significantly flatter (more elastic) for price increases away from the profit-maximizing price than for price decreases. That is, price increases result in a substantially larger decrease in unit sales compared to the increase in unit sales associated with price decreases. One reason for such a kink to exist is that purchasers, in aggregate, react more strongly to price increases than to price decreases from the existing price  $P_X^*$ .<sup>17</sup>

With such a demand curve, the Lerner Equation no longer holds at the profit-maximizing price. In this situation, Y may no longer be a unique constraint on the price of X and whether or not the merger of X and Y will lead to an increase in the price of X is fact specific. Specifically, the benefit from the diversion of sales from X to Y would still exist, but the loss in sales of X due to diversion to other products may be too large to make a post-merger price increase profitable.

Differentiability is a very strong assumption to impose on actual real world relationships and may not be satisfied for a number of reasons other than kinked consumer demand. For example, the demand curve facing firm X depends on the actions of X's competitors, who are likely to react to changes in X's prices. Thus, the relevant demand curve depends not only consumer reactions, but the reactions of competing producers as well. This is discussed further below. In addition, supply curves for competitors may have kinks or steps resulting from the need to overcome transportation costs to the geographic area in question. As the price of X rises over a range, it may be the case that transport costs from more and more distant locations are increasingly exceeded by the price increase on X, making additional amounts of capacity competitive where X is sold. There is no a priori reason to think that the relationship between increases in the price of X and supply from distant locations should be smooth. Finally, the marginal cost curve of the firm may not be differentiable.

<sup>17</sup> As explained below, another reason for a kink can be that substitute products respond differently to an increase in the price of X than to a decrease in the price of X.

Below we discuss a body of marketing and economics research, both theoretical and empirical, which indicates that there is likely to be a kink at the pre-merger profit-maximizing price because purchasers are likely to react differently to price increases compared to price decreases.

### **Marketing Research Indicates the Likelihood of Kinked Demand**

Marketing research indicates that it is likely that purchasers respond differently to price increases than to price decreases. The intuition is straightforward: Purchasers view a price increase as a loss while viewing price decreases as a gain. There is substantial research indicating that purchasers respond asymmetrically to losses and gains.

One body of marketing research is devoted to the hypothesis that purchasers use “reference prices,” typically incorporating information about past prices into current purchase decisions. As explained in a survey article:

The concept of a reference price is that it is an internal standard against which observed prices are compared . . . . The purpose of this paper is to argue that there is now sufficient empirical evidence from the marketing literature to strongly support the reference price concept . . . .

Reference price is also a uniquely marketing “spin” on the traditional economics view of price. The classical microeconomic agent makes purchase decisions based on actual prices and income. The concept of a reference price asserts that consumers make decisions based on both actual and perceived prices. Incorporating both concepts into the classical microeconomic model changes the results in some interesting ways, such as producing kinked demand curves . . . .<sup>18</sup>

This paper concludes that “[c]onsumers react differently to price increases and price decreases relative to the reference price. Consumers react more strongly to price increases than to price decreases.”<sup>19</sup>

In the context of merger analysis, pre-merger prices (and historical relationships of prices) for the products involved in the merger and for substitute products may be reference prices for consumers. Specifically, a merger that leads to, say, an increase in the price of X (relative to historic levels) and that increases the historic differentials with prices of substitute products will be a deviation from the references that purchasers are likely to rely upon. In that case marketing research tells us that a post-merger price increase is likely to lead to a much larger response by purchasers than would a price reduction of the same amount, and hence the relevant demand curves may be kinked.

### **Economics Research Indicates the Likelihood of Kinked Demand**

Economics research also provides support for asymmetric responses by purchasers. For example, a paper by two leading economists in the area of behavioral economics finds that

asymmetric evaluations of gains and losses will affect the responses of both buyers and sellers to changes of price or profit, relative to the reference levels established in prior transactions . . . . The

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<sup>18</sup> Gurumurthy Kalyanaram & Russell S. Winer, *Empirical Generalizations from Reference Price and Asymmetric Price Response Research*, 14 Mktg. Sci. No. 3 (Part 2 of 2), 161–62 (1995) (emphasis added). This article cites and discusses a number of papers with similar conclusions. See also Daniel S. Putler, *Incorporating Reference Price Effects into a Theory of Consumer Choice*, 11 Mktg. Sci. No. 3, 287 (1992).

<sup>19</sup> *Id.* at 165 (emphasis added).

response to changes is expected to be more intense when the changes are unfavorable (losses) than when they are for the better.<sup>20</sup>

As explained in an empirical econometrics paper:

Asymmetric demand responses to price changes are not one of the observable implications of classical demand theory; however, they are not precluded by one notable alternative to classic demand theory, namely prospect theory. The basic premise of prospect theory is that a consumer's utility from a particular commodity bundle depends on a reference bundle. When consumers evaluate commodity bundles below the reference bundle, they suffer a loss. On the other hand, when they evaluate commodity bundles above the reference bundle, they enjoy a gain. The key insight for our purposes is that differences in the absolute value of the assessed gains and losses can cause asymmetric demand responses.<sup>21</sup>

The paper estimates demand elasticities with data for local telephone calls and finds that customers react more quickly and strongly when prices go up than they do when prices go down.

Another body of work in economics focuses on the reactions of firms to changes in their competitors' prices. When the federal antitrust agencies are investigating a merger between differentiated products X and Y that appear to be close substitutes, one can infer that they suspect that the number of other close substitutes for X and/or Y is small. When the number of substitutes is small, competitors are likely to react to changes in the prices of X and Y, and the sellers of X and Y are likely to anticipate this. The demand curve for X will have a kink at the pre-merger equilibrium price of X if competitors' responses to changes in the price of X—and therefore the effects of these responses on the demand curve for X—are asymmetric.

To understand the role of competitor responses, we need to understand that the demand for differentiated product X is quite complex. As pointed out by Katz and Shapiro:

[T]he demand curve facing a single firm acting unilaterally accounts for the responses that firm anticipates its rivals will make if it changes its price. The rivals' responses can come in the form of price changes, quantity changes, product quality changes, or some other competitive variable. Moreover, rivals' anticipated reactions can be the results of highly complex competitive interactions that take place over time. In other words, the firm-specific demand curve can be viewed as a summary of how an individual supplier perceives its competitive environment.<sup>22</sup>

It has long been postulated by economists that there are reasons why competitors' responses to changes in the price of X, or what are known as “reaction functions,” may be asymmetric.<sup>23</sup> A reduction in the price of X diverts sales from competitors to X, and this likely leads the competitors to reduce their prices to mitigate the loss in sales to X and to each other. On the other hand,

<sup>20</sup> Amos Tversky & Daniel Kahneman, *Loss Aversion in Riskless Choice: A Reference-Dependent Model*, 106 Q.J. ECON. 1055 (1991). The coauthor, Daniel Kahneman, was a 2002 recipient of the Nobel Prize in Economics for his work in behavioral economics. See also Russell S. Winer, *A Reference Price Model of Brand Choice for Frequently Purchased Products*, 13 J. CONSUMER RES. 250–56 (1986).

<sup>21</sup> Miles O. Bidwell, Jr., Bruce X. Wang & J. Douglas Zona, *An Analysis of Asymmetric Demand Response to Price Changes: The Case of Local Telephone Calls*, 8 J. REG. ECON. 285, 285–95 (1995) (footnotes omitted). This article also refers to other studies with similar results (“Specifically, a number of marketing studies . . . have attempted to measure the extent of asymmetry in terms of elasticity differences. These studies suggest that consumers react, in the short run, more strongly to price increases than they do to price decreases.”). *Id.* at 286.

<sup>22</sup> Michael L. Katz & Carl Shapiro, *Further Thoughts on Critical Loss*, ANTITRUST SOURCE, Mar. 2004, at 4, <http://www.abanet.org/antitrust/antitrust-source/04/03/katzshapiro.pdf>.

<sup>23</sup> See, e.g., PINDYCK & RUBINFELD, *supra* note 9, at 457–48 (discussing a kinked demand model where the kink is due to competitors responding differently to price increases than to price decreases).

an increase in the price of X diverts sales to competitors, who may not respond by raising their prices because they view an increase in their market shares as valuable in the long run. There does not have to be much asymmetry to lead to a kink in the demand curve. If significant competitors much more closely match price decreases than price increases, the relevant demand curve is likely to have a kink. Suppose, for example, significant competitors match a price decrease one-for-one, but increase prices relatively only 50 percent.

The way in which parties to a merger perceive how significant competitors are likely to respond to price changes is an empirical issue. Specifically, the parties' perceptions of their competitors' likely reactions to changes in the firm's prices can be investigated in a merger investigation. Evidence on past price changes are relevant. However, analyses of past price changes will generally have to be supplemented by evidence bearing on how competitors may react to an anti-competitive price increase arising from a merger. This is because past price changes may arise primarily or entirely from competition. Competitors might react to an anticompetitive price increase arising from a merger as an opportunity from which they can gain market share. Alternatively, competitors may react as an opportunity to increase short run profits. In our experience with many mergers involving differentiated products, firms typically expect competitors to react to a firm's "unusual" unilateral price decrease by lowering their prices, but do not necessarily expect their competitors to match an "unusual" price increase.<sup>24</sup>

There is economic literature pointing out that asymmetric competitor responses might facilitate tacit collusion.<sup>25</sup> However, asymmetric competitor responses are plausible *competitive* competitor responses, particularly when competitors view their market shares as important, and such responses do not necessarily facilitate tacit collusion, i.e., they might and probably do exist in quite competitive situations. If competitor responses are asymmetric, then further fact-based analysis is required to determine their implications. For example, a situation in which there are asymmetric responses but vigorous competition for market share is most likely a situation of strong competition, rather than tacit collusion, since inconsistent market share objectives are not conducive to tacit collusion.

## Conclusion

The economic models underlying the Guidelines' analysis of unilateral effects of mergers between differentiated substitutes make a critical and unwarranted mathematical assumption that leads to the conclusion that such mergers always lead to higher prices, absent sufficient efficiencies. Specifically, the Lerner Equation, which underlies all the models of differentiated products, requires a mathematical assumption of differentiability.

A significant body of scholarly research establishes that differentiability is not likely to fit real world facts. For example, purchasers are likely to respond differently to price increases and price decreases, with the result that demand curves are likely to have kinks at pre-merger prices. Also, it may be that competitors respond differently to price increases and price decreases, which is another reason to expect that demand curves will be kinked at pre-merger price levels. Finally, there is no reason, a priori, why real world demand curves have the strong smoothness properties required for the Lerner Equation.

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<sup>24</sup> By "unusual" we mean a price increase brought about by an anticompetitive merger, not price increases brought about by demand and/or cost changes.

<sup>25</sup> See, e.g., Katz & Shapiro, *supra* note 22, at 6–7.

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For this reason, the economic models of differentiated products underlying analyses of potential unilateral effects cannot, in themselves, provide a basis for a presumption of anticompetitive effects. Rather, the conditions required for the Lerner Equation need to be verified in each specific setting. More importantly, more attention needs to be paid in the typical differentiated products merger to what constrains the prices of the parties to the merger. The fundamental issue in the analysis of potential unilateral effects arising from a merger of differentiated products is what constrains the prices of the relevant products. ●

# Antitrust Issues in Clean Technology

**Craig Waldman and Margaret Ward**

*Energy forecasting is easy. It's getting it right that's difficult.* — GRAHAM STEIN, 1996

“Clean technology” has emerged as the potential “new new thing” of Silicon Valley and elsewhere, with over \$14 billion in venture capital investment in the past two years alone.<sup>1</sup> The United States, spurred by the Obama Administration’s policies and appointment of Steven Chu as Secretary of Energy, is focused on how to establish new industries based on clean energy technologies. As these industries increase in size, so, too, will potential antitrust issues. This article briefly describes what has become the commonly accepted meaning of so-called “clean tech” and discusses a number of potential antitrust issues surrounding the growth of clean technologies.

## What Is Clean Tech?

Defining “clean tech” is not as easy as it would appear at first glance.<sup>2</sup> According to authors Pernick and Wilder, “[c]lean tech refers to any product, service, or process that delivers value using limited or zero nonrenewable resources and/or creates significantly less waste than conventional offerings.”<sup>3</sup> That definition is very broad but captures, among other segments, the ones we note below, namely, solar energy, wind power, biofuels and biomaterials, green building materials, and smart grids. Although much of the attention in the clean energy industry has been focused on start-up operations, established firms such as GE, Honeywell, Applied Materials, and even Google, also have made substantial clean tech investments.<sup>4</sup>

Although this article might raise more questions than it answers, we hope it can serve as a starting point to consider the particular issues that may arise in applying antitrust principles to clean tech industries.

## Antitrust Matters in Clean Tech

Antitrust has not, up to this point, played a major role in clean tech. This is hardly surprising given that many clean tech sectors are still in the early stages of commercial development. This period of relative antitrust quiet is likely to change over the next three to five years as companies and

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<sup>1</sup> Press Release, CleanTech Group, LLC, Clean Technology Venture Investment Totaled \$5.6 Billion in 2009 Despite Non-Binding Climate Change Accord in Copenhagen, Finds the Cleantech Group and Deloitte (Jan. 6, 2010), available at <http://cleantech.com/about/pressreleases/20090106.cfm>.

<sup>2</sup> The emergence of “clean tech” is reminiscent of the emergence of “high tech,” which loosely referred to all forms of PCs, software, hardware, networking, telecom, and a host of other products and services. Over time, clarity emerged as to specific sectors and specific products and services within those sectors. One would expect the same to occur in clean tech.

<sup>3</sup> RON PERNICK & CLINT WILDER, THE CLEAN TECH REVOLUTION 2 (2008).

<sup>4</sup> Jonathan Burton, *Rolling Up Their Green Sleeves: Five Tech and Industrial Giants that Are Surprising Alternative-Energy Leaders*, MARKETWATCH, Apr. 21, 2009, <http://www.marketwatch.com/story/story/print?guid=AD080520-E2C6-43B4-932B-2F9A57375184>.

technologies mature, the distance between successful and unsuccessful market players widens, and competitors and vertically related entities align.

We discuss in this article certain antitrust issues likely to arise in this emerging sector over the near term: (1) market definition; (2) the approach of enforcers to increased M&A activity; (3) the growth of competitor collaborations short of merger; (4) vertical integration; and (5) approaches to monopolization claims. In assessing these issues, we also consider how the U.S. antitrust enforcement agencies might approach this industry.<sup>5</sup>

**Market Definition and Market Power.** Even a cursory review of clean tech industries reveals both their breadth on one hand, and many potentially narrow markets on the other. Consider solar energy for instance, probably the most mature of the clean tech categories. The products and services that comprise the solar industry include, to name just a few, solar panels, tools to manufacture solar panels, poly silicon, ingots, inverters, and installation services.

The infancy of clean tech technologies, products, and services complicates the market definition question. Defining a market is critical to assessing possible market power and evaluating most conduct challenged under Sherman Act Sections 1 and 2. Markets are largely defined based on the interchangeability of products or services, and thus it is often hard to define markets for products or services in their infancy. Much is yet to be determined as to the manner in which they will be adopted by consumers, if at all, and at what expense to other products and services. This difficulty may also hinder efforts to define innovation or technology markets in clean tech.

Questions that may arise include, for instance, does solar “compete” sufficiently with wind, other renewable energy sources, or conventional oil and gas for that matter, such that those alternatives should be considered in the same market? Depending upon the facts, parties to a transaction regarding solar panel systems may argue that customers who purchase solar panel systems view “traditional” electric power and, depending upon their location, wind as alternatives. Indeed, although we have not undertaken an economic analysis of potential substitutability, every wind turbine built may, to some extent, lessen demand for some other clean tech energy or historical energy source.

In defining relevant markets, U.S. antitrust enforcement agencies will likely assess what realistic alternatives a consumer or other purchaser in the distribution chain may have. Aside from the more typical analysis of demand-side substitutability, other market dynamics in this nascent industry may impact market definition and market power determinations. To describe just a few:

- Current and proposed government mandates and other regulations can limit substitutability between clean tech and traditional energy supply solutions and even among different clean tech solutions. How should such potential limitations affect market definition?
- Regarding solar in particular, are solar products and methodologies “competitive” with historical energy resources such that they should be considered in the same relevant product market? Solar power is gaining the widest adoption, and in part due to solar firms’ ability to use pre-existing semiconductor manufacturing processes, many believe that solar power will be cost competitive with conventional retail electricity rates at the mid-point of this decade.<sup>6</sup> If this growth is occurring at the expense of traditional energy, are solar and traditional energy sources in the same market for antitrust purposes?

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<sup>5</sup> The likely approaches of EU and other non-U.S. enforcement agencies are beyond the scope of this article, but they are no less significant. Counsel to clean tech companies should be mindful that multi-jurisdictional antitrust scrutiny is common.

<sup>6</sup> See, e.g., Ron Pernick & Clint Wilder, *Utility Solar Assessment (USA) Study: Reaching Ten Percent Solar by 2025*, at 7 (Clean Edge, Inc. & Co-op America Foundation June 2008), available at [http://www.cleandedge.com/reports/pdf/USA\\_Study.pdf](http://www.cleandedge.com/reports/pdf/USA_Study.pdf).

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- In green buildings, the goal is to create what are known informally as “negawatts,” which is a measurement of how many megawatts of “other” energy resources are saved. How would the agencies look at this inherent zero sum game? What level of competition between alternative energy sources—taking into account the negawatt calculation—would be sufficient to consider broader antitrust markets?
- The heavy upfront investment required in certain sectors, principally wind and biofuels, may foster an environment where fewer players may succeed (at least relative to other clean tech segments) and large multinational corporations, such as ADM in biofuels and GE in wind, may have an early advantage. In light of this, are these sectors more likely targets for antitrust scrutiny?
- How will the inability to “transport” energy impact geographic market analysis? For instance, wind turbines must be placed in locations that have certain wind flows, and the converted kinetic energy cannot be “shipped” very far, at least not until smart grids are more fully developed.
- How will the impact of China’s development of clean tech be felt? It is by far the largest investor in clean tech.<sup>7</sup> Will the presence of Chinese companies alleviate concerns about the exertion of market power in the United States? To what extent will that depend upon the ability to export Chinese output to the United States?

In the end, like all market definition analyses, much will depend on the actual customer purchasing patterns and the companies’ view of the market(s) in which they compete.<sup>8</sup>

**Mergers & Acquisitions.** Although we expect mergers and acquisitions in this area to pick up considerably in the next three to five years, certain notable transactions have already been consummated. To name a few:

- SunPower announced an agreement to acquire SunRay Renewable Energy (solar power plants) in February 2010 for \$277 million.<sup>9</sup> SunPower designs and manufactures solar panels, serving residential, commercial and utility customers. This transaction was SunPower’s fourth in three years.
- In February 2010, French state-controlled nuclear power developer Areva announced an agreement to acquire Silicon Valley-based solar thermal developer Ausra.<sup>10</sup>
- In October 2009, MEMC Electronic Materials (MEMC), a global provider of wafers and other products to the semiconductor and solar industries, and SunEdison, a solar energy services company, announced that MEMC will acquire SunEdison.<sup>11</sup> The transaction was valued at \$200 million.

<sup>7</sup> Jennifer Kho, *The Largest Cleantech VC: China*, EARTH2TECH.COM, Feb. 26, 2010, <http://earth2tech.com/2010/02/26/the-largest-cleantech-vc-china/>.

<sup>8</sup> We caution against falling into the “Cellophane Trap” in testing for product markets in clean tech sectors. The Cellophane Trap occurs when the prevailing prices are already supracompetitive. If that is the case, asking whether consumers would switch to another product if prices rose may very well overstate the substitutability of products. This scenario seems plausible in clean tech, where certain nascent areas may only be served by one or two players, and thus in theory at the outset certain markets may reflect higher than “competitive” prices. See *United States v. E.I. du Pont de Nemours & Co.*, 351 U.S. 377 (1956) (*Cellophane*).

<sup>9</sup> Candace Lombardi, *SunPower to Acquire SunRay for \$277 Million*, CNET, Feb. 11, 2010, [http://news.cnet.com/8301-11128\\_3-10451662-54.html](http://news.cnet.com/8301-11128_3-10451662-54.html).

<sup>10</sup> Press Release, Ausra, Inc., AREVA to Acquire the U.S. Solar Company Ausra (Feb. 8, 2010), available at <http://www.ausra.com/news/releases/100208.html>.

<sup>11</sup> Press Release, SunEdison LLC, MEMC to Expand Scope of Solar Business with Acquisition of SunEdison (Oct. 22, 2009), available at [http://www.sunedison.com/press\\_releases.php?id=82](http://www.sunedison.com/press_releases.php?id=82).

The SunPower/Sun Ray and MEMC/SunEdison transactions are two examples of the trend towards integration emerging in the solar power sector. The SunPower transaction reflects a trend towards vertical integration intended to achieve scale and cost savings, both of which will help the firm's output become more cost competitive with conventional retail electricity. The Areva transaction, in turn, illustrates the expansion of larger, incumbent energy firms—Areva is a leading provider of nuclear power—into the clean tech sector.

The U.S. antitrust enforcement agencies have not had much opportunity or reason to review clean tech transactions. However, the Federal Trade Commission's 2009 review of the proposed Panasonic/Sanyo transaction,<sup>12</sup> which arguably skirts the edges of clean tech, may shed some light on how the agencies might define a relevant "clean tech" market in the context of a merger investigation. The transaction proposed to combine, among other assets, the parties' portable nickel-metal hydride (NiMH) and hybrid electric vehicle (HEV) battery assets. Portable NiMH batteries are used to power, among other kinds of portable consumer devices, two-way radios used by police and fire departments. HEV batteries, in turn, are used to power hybrid electric vehicles.

After an extended review,<sup>13</sup> the FTC asserted that the transaction would substantially lessen competition in the sale of portable NiMH batteries, but would not pose any such concerns in the HEV battery segment. The FTC acknowledged that there are other portable rechargeable battery chemistries, including nickel cadmium and lithium-ion ("Li-ion"), but nonetheless concluded that portable NiMH batteries constituted a relevant antitrust market. The FTC alleged that even though all three chemistries can be used in the production of rechargeable batteries, some products, most notably two-way radios, were designed to accommodate portable NiMH batteries, and customers of two-way radios could not switch to another battery. The FTC further claimed that customers—even those not allegedly locked into using a NiMH battery—had a strong cost- and performance-driven preference for NiMH batteries. According to the FTC, Panasonic and Sanyo produced the highest quality portable NiMH batteries and thus were each others' closest competitors. For these reasons, coupled with the FTC's conclusion that new entry or repositioning would be insufficient to counteract any alleged anticompetitive effects of the merger, the FTC challenged the transaction. To resolve the agency's concerns, the merging parties agreed to divest certain of Sanyo's portable NiMH battery assets, including a manufacturing plant, to FDK Corporation, a subsidiary of Fujitsu.<sup>14</sup>

The FTC also investigated, but reached a different conclusion regarding, the transaction's likely impact on competition for HEV batteries. According to the FTC, Panasonic and Sanyo were the most significant suppliers of NiMH batteries used in current-generation HEVs, but improvements in Li-ion technology made Li-ion HEV batteries a better alternative to NiMH HEV batteries. The FTC concluded that the combined firm would compete directly against a number of Li-ion HEV battery producers in the future. As a result, the FTC concluded that the merger did not raise any competitive concerns in the "HEV battery market."

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<sup>12</sup> Panasonic Corp., FTC Docket No. C-4274, File No. 091-0050 (Jan. 6, 2010) (decision and order), available at <http://www.ftc.gov/os/caselist/0910050/index.shtm>.

<sup>13</sup> The parties announced the transaction in December 2008, and it closed in December 2009.

<sup>14</sup> The parties also previously agreed to divest certain European assets to resolve European Commission concerns over the transaction's alleged effect on competition for primary cylindrical lithium batteries, portable rechargeable nickel-metal hydride batteries and rechargeable coin-shape batteries based on lithium.

This enforcement action suggests that, in merger reviews, the FTC is likely to approach market definition issues in clean tech industries as it does in more traditional industries: identify the overlapping products and the firms that supply those products and assess—in a fact intensive way—the full range of competition from other products. The enforcement agencies are unlikely to consider “clean tech” as a relevant antitrust market. Instead, they will likely consider “clean tech” as consisting of many markets whose contours will undoubtedly change as these sectors evolve over time.

An increase in the rate of transactions in the clean tech industry would be consistent with the evolution of the technology industry. More specifically, over the next several years in clean tech, companies may seek to acquire other companies to achieve additional scale (a critical differentiator over time), enhance capacity, and/or combine complementary customer bases and skill sets.

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Given the likely growth in transactions and enforcement of the merger laws in the United States and abroad, companies seeking to expand by acquisition should consider how best to position themselves. Market definition will play a significant role in the outcome of these investigations, as will the parties’ documentary evidence concerning meaningful rivals. Parties may argue that, given the nascent status of clean tech, markets are highly dynamic, fast moving, and should not be the subject of government intervention. The power of this argument will depend on the facts of the particular merger, but it is an argument often made in technology mergers, with mixed success. Often such concerns are overblown by some and, more importantly, not accepted by regulators.

**Collaborations Short of Merger.** We also expect an alignment of rivals and, probably more likely, of complementary parties through collaborations short of merger. For example, in February 2010, Royal Dutch Shell plc and Cosan SA announced their intention to form a \$12 billion joint venture in Brazil for the production of ethanol, sugar, and power, and the supply, distribution, and retail of transportation fuels.<sup>15</sup> In the near term, we expect the number of such complementary alignments to outnumber horizontal transactions as industry participants seek to quickly plug holes in their portfolios and capabilities. Some clean tech strategies are indeed targeted at harnessing complementarities in clean tech energy approaches. For instance, the development of smart grids is intended to capitalize on the optimal time of day and weather usage; where one technology may have “downtime,” another may not, thereby maximizing a full grid.<sup>16</sup>

Another area of likely collaboration will involve the increasing use of industry standards. Cooperation around standards can reduce unnecessary costs and facilitate the adoption of technologies, as occurred in personal computing. Indeed, one of the many challenges in the advancement of solar technology is the inconsistency among utility districts, rendering the development of industry-wide standards and protocols that are desirable but difficult to achieve.<sup>17</sup> They are also needed in the development of smart grids.<sup>18</sup>

In considering the potential pitfalls associated with standard setting in clean tech, firms and their counsel should take into account the 1969 consent decree entered to resolve the Department

<sup>15</sup> Press Release, Royal Dutch Shell plc, Shell and Cosan Sign MOU to Form Joint Venture in Brazil (Jan. 2, 2010), available at [http://www.shell.com/home/content/media/news\\_and\\_library/press\\_releases/2010/shell\\_cosan\\_mou\\_brazil\\_01022010.html](http://www.shell.com/home/content/media/news_and_library/press_releases/2010/shell_cosan_mou_brazil_01022010.html).

<sup>16</sup> Many company interactions in clean tech may very well involve both complementary and competitive elements. In these situations, the parties should be careful to understand which “hat”—whether competitor or complement supplier—they are wearing.

<sup>17</sup> Pernick & Wilder, *supra* note 6, at 31.

<sup>18</sup> *Id.* at 186.

of Justice's complaint against the Automobile Manufacturers Association that alleged an illegal conspiracy relating to the development of automotive pollution control devices.<sup>19</sup> California regulators have long led the setting and enforcement of environmental policy in the United States. In the 1960s, the State of California adopted new auto emissions standards and announced that automotive manufacturers would be required to install pollution control devices on new vehicles when at least two devices satisfied the state's criteria for such devices. In 1964, the major U.S. auto manufacturers announced that they would not be able to meet the state's pollution control standards until 1967, but just three months later, the state certified four pollution control devices developed by independent manufacturers. Two months later, in August 1964, the auto manufacturers announced that they had developed design changes to their engines that were better than any independently produced devices and could implement the proposed changes soon thereafter.

This set of circumstances sparked the interest of the DOJ, which opened an investigation into whether the leading U.S. auto manufacturers had colluded to delay the development of pollution control devices. In 1969, the DOJ brought a complaint against the Automobile Manufacturers Association (whose members were the auto majors), alleging that its members had, since as early as 1953, conspired to eliminate "competition in the research, development, manufacture and installation of air pollution control equipment, and . . . in the purchase of patents and patent rights from other parties covering" such equipment.<sup>20</sup> The DOJ further alleged that the manufacturers had agreed, among other things: (1) to undertake all air pollution control equipment development on a noncompetitive basis; (2) to seek joint appraisal of any patents submitted to the manufacturers by third parties; and (3) to install air pollution control equipment only upon an agreed date.

After months of negotiation, the manufacturers agreed to a consent decree resolving the DOJ's concerns. The decree required, among other things, that the defendants issue to any applicant interested in developing motor vehicle air pollution technology royalty-free licenses under all patents covered by a 1955 cross-licensing agreement among the manufacturers.

Although this case does not fit squarely into the category of "clean tech," the issues it raises could arise for clean tech firms faced with the prospect of complying with state- or federally-mandated product or performance standards or otherwise collaborating on industry standards. In many, if not most, instances, standard setting can be procompetitive, efficiency-enhancing, and good for consumers. However, as *Automobile Manufacturers Association* suggests, participants in collaborations intended, for example, to exclude competitors or delay the process of innovation may find themselves in the crosshairs of antitrust.

***Relationships Among Vertically Aligned Companies.*** Vertical mergers, where one party purchases a supplier of a key input or component, should be of lesser interest to the agencies than horizontal mergers, despite the Obama Administration's pronouncement that it expects to be more vigilant regarding vertical foreclosure issues.<sup>21</sup> That is because in most instances, vertical transactions are likely to create substantial cost efficiencies. Moreover, clean tech industries are

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<sup>19</sup> See *United States v. Automobile Mfrs. Ass'n*, 307 F. Supp. 617 (C.D. Cal. 1969) (approving consent decree); see also *United States v. Motor Vehicle Mfrs. Ass'n*, 643 F.2d 644 (9th Cir. 1981) (reversing the district court's denial of the DOJ's motion to extend the term of the consent decree). The Ninth Circuit quoted extensively from the DOJ's complaint.

<sup>20</sup> *Motor Vehicle Mfrs. Ass'n*, 643 F.2d at 645.

<sup>21</sup> Christine A. Varney, Vigorous Antitrust Enforcement in this Challenging Era, Prepared Remarks Before the Center for American Progress (May 11, 2009), available at <http://www.justice.gov/atr/public/speeches/245711.htm>.

relatively fragmented, rendering it difficult to identify “dominant” firms in “new” energy generation, transmission and distribution chains.

However, one cannot rule out close scrutiny in acquisitions where one company purchases another that is the only or one of only a few sources of important inputs. In these cases, vertical integration could foreclose rivals from access to key inputs or otherwise increase their costs of obtaining them. Alternatively, such integration could facilitate collusion in the upstream or downstream market (e.g., a supplier’s acquisition of a disruptive buyer that eliminates significant head-to-head competition between the supplier and its competitors). Moreover, given the heavily regulated energy environment into which clean tech is entering (e.g., the price at which electricity can be sold by utilities is at best only partially market-driven), there may be incentives for downstream companies to integrate upstream as a means of avoiding rate regulation. In those limited cases that may present competitive concerns, the DOJ and FTC may increasingly ask for non-discrimination commitments in the form of consent decrees, and/or firewalls to prevent the flow of competitively sensitive information between the upstream and downstream components of the merged firm.

**Monopolization.** As noted above, although clean tech industries remain somewhat fragmented, growth and consolidation is likely. As a result, there is a risk that a clean tech company may have market power or may use that power to engage in exclusionary behavior.

Monopolization issues that could surface in the clean tech industry include the following:

- To a certain extent the government plays a role in determining clean tech winners and losers. This can be through a “carrot” of investment funds or through “stick” mechanisms, such as penalties for certain usage, sin tax, caps, etc. Will that weaken a plaintiff’s ability to contend that a company has either obtained or maintained a monopoly through unlawful means? To the extent government regulation plays a significant role in clean tech growth, could that lead to dual, and possibly conflicting, enforcement priorities for antitrust and other industry-specific agencies?
- Where will the state of law be regarding bundling issues and how will it be applied in the clean tech arena? One could see more mature industry players trying to capitalize on their breadth of product offerings to drive adoption of related but nascent clean technologies.
- As firms vertically integrate and potentially terminate supply relationships with competitors, are there any scenarios that could give rise to allegations of a duty to deal?

## Conclusion

As discussed above, clean tech industries will raise fascinating competition questions as the market dynamics, preferred resources and solutions, and agency oversight shake out over time. In the meantime, clean tech companies should be mindful of the pitfalls that can occur, and pay attention to the development of antitrust policy in this area in the coming years. ●

# What Is Superiority?

## The Role of Completed, Pending, and Anticipated Government Activity in Certifying a Class Action

**Steven Malech and Seth Huttner**

Consumer protection and antitrust attorneys seeking to prevent class certifications have three powerful, but underused, defenses upon which they can rely: a completed, a pending, or an anticipated government investigation or lawsuit (collectively, government action). In certain circumstances, these potential defenses could result in denial of a class certification motion, as a court may find that due to the government action, a class action lawsuit is *not* “superior to other available methods for fairly and efficiently adjudicating the controversy.”<sup>1</sup> While this argument has been periodically addressed in courts across the country over the last four decades, given the current prevalence of private class action lawsuits “following” investigations by federal, state, and local enforcement agencies, surprisingly few cases directly address this issue, let alone offer any substantive analysis.

Some courts and commentators have noted the importance of completed, pending or potential government action to the determination of whether to certify a class. For example, one court has explained that a trial judge cannot simply “ignore the existence of an Attorney General investigation into [defendant’s conduct].”<sup>2</sup> And, a former Deputy Director of the Bureau of Competition at the Federal Trade Commission has made a “modest proposal” that “courts considering the certification of a class under Federal Rules of Civil Procedure Rule 23, or its state law equivalents . . . analyze carefully the full implications of a pending or completed government enforcement action.”<sup>3</sup>

In addition, as set forth more fully below, the current trend for trial courts to “assess the relevant evidence” at the class certification stage,<sup>4</sup> also suggests that litigants should be prepared to more frequently raise or otherwise address the interplay between government actions and class certification in antitrust and consumer protection cases.<sup>5</sup> At the very least, defense counsel may benefit from arguing that trial courts should be very careful about certifying a class seeking pri-

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<sup>1</sup> FED. R. CIV. P. 23(b)(3). See also, e.g., TEX. R. CIV. P. 42(b)(4) (2009); MAINE R. CIV. P. 23(b)(3) (2009).

<sup>2</sup> Levine v. 9 Net Ave., Inc., No. A-1107-0071, 2001 WL 34013297 (N.J. Super. A.D. June 7, 2001) (affirming the trial court’s denial of class certification based, in part, on the pending Attorney General’s investigation).

<sup>3</sup> D. Bruce Hoffman, *To Certify or Not: A Modest Proposal for Evaluating the “Superiority” of a Class Action in the Presence of Government Enforcement*, 18 GEO. J. LEGAL ETHICS 1383 (2005).

<sup>4</sup> *In re* Initial Pub. Offerings Sec. Litig., 471 F.3d 24, 42 (2d Cir. 2006). This case was decided after Bruce Hoffman’s article, *supra* note 3, but merely serves, in our opinion, to buttress his “modest proposal.”

<sup>5</sup> See *Mooney v. Allianz Life Ins. Co. of North Am.*, 244 F.R.D. 531, 538 n.3 (D. Minn. 2007) (noting that while the court’s class certification decision was pending, “the Minnesota Attorney General initiated litigation against [the defendant] on behalf of senior citizens of Minnesota. *Minn. v. Allianz Life Ins. Co. of N. Am.*, Civ. No. 07-581 (Minn. Dist. Ct.). Neither Plaintiffs nor [defendant] has addressed whether that litigation affects the superiority analysis”). This may have been a missed opportunity for defense counsel.

*[T]rial courts should be very careful about certifying a class seeking primarily money damages where a state Attorney General (or other state or federal agency) has already settled claims with the same defendant(s) arising from the same course of conduct.*

marily money damages where a state Attorney General (or other state or federal agency) has already settled claims with the same defendant(s) arising from the same course of conduct.<sup>6</sup> After all, a court could justify its refusal to certify a class under such circumstances to prevent “double dipping” by plaintiffs and prevent the unnecessary expenditure of resources by the executive and judicial branches of government.

In this article we identify and explain the patchwork of cases in which courts have, to some degree, addressed this issue. More specifically, we focus on three categories: (1) where the government action has been completed and the consumer harm remedied; (2) where the government action (whether it be an investigation or lawsuit) is pending; and (3) where the government action is anticipated or merely possible (which is predictably the weakest argument against certification, although a potentially useful factor that a court might consider).

### Courts’ “Rigorous Analysis” of Certification Decisions

The plaintiff bears the burden of convincing a court to certify a class.<sup>7</sup> In federal cases governed by Rule 23 of the Federal Rules of Civil Procedure, a plaintiff’s initial hurdle is Rule 23(a)’s four prerequisites: numerosity, commonality, typicality, and adequacy.<sup>8</sup> If the plaintiff satisfies these prerequisites, a class then may only be certified if it meets one of the three additional standards set forth in Rule 23(b). The most commonly raised standard is found in is Rule 23 (b)(3), which requires the court to find that “the questions of law or fact common to class members predominate over any questions affecting only individual members, and that any class action is superior to other available methods for fairly and efficiently adjudicating the controversy.”<sup>9</sup>

In *General Telephone Company of the Southwest v. Falcon*,<sup>10</sup> the Supreme Court held that a class may only be certified “if the trial court is satisfied, after a rigorous analysis, that the prerequisites of Rule 23(a) have been satisfied.”<sup>11</sup> Courts have offered differing interpretations of the contours of this “rigorous analysis” test since that 1982 ruling, but recent decisions have clarified the scope of inquiry to be used by the trial courts in deciding whether to certify a class. For example, the Court of Appeals for the Second Circuit recently explained in *In re IPO* that “[a] district judge is to assess all of the relevant evidence admitted at the class certification stage and determine whether each Rule 23 requirement has been met, just as the judge would resolve a dispute about any other threshold prerequisite for continuing a lawsuit.”<sup>12</sup>

*In re IPO* and its progeny focused on the district court’s obligation to resolve pertinent merits and expert issues at the class certification stage. But, the unmistakably broader point is that a district court must consider “all . . . relevant evidence” before certifying a class. The presence of a completed, pending, or anticipated government action constitutes part of this “relevant evidence.”

<sup>6</sup> See, e.g., *Kamm v. Cal. City Dev. Co.*, 509 F.2d 205 (9th Cir. 1975).

<sup>7</sup> See, e.g., *In re Hydrogen Peroxide Antitrust Litig.*, 552 F.3d 305, 315–16 (3d Cir. 2008).

<sup>8</sup> The full version of Rule 23(a) provides that “[o]ne or more members of a class may sue or be sued as representative parties on behalf of all members only if: (1) the class is so numerous that joinder of all members is impracticable; (2) there are questions of law or fact common to the class; (3) the claims or defenses of the representative parties are typical of the claims or defenses of the class; and (4) the representative parties will fairly and adequately protect the interests of the class.” FED. R. CIV. P. 23(a).

<sup>9</sup> FED. R. CIV. P. 23(b)(3).

<sup>10</sup> *Gen. Tel. Co. of the Sw. v. Falcon*, 457 U.S. 147 (1982).

<sup>11</sup> *Id.* at 161.

<sup>12</sup> *In re Initial Pub. Offerings Sec. Litig.*, 471 F.3d at 42. See also *In re Hydrogen Peroxide Antitrust Litig.*, 552 F.3d at 315–16.

Accordingly, courts may find it necessary to consider the presence or possibility of a government action when ruling on a motion for class certification.<sup>13</sup>

### The Leading Case: *Kamm v. California City Development Company*

The Ninth Circuit's 1975 decision in *Kamm v. California City Development Company*,<sup>14</sup> provides the most detailed analysis of when a government action should preclude class certification. In *Kamm*, a group of investors alleged that land promoters failed to disclose the nature of the property and the inherent risks associated with certain real estate investments. After the lawsuit was filed, but before the district court's class certification ruling, the California Attorney General and Real Estate Commissioner reached a settlement agreement with many of the defendants.<sup>15</sup> The settlement agreement "provided for offers of restitution of principal payments to certain purchasers[]," permanently enjoined defendants from making further misrepresentations, and required defendants to use their "best efforts" to settle future disputes.<sup>16</sup> Based on the relief already provided, the district court found that a class action was not the superior method of adjudicating these claims.

The Ninth Circuit affirmed, explaining that, in no particular order of importance, "[s]uperiority must be looked at from the point of view of (1) the judicial system, (2) the potential class members, (3) the present plaintiff, (4) the attorneys for the litigants, (5) the public at large and (6) the defendant."<sup>17</sup> Some of the factors that led the court to affirm denial of class certification included recognition that:

- a class action would require "a substantial expenditure of judicial time which would largely duplicate and possibly to some extent negate the work on the state level[;]"
- the state action provided restitution, an agreement to settle future disputes, and a permanent injunction;
- no investor was barred from initiating his/her own suit; and
- defending a class action would be costly to defendants and duplicate the hours spent working to achieve the result with the state.<sup>18</sup>

As discussed more fully in the next section, other courts have similarly concluded that the class action mechanism is not the best means of adjudicating the controversy where a state or federal agency had already entered the proverbial fray.<sup>19</sup>

<sup>13</sup> See, e.g., *Levine*, 2001 WL 34013297 at \*3 (noting that the trial judge had an "obligation not to ignore the existence of an Attorney General investigation into [defendant's conduct] when he learned that such an investigation was being conducted").

<sup>14</sup> *Kamm v. Cal. City Dev. Co.*, 509 F.2d at 205.

<sup>15</sup> See *id.* at 207–08. On March 8, 1973, the California Attorney General and Real Estate Commissioner filed their complaint. On that same day, the parties filed a stipulated judgment enclosing the settlement agreement.

<sup>16</sup> *Id.* at 208.

<sup>17</sup> *Id.* at 212 (quoting *Katz v. Carte Blanche Corp.*, 496 F.2d 747, 760 (3d Cir. 1974)).

<sup>18</sup> *Id.* The other factors that supported the trial court's decision were that (1) the class action would involve 59,000 buyers in separate transactions over fourteen years, with some of the buyers desiring to retain their land; (2) the state court retained continuing jurisdiction, and (3) the individual named plaintiffs' suit can still proceed. *Id.*

<sup>19</sup> A settlement reached after litigation brought by the executive branch is not the only form of settlement that could counsel against certification. In *Millett v. Atlantic Richfield Co.*, No. Cv-98-555, 2000 WL 359979 (Me. Super. Ct. Mar. 2, 2000), the Maine Legislature created a Ground Water Oil Cleanup Fund to provide money for persons whose property was damaged by an oil spill. The court refused to certify a class of plaintiffs allegedly affected by the spill. While there were other reasons why the court declined to certify the class (primarily the plaintiff's inability to meet the predominance requirement), it also found that the Legislature's Fund, even though it placed limitations on a claimant's right to recover, "lend[ed] support to this court's conclusion that a class action is not the superior method of resolving this controversy." *Id.* at \*18.

## Completed Government Action as a Bar to Class Certification

Relying on *Kamm*, the court in *Caro v. Procter & Gamble Co.*,<sup>20</sup> a consumer protection case, similarly denied class certification, in part, because of a completed government action.<sup>21</sup> In *Caro*, a putative class of consumers alleged that Procter & Gamble falsely labeled its orange juice. The court denied certification, in part, because P&G had already disgorged funds and spent more than \$450,000 “complying with consent decrees and settlement agreements with various governmental agencies including the California Attorney General and District Attorneys in Santa Cruz and Alameda Counties.”<sup>22</sup> The *Caro* court further found that the class action would “effectively duplicat[e] work which has been or could be done by the state [and the FDA],”<sup>23</sup> and that the superficial differences between the allegations in the complaint and those involved in the government action failed to make the class action superior because the same or similar conduct was alleged in both.<sup>24</sup>

A court . . . may be advised to carefully consider whether the class allegations are actually the same as those brought in the government action . . .

This final point is particularly important. Plaintiffs’ counsel often assert different legal theories to avoid the “duplication defense,” notwithstanding that the same operative facts provide the basis for both the private and public actions. Thus, as in *Caro*, a court evaluating whether to certify a class under these circumstances may be advised to carefully consider whether the class allegations are actually the same as those brought in the government action—particularly given *In re IPO’s* and *In re Hydrogen Peroxide’s* emphasis on conducting a “rigorous analysis” at the class certification stage.

In *Brown v. Blue Cross & Blue Shield of Michigan*,<sup>25</sup> the defendant’s settlement with the Michigan Attorney General formed the primary basis for the court’s denial of class certification. The Michigan Attorney General and Insurance Commissioner investigated the defendant for allegedly misrepresenting the amounts the company’s subscribers had to co-pay for hospital stays. The government agencies and the company reached a settlement agreement pursuant to which Blue Cross agreed to refund all overpayments (amounting to approximately \$24.4 million) for those subscribers who signed and returned a claim form, contingent on the denial of class certification in the private suit.<sup>26</sup>

Based on the settlement, the court declined to certify a class because “the interests of the class would be adequately served by the agreement between defendant and the State of Michigan ren-

<sup>20</sup> *Caro v. Procter & Gamble Co.*, 18 Cal. App. 4th 644 (1993).

<sup>21</sup> The *Caro* court, however, also found other deficiencies with the class action claims. *See Caro*, 18 Cal. App. 4th at 662–69 (holding that plaintiff’s claims were atypical of the proposed class and that individual issues predominated). The same is true in the dairy price-fixing case of *Lohse v. Dairy Commissioner of State of Nevada*, No. R-75-194BRT, 1977 WL 1523 (D. Nev. Dec. 21, 1977), where the court denied class certification because, *inter alia*, plaintiffs’ claims would require individualized issues, chief among them that each plaintiff would have to show that he purchased the dairy product in question. At the end of the decision, although denial of certification was a foregone conclusion, the court noted that “[w]hile the exact records are not before this court, reference is made in the files to action which has been taken by the Attorney General of Nevada against most of these same defendants with respect to their misconduct in granting and accepting rebates in the state regulated milk industry. Settlements have been reached. This kind of state action is much preferred to a punitive treble damage antitrust private civil remedy the proceeds from which will only slightly benefit any individual plaintiff.” *Id.* at \*7.

<sup>22</sup> *Caro*, 18 Cal. App. 4th at 660.

<sup>23</sup> *Id.* at 661.

<sup>24</sup> *See id.* (“[T]he fact [that plaintiff’s] lawsuit may assert different theories than those involved in the other federal and state proceedings does not preclude consideration of those other proceedings in determining whether to certify the class action here, since such actions involve the same or similar misconduct by defendants.”).

<sup>25</sup> *Brown v. Blue Cross & Blue Shield of Mich.*, 167 F.R.D. 40 (E.D. Mich. 1996).

<sup>26</sup> *Id.* at 42 & n.2.

dering a class action unnecessary.<sup>27</sup> In fact, the court explained that consumers would be *better served* by the state's settlement than a class action, because the plaintiffs would not have to pay attorneys' fees.<sup>28</sup> Moreover, the court further explained that, although

the State agreement may not be perfect or may not be how plaintiffs' counsel would have advocated a settlement in the present case[,] . . . based on the uncertainty of litigation . . . and the complete repayment of subscribers' claims, the Court does not believe that a class action is necessary in light of the State agreement.<sup>29</sup>

In *Thornton v. State Farm Mutual Auto Insurance Company*,<sup>30</sup> the court relied primarily on the defendant's settlement with multiple states attorneys general in denying class certification. In that case, State Farm had entered into an Assurance of Voluntary Compliance (AVC) regarding its failure to obtain branded or salvaged titles for certain vehicles. Pursuant to the AVC, State Farm agreed to pay consumers 20–50 percent of the Blue Book value of their salvaged vehicles (totaling approximately \$40 million).<sup>31</sup> The *Thornton* court, echoing the *Brown* court's statements about the purity of the states' motivations versus the motivations of private class action plaintiffs' attorneys, concluded that the attorneys general's actions are "presumably taken with the best interests of state residents in mind."<sup>32</sup> In denying class certification, the court held:

[I]f courts consistently allow parallel or subsequent class actions in spite of state action, the state's ability to obtain the best settlement for its residents may be impacted, since the accused may not wish to settle with the state only to have the state settlement operate as a floor on liability or otherwise be used against it.<sup>33</sup>

### **Class Certification Despite a Completed Government Action**

Other courts, however, have certified class actions following a completed government action. In *County of Stanislaus v. Pacific Gas & Electric Company*,<sup>34</sup> for example, the court certified a class of natural gas users who alleged that the defendants violated the antitrust laws to artificially increase the price of natural gas. Defendants argued that the California Public Utilities Commission (CPUC) had "adjudicated the same issues raised by plaintiffs, and ha[d] ordered a \$100 million 'refund' to class members," but the court held that the class action was nevertheless the superior method to adjudicate the claims.<sup>35</sup>

Although this case arose within the Ninth Circuit, the district court did not address *Kamm*. Instead, citing a treatise which stated that courts should look at the "type of remedy that could be awarded by the agency and the general attitude of the agency toward the issues and problems

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<sup>27</sup> *Id.* at 44. *Brown* explicitly stated that it was not addressing whether the prerequisites of Rule 23 had been satisfied. *Id.* The court may have denied certification generally based on its discretion to do so, but it did cite to *Kamm*—which was based on the superiority requirement in Rule 23(b)(3)—as supporting its decision. *Brown*, 167 F.R.D. at 44, 46.

<sup>28</sup> *Id.* at 45.

<sup>29</sup> *Id.* at 47.

<sup>30</sup> *Thornton v. State Farm Mut. Auto Ins. Co.*, No. 06-CV-0018, 2006 WL 3359482 (N.D. Ohio Nov. 17, 2006).

<sup>31</sup> *Id.* at \*1.

<sup>32</sup> *Id.* at \*3.

<sup>33</sup> *Id.*

<sup>34</sup> *County of Stanislaus v. Pac. Gas & Elec. Co.*, No. CV-F-93-5866-OWW, 1994 WL 706711 (E.D. Cal. Aug. 25, 1994).

<sup>35</sup> *Id.* at \*5.

raised by the claimants,”<sup>36</sup> the court held that the CPUC action was not superior because the CPUC “has only a limited ability to issue injunctive relief—a remedy sought by plaintiffs—and no direct jurisdiction over [one of the defendants].”<sup>37</sup>

Similarly, the trial court in *Gould v. Lowrance*,<sup>38</sup> a Ponzi scheme case, also certified a class after a completed government action. On appeal, the defendants relied on *Kamm* to argue, among other things, that a class action was not the superior means of adjudication because they had previously settled investigations by various states’ attorneys general. The court rejected this contention because the settlement agreements did not “provide any relief to any class members on the matters of which [the class members] complain.”<sup>39</sup>

*Gould* and *County of Stanislaus* rejected the argument that a completed government action precluded finding the class action superior because the governmental settlements, according to the courts, did not provide a sufficient remedy to the consumers in the putative class.<sup>40</sup> Two leading treatises also suggest that the state’s remedy may be the dispositive factor,<sup>41</sup> but it is not clear from *Kamm* and other cases that the remedy should, by itself, determine whether a class should be certified notwithstanding a completed government action.

Indeed, in *Kamm*, the Ninth Circuit focused on seven factors in evaluating whether the trial court properly concluded that a class action was not superior—and only one of those factors involved the available remedy.<sup>42</sup> Similarly, courts following *Kamm*, such as *Brown* and *Caro*, have highlighted the need for courts to consider how plaintiffs’ attorneys’ fees affect injured consumers’ ultimate recovery<sup>43</sup> and the waste of resources for duplicated work.<sup>44</sup> Both *Gould* and *County of Stanislaus* abandoned *Kamm*’s multi-faceted approach and did not consider other collateral affects of proceeding as a class action.

In summary, each of the aforementioned courts considered the existence of a completed government investigation in making a class certification decision. An open question remains, however, as to whether the remedy provided by the government action should be the only relevant inquiry,

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<sup>36</sup> *Id.* at \*5 (quoting 7A WRIGHT, MILLER & KANE, FEDERAL PRACTICE AND PROCEDURE, § 1779 at 560–61).

<sup>37</sup> *Id.* at \*6.

<sup>38</sup> *Gould v. Lowrance*, No. 08-97-0401-CV, 1998 WL 526489 at \*7 (Tex. Ct. App. Aug. 24, 1998), *reh’g denied*, Sept. 25, 1998).

<sup>39</sup> *Id.* at \*7.

<sup>40</sup> Another case in which a trial court certified a class notwithstanding a prior government action was *Andrews v. Trans Union Corp.*, 917 So.2d 463 (La. Ct. App. 2005). In *Andrews*, the FTC issued an order precluding Trans Union from using consumer information for the purpose of target marketing because the agency asserted that the practice violated the Fair Credit Reporting Act (FCRA). After the FTC issued its order, the plaintiff filed a putative class action under state law. The court rejected defendant’s argument that this prior FTC action precluded a finding of superiority. In doing so, the *Andrews* Court relied on two cases—*Swecker v. Trans Union Corp.*, 31 F. Supp. 2d 536 (E.D. Va. 1998) and *Watkins v. Trans Union, LLC*, 118 F. Supp. 2d 1217 (N.D. Ala. 2000)—that primarily addressed the issue of whether the FCRA preempted state law defamation claims. As such, it is not clear to what extent, if any, *Andrews* will provide persuasive authority on the issue of whether a class action provides the superior method of adjudicating claims subject to a completed government action.

<sup>41</sup> See 7AA WRIGHT, MILLER & KANE, FEDERAL PRACTICE AND PROCEDURE § 1779, at 173 (3d ed. 2005) (“[W]hether an administrative adjudication would provide a more advantageous procedure than a class action may depend on the type of remedy that could be awarded by the agency and the general attitude of the agency toward the issues and problems raised by the claimants.”); 2 CONTE & NEWBERG, NEWBERG ON CLASS ACTIONS § 4:27, at 255 (4th ed. 2002) (“Although a court, in assessing the superiority requirement, may consider whether administrative proceedings which embraced the issue before the court can adequately resolve the controversy, whether the administrative adjudication is preferable over a class action may depend on the remedy available to the agency.”).

<sup>42</sup> *Kamm*, 509 F.2d at 212.

<sup>43</sup> See *Brown*, 167 F.R.D. at 45.

<sup>44</sup> See *Caro*, 18 Cal. App. 4th at 661.

or whether courts should consider all of the *Kamm* factors. It is likely, however, that courts will not have an opportunity to evaluate the existence of a completed government action in the context of class certification proceedings unless the issue is raised by one or more of the parties.

### Pending Government Action

In some cases, defense attorneys have raised the existence of a pending, but not completed, government action as a basis for denying class certification. In response, some courts have held that, depending on the circumstances, a pending government action can either defeat superiority or, at a minimum, factor into the court's denial of certification where the government, as opposed to a private party, had the authority and intent to bring about an appropriate remedy.<sup>45</sup>

The first case to consider this issue appears to be *Wechsler v. Southeastern Properties*,<sup>46</sup> in which the plaintiff alleged that the defendants made false representations in connection with a public offering of securities. The defendants informed the court that there was a pending proceeding brought by the New York Attorney General, and, in response, the court stayed the proceedings "until it could be determined whether the Attorney General's New York Supreme Court action would be adequate to protect the interests of the plaintiff."<sup>47</sup> Almost one-and-a-half years later, the court dismissed the class action because the Attorney General obtained sufficient relief.<sup>48</sup> Although the case lacks any detailed analysis of how the settlement precluded a superiority finding, the government action appears to have been the dispositive factor in the court's denial of class certification.

In *Commonwealth of Pennsylvania v. Budget Fuel Company*,<sup>49</sup> a private class action complaint was filed the same day as a Pennsylvania Attorney General *parens patriae* complaint, both alleging that the defendants engaged in a price-fixing conspiracy in the home heating oil industry. Rather than holding the private suit in abeyance as in *Wechsler*, the court immediately struck the class allegations. The court held that the "*parens patriae* action is superior to a class action as a means for adjudication of collective claims," as evidenced by "the lack of any provision or requirement for court approval or certification of a *parens patriae* action."<sup>50</sup> Arguably, the *Budget Fuel* rationale should also apply to Attorney General consumer protection investigations based on Little FTC Acts.

While *Wechsler* and *Budget Fuel* denied certification based exclusively on pending government actions, other cases find such parallel proceeding relevant, but not dispositive, to the class certification inquiry. For example, in *Levine v. 9 Net Avenue, Inc.*,<sup>51</sup> the plaintiff brought a putative class action against multiple defendants for allegedly sending unsolicited faxes. The trial court denied class certification based, in part, on the New Jersey Attorney General's investigation into the same conduct. The appellate court, affirming, explained that it was "neither error nor a mis-

*[C]ourts will not have an opportunity to evaluate the existence of a completed government action in the context of class certification proceedings unless the issue is raised by one or more of the parties.*

<sup>45</sup> See *Cartwright v. Viking Indus., Inc.*, No. 07-CV-02159 FCD EFB, 2009 WL 2982887, at \*14 (E.D. Cal. Sept. 14, 2009) (refusing to follow *Kamm* because the parallel action (1) did not provide any relief for consumers, and (2) was brought by a private citizen, not by a state agency).

<sup>46</sup> *Wechsler v. Southeastern Props., Inc.*, 63 F.R.D. 13 (S.D.N.Y. 1974), *aff'd*, 506 F.2d 631 (2d Cir. 1974).

<sup>47</sup> *Id.* at 16.

<sup>48</sup> *Id.* at 16–17.

<sup>49</sup> *Commonwealth of Pa. v. Budget Fuel Co.*, 122 F.R.D. 184 (E.D. Pa. 1988).

<sup>50</sup> *Id.* at 185.

<sup>51</sup> *Levine*, 2001 WL 34013297.

taken exercise of discretion to weigh the existence of such an ongoing investigation, *together with all other relevant factors*, as part of the court's [class action] determination. . . ."<sup>52</sup>

In response to concerns raised by the Attorney General in an amicus brief, the appellate court explained that it was "not endors[ing] the proposition that an Attorney General investigation, or the mere statutory authorization for such alternative relief, should automatically preclude private consumer actions. However, the [instant class] action, like any other class certification proceeding, had to be considered in light of its own unique foundational circumstances."<sup>53</sup> Unfortunately, the court's analysis ended there, and did not offer any explanation as to when class certification should not be denied because of an Attorney General's investigation into the same alleged conduct as that raised in the proposed class action.

Similarly, in *Ostrof v. State Farm Mutual Automobile Insurance Company*,<sup>54</sup> the court held that an investigation by the Maryland Insurance Commissioner concerning the use of computer programs in reviewing medical claims was one factor militating toward denying certification of a class of insureds claiming, among other things, that using those programs was a deceptive and unfair business practice. After first concluding that the plaintiffs' claims could not satisfy either commonality or predominance,<sup>55</sup> the court also found that the plaintiffs could not satisfy the superiority requirement because the Maryland Insurance Administration, which had been investigating State Farm's and others' use of these programs for two years, had (1) expertise in this area, and (2) the power to impose a remedy.<sup>56</sup>

In another case in which an ongoing government investigation precluded class certification, the plaintiffs brought a putative class action based on defendant's allegedly defective anti-lock braking system.<sup>57</sup> The court denied plaintiffs' motion for class certification based primarily on predominance,<sup>58</sup> but also held that the plaintiffs' class claims failed to meet the superiority requirement because "the administrative remedy provided by [the National Highway Transportation Safety Administration], including recall of vehicles for inspection and/or repair, is more appropriate than civil litigation seeking equitable relief and money damages in a federal court."<sup>59</sup>

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<sup>52</sup> *Id.* at \*3.

<sup>53</sup> *Id.* The court in *Budget Fuel* also made an attempt to avoid drawing a bright line rule that Attorney General actions preclude a superiority finding. See *Budget Fuel*, 122 F.R.D. at 186 ("By striking [plaintiff's] class action allegations, the court is not stating that *parens patriae* actions were intended to supplant the private class action in antitrust damage cases. All the court is stating is that in the situation where a state attorney general and a private class representative seek to represent the same class members, the *parens patriae* action is superior to that of a private class action"). The *Budget Fuel* court, however, did not offer any analysis as to when an Attorney General proceeding and class action may proceed side-by-side.

<sup>54</sup> 200 F.R.D. 521 (D. Md. 2001).

<sup>55</sup> *Id.* at 528–31.

<sup>56</sup> See *id.* at 532 ("Not only does the MIA have the authority to order individualized remedies if the circumstances warrant; it has apparently indicated that it will exercise that authority. But if that is so, it is clear that adding a class action overlay in federal court makes little sense").

<sup>57</sup> *Chin v. Chrysler Corp.*, 182 F.R.D. 448 (D.N.J. 1998).

<sup>58</sup> See *id.* at 454.

<sup>59</sup> *Id.* at 464. It is not clear to what extent that court's decision to deny class certification rested upon the "mere possibility" that the NHTSA could take action to remedy the underlying conduct or, alternatively, relied upon the fact that the NHTSA had already initiated an investigation that, in turn, resulted in a voluntary recall overseen by the agency.

In reaching this conclusion, the trial court declared that it was not bound by the Third Circuit's dictum, which was subsequently criticized,<sup>60</sup> that Rule 23 was not "intended to weigh the superiority of a class action against possible administrative relief."<sup>61</sup>

### The Possibility of Government Action

*The most undeveloped category (and also the most aggressive from a defense counsel position) is the proposition that an anticipated or possible government action precludes a finding that a class action is the superior method of adjudicating a controversy.*

The most undeveloped category (and also the most aggressive from a defense counsel position) is the proposition that an anticipated or possible government action precludes a finding that a class action is the superior method of adjudicating a controversy. While no case has yet held that an anticipated or potential suit should be a dispositive factor in precluding certification, a number of courts have considered the government's ability to enter the fray as one of the factors influencing the overall class certification decision.

A good example is *Pettrey v. Enterprise Title Agency*,<sup>62</sup> where the plaintiffs brought a putative class action based on the defendants' alleged practice of referring purchasers to certain real estate settlement service providers in return for fees in violation of the Real Estate Settlement Procedures Act (RESPA). The *Pettrey* court held that class certification was not appropriate based on a lack of commonality,<sup>63</sup> typicality,<sup>64</sup> adequacy,<sup>65</sup> and predominance.<sup>66</sup> And, although it is likely that the class would not have been certified even without the additional superiority analysis, the court did hold that a class action was not superior because: (1) the statute provided for recovery of costs and attorney's fees so potential plaintiffs had an incentive to bring individual actions, and (2) "HUD, the Attorney General of any state, or the insurance commissioner of any state may bring an action to enjoin violations of this section of [RESPA]."<sup>67</sup>

The possibility of an attorney general investigation as a factor in the court's certification analysis was likewise mentioned in *McNair v. Synapse Group, Inc.*<sup>68</sup> The *McNair* plaintiffs sought to certify a putative class of consumers who were allegedly duped by defendant's automated magazine renewal practices. The court's certification decision was based on a host of factors, especially whether individualized issues—i.e., what option each plaintiff chose in response to the automated system—predominated.<sup>69</sup> The *McNair* court also rejected the plaintiffs' argument that without the class device the defendant's practices would never be challenged, by explaining that the state

<sup>60</sup> See WRIGHT, MILLER & KANE, *supra* note 41, at 173–74.

<sup>61</sup> *Amalgamated Workers Union of V.I. v. Hess Oil V.I. Corp.*, 478 F.2d 540, 543 (3d Cir. 1973). For discussion of *Amalgamated Workers* decision in *Chin*, see 182 F.R.D. at 464–65.

<sup>62</sup> *Pettrey v. Enterprise Title Agency, Inc.*, 241 F.R.D. 268 (N.D. Ohio 2006).

<sup>63</sup> *Id.* at 280.

<sup>64</sup> *Id.* at 281.

<sup>65</sup> *Id.*

<sup>66</sup> *Id.* at 283–84.

<sup>67</sup> *Id.* at 284 (internal quotation marks omitted). See also *Gardner v. First Am. Title Ins. Co.*, No. 00-2176 (RHK/AJB), 2003 WL 221844, at \*8 (D. Minn. Jan. 27, 2003) (denying class certification in another RESPA case based primarily on predominance, but also noting that the plaintiffs could not meet the superiority requirement because (1) RESPA allows for the recovery of attorneys fees and costs, suggesting that individual cases are likely to be brought; (2) Congress gave the U.S. Department of Housing and Urban Development (HUD) "global oversight" over enforcement; and (3) HUD had, in fact, already investigated defendants and concluded that "corrective action was unnecessary"). Because *Gardner* referenced an earlier HUD investigation that resulted in no finding of wrongdoing and HUD's continuing "global oversight," it is most appropriately classified as a hybrid case, involving both completed and anticipated government action.

<sup>68</sup> *McNair v. Synapse Group, Inc.*, No. Civ.A 06-5072 JLL, 2009 WL 1873582 (D.N.J. June 29, 2009).

<sup>69</sup> *Id.* at \*11–\*14.

could bring an action on behalf of individual subscribers and noting that “the attorney generals for numerous states have challenged policies similar to those at issue here with [defendant’s] parent [corporation].”<sup>70</sup>

In combination, these cases provide a framework for a potentially powerful argument that the possibility of a government action providing restitution for state consumers is one factor that the court should consider in assessing the propriety of certifying a class. In particular, where the predominance inquiry is a close call and the class certification decision therefore is focused on superiority, this argument may be the dispositive factor considered by the court. It appears, however, that such an argument faces an uphill battle if the potential government action could not provide the same remedy that a private action affords.

For example, in another vehicular-defect case, *Hiller v. DaimlerChrysler Corporation*,<sup>71</sup> the court noted that it was “questionable whether the NHTSA can provide the precise relief sought by the plaintiff in this case.”<sup>72</sup> Therefore, the court held that an anticipated NHTSA proceeding would not be superior to a class action.<sup>73</sup> Similarly, in *McLaughlin v. Liberty Mutual Insurance Co.*,<sup>74</sup> the court certified a class of Liberty Mutual employees seeking overtime pay notwithstanding the defendant’s argument that the plaintiff could “request the attorney general to bring a claim on their behalf.”<sup>75</sup> The *McLaughlin* court refused to deny certification simply “because plaintiffs *could* petition the Attorney General to bring suit on behalf of all auto damage appraisers in the Commonwealth, but where the Attorney General has not *actually* brought suit.”<sup>76</sup> The court explained that “no reason exists for [the court] to presume that the Attorney General would take on the plaintiffs’ case, nor does any basis exist for [the court] to know that the Attorney General’s suit would bring adequate relief to the class.”<sup>77</sup> Thus, without knowing whether the Attorney General would bring suit, the court decided it could not evaluate the remedy.

*McLaughlin* is probably the most helpful of the “anticipatory” cases for defense counsel because it frames the issues on which future courts are likely to focus. More specifically, the potential for government action is likely to be a factor in a court’s decision only where (1) the state or federal agency has either (a) specific expertise in that area or (b) general expertise but has looked into this issue before, and (2) the government entity involved has the authority to bring about significant relief.

**[T]he potential for government action is likely to be a factor in a court’s decision only where (1) the state or federal agency has either (a) specific expertise in that area or (b) general expertise but has looked into this issue before, and (2) the government entity involved has the authority to bring about significant relief.**

<sup>70</sup> *Id.* at \*14. See also *Freeman Indus. LLC v. Eastman Chem. Co.*, No. E2003-00527-COA-R9Cv, 2004 WL 1102435, at \*8–\*9 (Tenn. App. Ct. May 18, 2004), *rev’d in part on other grounds* by 172 S.W.3d 512 (Tenn. 2005) (affirming the trial court’s denial of certification based, in part, on the trial court’s finding that a class action was not superior because “the individual state’s Attorney Generals are the proper people to represent the people in their individual states[;] . . . [a]lthough most of this litigation by the respective Attorneys General has not been filed, it appears they would”).

<sup>71</sup> *Hiller v. DaimlerChrysler Corp.*, No. 02-681, 2007 WL 3260199 (Mass. Super. Ct. Sept. 25, 2007).

<sup>72</sup> *Id.* at \*5.

<sup>73</sup> The court ultimately denied certification, but apparently did so because individualized issues predominated, and not on the grounds that plaintiffs failed to satisfy the superiority requirement. *Id.* at \*5.

<sup>74</sup> *McLaughlin v. Liberty Mut. Ins. Co.*, 224 F.R.D. 304 (D. Mass. 2004).

<sup>75</sup> *Id.* at 312.

<sup>76</sup> *Id.*

<sup>77</sup> *Id.*

## Conclusion

Recent class action cases have emphasized that trial judges are expected to “assess all of the relevant evidence” to determine whether plaintiffs have satisfied all Rule 23 requirements.<sup>78</sup> One effective argument for avoiding class certification could be whether a government action has already, is currently, or could potentially address the same issues raised in the class action complaint. To date, federal and state courts have not clearly delineated either (1) the parties’ obligations to identify the existence of a government action, or (2) the standards under which a court will determine that a government action, rather than a class action, provides a superior method for adjudicating or remedying the underlying conduct.

While the answers to these questions are not at all clear, the governing rules and legal precedent appear to require practitioners to identify the pertinent facts about a completed, pending or potential government investigation and for trial courts to analyze that information in making class certification determinations. If practitioners and courts abide by these obligations, it will only be a matter of time until a more in-depth body of case law provides the requisite guidance for all involved. ●

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<sup>78</sup> *In re Initial Public Offerings Securities Litig.*, 471 F.3d at 42.

# Paper Trail: Working Papers and Recent Scholarship

**Editor's Note:** We review an article that challenges the Easterbrook analysis of the rationality of the defendant's alleged conduct as a basis for judging the plausibility of the plaintiff's allegations and supporting evidence, and argues that judges are ill-suited to that task. Send suggestions for papers to review to: [page@law.ufl.edu](mailto:page@law.ufl.edu) or [jwoodbury@crai.com](mailto:jwoodbury@crai.com).

—WILLIAM H. PAGE AND JOHN R. WOODBURY

## Recent Papers

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### Christopher R. Leslie, *Rationality Analysis in Antitrust*, 158 U. PA. L. REV. 261 (2010)

<http://www.pennumbra.com/issues/pdfs/158-2/Leslie.pdf>

In this article, Christopher Leslie of the University of California Irvine School of Law takes aim at one of the most common features of modern antitrust analysis: the judicial assessment of the rationality of the defendant's alleged conduct in order to judge the plausibility of the plaintiff's allegations and supporting evidence. If alleged conduct would be irrational for a profit-maximizing firm, then the allegation is implausible, and thus may be subject to dismissal on the pleadings, summary judgment, or judgment as a matter of law. This style of analysis is closely associated with Frank Easterbrook. For example, in his often-cited 1984 article, *The Limits of Antitrust*,<sup>1</sup> Easterbrook criticized the plaintiffs' predatory pricing claim in the *Japanese Electronic Products* case, which the Supreme Court was then reviewing.<sup>2</sup> He argued that the Japanese electronics manufacturers could not have been engaging for decades in below-cost cartel pricing, as the plaintiffs alleged, because they could not realistically have expected to recoup their losses by reaping cartel profits after American manufacturers succumbed. For such a plan to work, the period of cartel pricing would also have to last decades. But to expect a cartel to succeed that long would be irrational because there were no significant entry barriers and cartels are unstable: "The predation-recoupment story therefore does not make sense," Easterbrook concluded, "and we are left with the more plausible inference that the Japanese firms did not sell below cost in the first place. They were just engaged in hard competition."<sup>3</sup>

The Supreme Court accepted this line of analysis in *Matsushita*, concluding that "in light of the absence of any rational motive to conspire, neither petitioners' pricing practices, nor their conduct in the Japanese market, nor their agreements respecting prices and distribution in the American market, suffice to create a 'genuine issue for trial.'"<sup>4</sup> Leslie argues that the influence of this

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<sup>1</sup> Frank H. Easterbrook, *The Limits of Antitrust*, 63 TEX. L. REV. 1 (1984).

<sup>2</sup> *In re Japanese Elec. Prods. Antitrust Litig.*, 723 F.2d 238 (3d Cir. 1983), *petition for cert. filed sub. nom. Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 52 U.S.L.W. 3921 (U.S. June 7, 1984) (No. 83-2004).

<sup>3</sup> Easterbrook, *supra* note 1, at 27.

<sup>4</sup> *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 587 (1986).

approach on antitrust, especially the law of predatory pricing and horizontal conspiracy, has been mostly pernicious. Firms, he argues, often undertake conduct that appears to be irrational. In some instances, the conduct is irrational because of cognitive biases. Businesses, for example, are influenced by sunk costs that they have incurred, and are often overconfident of the success of new ventures. In other instances, conduct may only appear to be irrational to outsiders who misconceive the firm's real goals or the mechanism of its strategy.

Judges, Leslie argues, are ill-suited (at least for now) to analyze the rationality of firms' alleged conduct. First, they have no experience in business. They are also unaware of the latest developments in post-Chicago economics, which show that conduct that appears to be irrational may be a rational means of pursuing an inefficient goal. Firms may, for example, undertake practices that appear to be irrationally aggressive specifically to establish a reputation for being crazy: "It is rational for a firm to engage in predatory pricing and take a disproportionately greater loss than the firms that it is targeting so long as the firm believes that it will be able to recoup these profits once it establishes a credible reputation as a predator."<sup>5</sup> Such a reputation may deter potential entrants themselves or the venture capitalists that might have financed them.

Judges may also misinterpret business conduct because they fail to recognize that firms (especially foreign firms) may have goals other than profit maximization. Judges may also not take account of the limited information on which businesses must act. The Supreme Court in *Matsushita*, for example, found predatory pricing claims implausible because success was uncertain. But most business ventures are uncertain of success. Firms may nevertheless undertake risky ventures, in some instances because of their confidence (or overconfidence). Finally, judges seem to be prone to cognitive biases in antitrust cases. Leslie sees hindsight bias ("failing to recognize that alleged anticompetitive behavior may have been rational at its conception even though it failed when implemented"<sup>6</sup>) in *Matsushita's* assertion that the "alleged conspiracy's failure to achieve its ends in the two decades of its asserted operation is strong evidence that the conspiracy does not in fact exist."<sup>7</sup> He also sees confirmation bias (looking for and overvaluing evidence that tends to confirm one's belief system) in the *Baby Food* price-fixing case,<sup>8</sup> in which the court of appeals underestimated the probative value of the defendants' repeated communications about future price moves.

The heart of the article is an extended critique of the modern antitrust law of predatory pricing and conspiracy. Leslie criticizes *Brooke Group's* determination that it would have been irrational for Brown & Williamson to plan to recoup its losses from below-cost pricing in the generic segment of the cigarette market by a period of tacit price coordination.<sup>9</sup> For example, Leslie objects to the Court's central determination that the price increases in generic cigarettes following the price war did not "permit an inference of a collusive market dynamic [because] rising prices are equally consistent with growing product demand."<sup>10</sup> This reasoning, according to Leslie, was inconsistent

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<sup>5</sup> Christopher R. Leslie, *Rationality Analysis in Antitrust*, 158 U. PA. L. REV. 261, 298 (2010). Leslie does not cite *Spirit Airlines, Inc. v. Northwest Airlines, Inc.*, 431 F.3d 917 (6th Cir. 2005), which did note reputational effects as one part of a plausible predatory pricing scheme. *Id.* at 936 n.5.

<sup>6</sup> Leslie, *supra* note 5, at 312.

<sup>7</sup> *Matsushita*, 475 U.S. at 592.

<sup>8</sup> *In re Baby Food Antitrust Litig.*, 166 F.3d 112 (3d Cir. 1999).

<sup>9</sup> *Brooke Group v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993). Leslie's criticism follows Kenneth L. Glazer, *Predatory Pricing and Beyond: Life After Brooke Group*, 62 ANTITRUST L.J. 605 (1994).

<sup>10</sup> Leslie, *supra* note 5, at 321 (quoting *Brooke Group*, 509 U.S. at 235).

with the record, which showed that demand for cigarettes fell continuously. The majority's reasoning, Leslie argues, displayed ignorance of both post-Chicago economics and the history of the tobacco industry, as well as a bad case of confirmation bias.

Leslie also criticizes recent court of appeals decisions granting summary judgment in pricing-fixing cases. In *Williamson Oil*,<sup>11</sup> for example, the court displayed both hindsight bias and ignorance of cartel behavior in rejecting the allegation (and supporting evidence) that Philip Morris had restored a cartel by a drastic price cut in the mid-1990s. Similarly, the court in *Citric Acid*<sup>12</sup> displayed confirmation bias and ignorance of cartel behavior in rejecting evidence of communications that suggested that Cargill was a participant in the citric acid cartel. He offers interesting reevaluations of the evidence in other recent cases.<sup>13</sup>

Leslie objects that the Court in *Matsushita* erred by relying on shaky empirical and theoretical assumptions to craft a procedural rule—the standard for summary judgment—that has become a substantive rule of almost per se legality. He does not object in principle to the evaluation of plausibility in the context of summary judgment, only to its misapplication as a vehicle for orthodox Chicago School theory. He suggests that the “answer lies in educating judges about how businesses operate when they are trying to monopolize or cartelize a market.”<sup>14</sup> He proposes seminars, patterned on those organized by conservative organizations in the past, to expose judges to post-Chicago theories and modern studies of cartel dynamics.

He also proposes reinterpreting *Matsushita* to require a heightened, but not insurmountable, standard for summary judgment when the court determines that alleged conduct is apparently implausible. He suggests courts should require more evidence to avoid summary judgment, but should give greater weight than they do presently to certain categories of probative evidence. These categories include direct testimony about price communications and to “plus factors,” defined (in its older sense) as structural and behavioral features of the market that make collusion more likely. While these changes may mean more cases go to juries, Leslie suggests the shortcomings of jury decision making are manageable and preferable to inappropriate “judicial application of economic theory.”<sup>15</sup> He concludes that “[a]ntitrust doctrine would be well served if judges focused less on theory and more on the facts before them.”<sup>16</sup>

Many readers will find reason to question Leslie's argument at various points. I would suggest, for example, that courts' resistance to post-Chicago theories of anticompetitive effect, particularly in the area of predatory pricing, has less to do with lack of awareness (the theories, after all, have been out there for a while) than with ideology and related empirical (and largely untestable) assumptions about the relative competence of courts and markets in promoting the consumer interest.<sup>17</sup> I also would suggest that the difficulties he identifies in the cartel cases stem in large

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<sup>11</sup> *Williamson Oil Co. v. Philip Morris USA*, 346 F.3d 1287 (11th Cir. 2003).

<sup>12</sup> *In re Citric Acid Litig.*, 191 F.3d 1090 (9th Cir. 1999).

<sup>13</sup> He discusses *Blomkest Fertilizer, Inc. v. Potash Corp. of Saskatchewan*, 203 F.3d 1028 (8th Cir. 2000) (en banc); *Adaptive Power Solutions, LLC v. Hughes Missile Systems Co.*, 141 F.3d 947, 949 (9th Cir. 1998); and *In re DDAVP Direct Purchaser Antitrust Litig.*, No. 05-2237, 2006 U.S. Dist. LEXIS 96201 (S.D.N.Y. Nov. 2, 2006).

<sup>14</sup> Leslie, *supra* note 5, at 343.

<sup>15</sup> *Id.* at 352.

<sup>16</sup> *Id.* at 353.

<sup>17</sup> See, e.g., William H. Page, *The Ideological Origins and Evolution of U.S. Antitrust Law*, in 1 ABA SECTION OF ANTITRUST LAW, ISSUES IN COMPETITION LAW AND POLICY 1 (Wayne Dale Collins ed., 2008); William H. Page & John E. Lopatka, *Economic Authority and the Limits of Expertise in Antitrust Cases*, 90 CORNELL L. REV. 617 (2005).

part from the inadequacy of the law's definition of agreement in the Sherman Act context.<sup>18</sup> Nevertheless, the article offers an interesting application of post-Chicago and behavioral economics to important areas of antitrust law. ●

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<sup>18</sup> See, e.g., William H. Page, *Facilitating Practices and Concerted Action Under Section 1 of the Sherman Act*, in ANTITRUST LAW AND ECONOMICS (Keith Hylton ed., forthcoming 2010); William H. Page, *Twombly and Communication: The Emerging Definition of Agreement Under the New Pleading Standards*, 5 J. COMPETITION L. & ECON. 439 (2009); William H. Page, *The Gary Dinners and the Meaning of Concerted Action*, 62 SMU L. REV. 597 (2009).