

# You Too Can Win Antitrust Cases: The Myths and Realities of Trying an Antitrust Case to a Jury

**John M. Majoras**

Trying any type of case to a jury carries an inherent risk that the result may not line up with the weight of the evidence, whether from the jury's inability to understand key concepts or from lack of interest in technical presentations. Antitrust cases, in particular, can often seem ill-suited for jury trials. Indeed, some have argued that antitrust cases should be tried only to judges who have a background in economic issues because of the challenging combination of legal and economic principles presented in most antitrust matters.<sup>1</sup>

A jury adds a host of uncontrollable variables, only some of which can be managed through effective voir dire. Not surprisingly, litigants are often reluctant to jump into that unknown, particularly when additional risk factors such as treble damages and attorney's fees are added to the mix.<sup>2</sup> Combined, these concerns typically lead to decisions to settle that are probably even more frequent than the already high percentage of civil cases that are resolved out of court. Nothing can be done to lessen the possible impact of treble damages and fees, but the potential vagaries of jury decisions can be minimized by recognizing some of the unique aspects of trying an antitrust case and by setting aside some of the myths that can make that prospect seem so daunting.

Any number of successful trial strategies applies equally to antitrust cases. Keeping it simple, telling a story, and putting a human face on business entities are a few examples. In fact, lawyers who convince themselves that an antitrust case is so different from other types of civil litigation often run into problems when they stray from those basic principles. Perhaps the most common mistake is taking an approach that assumes an antitrust case is well outside a typical juror's capacity to understand. That path can easily lead a lawyer to engage in mind-numbing repetition and an overly complicated presentation that tries to explain every little business or economic point, regardless of whether a juror's understanding of that point will actually sway the ultimate decision. Similarly, lawyers probably spend too much time trying to make every point understandable to every member of the jury. The pitfalls are, again, repetition and elongation, which can turn off the more perceptive jurors, who are left to wonder why the lawyer thinks they are incapable of analyzing basic business and economic concepts.

Without a doubt, antitrust cases *do* present unique challenges. The cases can often be document-intensive and almost always require some understanding of how businesses would be expected to operate in the absence of the claimed illegal conduct. Plaintiffs are often faced with

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<sup>1</sup> Indeed, some courts have held that there is a "complexity exception" to the right to a jury trial. See ABA SECTION OF ANTITRUST LAW, ANTITRUST LAW DEVELOPMENTS 975-76 (6th ed. 2007).

<sup>2</sup> The fundamental issues addressed are equally applicable to both sides of a case, but I acknowledge that my practice has primarily been focused on the defense side.

the prospect of presenting their case through hostile witnesses, because the only observers of the relevant conduct are defendants' own personnel. On the other hand, defendants can lose access to key witnesses who are unwilling to testify when there are potential criminal ramifications. And both sides often face a task of knitting together various parts of the case without a witness who is able to unify the story.

All of these issues are manageable if you can avoid buying into some of the myths that seem to accompany antitrust cases and make them appear too risky to take to trial. Many of these relate to the capacity of jurors to understand the case, biases that jurors may have, and the appropriate role of expert witnesses.

Having successfully tried two antitrust jury trials in the last two years, including one class action, I will offer my thoughts on some of the myths and the realities of antitrust jury trials.

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**MYTH NO. 1:** Jurors cannot understand antitrust cases.

**The Reality:** Juries probably will not understand the antitrust issues as well as you do, but that should not prevent jurors from understanding enough to find for your client.

Every jury is of course different and will have a particular capacity to understand complicated issues, but it is a mistake to assume a severely limited intellectual capacity. That is especially true when we are concerned about the *collective* capacity. I do not want to try my case to the brightest juror, but I also do not want to spend my time catering to the least common denominator. I also need to be careful not to get caught up in theoretical issues about what the antitrust laws are designed to prevent and protect.

Take for example two possible approaches to a defendant's opening statement:

This is an antitrust case. The antitrust laws were designed to protect competition. Our economic system is based on competition, which ultimately provides consumers the widest range of product choices and pricing. So when plaintiff says that they are going to prove an antitrust violation, they will have to demonstrate that an agreement was made to restrain competition.

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This is a case about competition. The witnesses you will hear and the documents you will see will make clear that my client was constantly looking for ways to attract customers to its products. We offered a large variety of options, while charging prices that allowed the business to prosper and provided opportunities to develop new technology that our customers want. There is no evidence that shows any kind of agreement or understanding with our competitors about how we would run our business.

Hopefully, the second option will seem like the better approach, but too many lawyers get caught up in trying to “educate” the jury, rather than tell a story. Issues such as antitrust theory and the development of antitrust jurisprudence are unlikely to be of any serious interest to most jurors, and even if you can educate them, it may do little to help you prove the actual elements of the case. Jurors comprehend concepts such as competition, agreements, and understandings. The more we stray from those fundamentals, the less likely that the jury will understand the basic concepts needed to find for your client. Save the theory and high-brow antitrust philosophy for a bar association meeting.

**MYTH NO. 2:** Jurors do not understand economics.

**The Reality:** Most jurors are unable to spout economic theory, but they intuitively understand many of the fundamentals of economic theory from everyday experiences.

This myth is akin to the first one, and like most myths, there is often a grain of truth to them. Most jurors have the capacity to understand basic principles of supply and demand, as well as what it means to have the power to impose pricing. Indeed, some jurors will arrive with these understandings, not because they took a class in economics but because they see them applied in common situations. For example, most jurors understand that the local cable monopoly can seemingly set prices at its own whim, and there is little recourse because there is no competitor. Likewise, grocery shoppers in the Midwest recognize that the prices of fresh vegetables go down in the summer when local farms can increase the supply. Volume discounts are another common experience. People seem to understand that if you use more minutes on your cell phone plan, the provider is more willing to offer a lower per-minute price. Even if all jurors cannot fully articulate the economic theory, they recognize it when applied to their everyday life.

We need to recognize jurors' ability to understand basic economic concepts when presenting a case, particularly through expert testimony. It is not important for me to enable a juror to argue economic theory in the deliberation room if he can just as easily make the point by saying, "It's just like when I buy vegetables in the summer rather than the winter . . . ."

Like most cases, antitrust trials can be distilled into a limited number of key points and findings that are necessary for success. We take on a difficult and pointless burden if we try to teach an advanced-level economics class during the trial. A common example is the so-called small but significant non-transitory increase in price (SSNIP) test for determining market definition. Explaining the purpose and use of the SSNIP test when conducting merger analysis will be of absolutely no consequence to a vast percentage of jurors, especially when the case at hand does not concern a merger. And if you actually have your expert explain why the test is relevant and what one must consider when conducting it, you will just convince the one or two jurors still listening that it is complete hocus pocus. Of course, the performance of the SSNIP test may indeed be important to your expert's conclusions, but the better approach is through testimony providing a generalized and interesting description that may never include the term "SSNIP."

Jurors are more likely interested in the "why" of the geographic market than the "what." An economist who reaches conclusions about market boundaries should be able to explain why these markets conform to common sense as well as the SSNIP test. For example, although two markets may be next to each other, certain topographic features like a ridge line or a river may be an effective dividing line, although it does not impose an actual barrier. In many cities, inhabitants define themselves as an "east-sider" or a "west-sider," despite having ready access across both sides of town. In some cases, those self-defining differences can result in separate geographic markets. An economist who can talk about those differences will resonate with the jury, which intuitively already sees the distinction. The bottom line is that economic theory should be doled out in limited doses and only when it is an important building block that the jury needs to understand in order to find for your client.

**MYTH NO. 3: A good expert can bamboozle the jury.**

**The Reality:** While an effective expert is important in articulating difficult concepts to jurors, do not be mesmerized by your own witness's expertise.

If you are bedazzled by your economist's ability to articulate economic theory and applicability to the facts and data in your case, do not assume that a juror will be similarly taken. Just as with fact witnesses, likeability and credibility are critical factors for expert witnesses. And if the other side's expert is as likeable and credible as yours, do not expect the jury to roll up its sleeves and try to

understand the differences between the two, even though you firmly believe that a roomful of economists would conclude that your expert is right.

As antitrust lawyers, we spend a considerable amount of time with our consulting and testifying economists, exchanging and debating theories and obtaining necessary clarifications. Many of us already have a background, or at least an interest, in antitrust economics, and we are certainly motivated by the task at hand to understand the economics as they relate to our case. Now compare that to average jurors. They may spend a couple of hours with the economist, but they are not permitted to ask any questions to aid in their understanding. Very seldom will you have a trained economist on the jury because at least one side will find that to be worthy of a peremptory challenge. Jurors have no particular motivation to understand the economist. Neither compensation nor a test grade hangs in the balance. And even those jurors who try their hardest to follow and understand an expert witness have myriad opportunities to get distracted, lose interest, or fall asleep.

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So how do we deal with this problem? Start by recognizing that it is not the economist's problem. Those variables and coefficients are important, and the economist's credentials are as well (sort of). If the economic analysis is done poorly or the economist lacks adequate credentials, she will be subject to attack on cross-examination. Jurors may not like or understand economic principals, but they do like effective attacks on cross-examinations. After all, *Law and Order* and other lawyer dramas have conditioned our jurors to take notice if a witness cannot withstand a withering attack. Jurors may not appreciate a carefully crafted regression analysis, but they can sure see an expert hemming and hawing when an incorrect one is thrown back in her face.

Effectively using expert economic testimony requires counsel and the witness to be in tune with the jury by understanding what has already resonated in the case and what still needs to be explained. Ignoring the former leads to repetition that will lose jurors' attention, and a failure to consider the latter results in a huge lost opportunity to use a witness who is permitted to analyze and give conclusions about the facts that the jury has not even thought to marshal. This means that the lawyer is going to have to stray from the comfort zone of a typical expert examination.

The do-it-in-your-sleep direct exam outline of an economist goes something like this:

Q: *Who are you?*

A: *I'm an economist, and I'm really smart.*

Q: *What did you do in this case?*

A: *I considered everything.*

Q: *Then what?*

A: *I fed it into a big computer.*

Q: *What did you conclude?*

A: *Damages were huge (plaintiff)/non-existent (defendant).*

Q: *Are you sure?*

A: *Absolutely.*

Q: *How do you know?*

A: *I considered everything, I'm really smart, and I have a really big computer.*

That outline can be rendered quite readily into four or more hours of testimony, allowing the witness to talk about all of the awards she won, the books and articles she wrote, what "peer review" means, her theories on econometrics, the data sets she compiled, and so on. But how much of

that really matters to most jurors? I make no claims that I have arrived at the new paradigm for expert exams, because the outline (stripped of some of its acerbic nature) really does encompass the main points that most economic experts must make. The problem lies more in the application.

The only person who tends to be more fascinated than the expert herself in the subject matter of the testimony is the lawyer conducting the exam. This can lead to a conversation that, although technically brilliant, is of little interest to the jury, which is relegated to a bystander role. The expert must engage the jury, and the only way to do it is to anticipate and respond to what the jurors will find interesting or at least informative. By the time many experts conclude their discussion of their credentials, many jurors are long gone.

The easy part of the expert exam should be providing the substance. The lawyer should know with some precision what the expert will be saying, and the expert will be fully briefed on where the exam will go. On top of that, the expert is typically a seasoned witness and is not likely to succumb to a case of nerves the way fact witnesses can. Those factors should free the lawyer to pay more attention to the jury than to the expert. The lawyer should be the first to know when juror interest is waning or when concepts are not registering. If those points can be recognized early, the exam can be guided to address the concern.

Creativity is important in an expert examination, far more so than during most fact examinations. Jurors can often identify with fact witnesses. They seem more like the typical juror, and often already speak the same language. If experts and their lawyer get caught up in their own private conversation about complicated topics that they have been discussing among themselves for the last year and a half, the jury will feel like an outsider.

The problem is pretty easy to identify, but what is the solution? After all, at some point the regression analysis has to be explained. There are a variety of useful techniques: humor, the use of analogies that reference common experiences, and pointing out unique facts or circumstances are a few. Take the expert qualifications, for example. Education, experience, and scholarship are all important attributes that need to be discussed, but it does not mean that the expert has to recite her resume. I once had an expert metallurgist on the stand (not in an antitrust case), and his role was to discuss metallurgy as it applies to welding electrodes. I think it is safe to say that most jurors would not find the topic scintillating. Instead of starting the exam by asking him to describe his education and experience, my first question started by showing him and the jury a picture. It was a Tennessee license plate (he taught at the University of Tennessee), and it simply said "Dr. Weld." It was a gift from his students, and it was a perfect lead-in to the examination, especially since he was able to discuss it without any apparent arrogance. By the time that trial was over, I doubt the jurors could identify my expert by name, but you can be sure they remembered "Dr. Weld."

Though tempted, I have never asked one of my economists to get a license plate that reads "Dr. Econ," but experts always have some unique attributes or experiences that can be used to keep jurors interested as you qualify the expert, and the added benefit is that it can humanize her and make her memorable. We also need to resist the urge to go to great lengths to prove that our expert is "better" than theirs. I don't believe that jurors spend much time distinguishing between which side's expert has the greater qualifications or resume value. And even if they did, I am not sure we should care. If, as I believe, most jurors look at competing expert qualifications as a wash absent extraordinary differences, then I am much more concerned about my expert being memorable. So even if the jury may not comprehend everything in the context of the examination, I can more easily emphasize the relevant points on closing by being able to refer to "Dr. Weld." The presentation that might impress a roomful of economists with the witness's and lawyer's mastery of the subject is unlikely to be the one that will win the day for the jury.

**MYTH NO. 4:** Once a class is certified in an antitrust case, it is headed for settlement.

**The Reality:** There is no question that a class case will carry greater financial risks to a defendant, but a successful defense of a class action carries a substantial reward by extinguishing the potential liability across the full range of the class. Antitrust class actions do get tried.

I can speak directly to this myth because of my experience in successfully defending an antitrust class action in November 2008 in *Louisiana Wholesale Drug Co. v. Sanofi-Aventis U.S. LLC*.<sup>3</sup> There are other antitrust class actions that have gone to trial.<sup>4</sup> Nonetheless, they are infrequent.

There is a litany of reasons to settle antitrust cases from both the defendant's and plaintiff's perspective. The most obvious one is the potential scope of damages after trebling and fees. Joint and several liability also plays an important role if there are multiple defendants. Generally speaking, those defendants who settle early get the better result.

But it is not the class aspect of the case that is the most important factor in whether a settlement is reached. Certainly, avoiding class certification can often lead to the end of the case, but even then, there is now a very strong plaintiffs' bar that represents individual claimants who will either opt out of the class if it is certified or will carry on the litigation in combination with other individual claimants by design or as a consequence of the multi-district litigation process. Understanding the size, capabilities, and motivations of the individual members of the class may even lead to a decision by defendants not to challenge certification. If none of the individuals opt out, then the resolution or trial of the matter will cover all claimants. If there are opt-outs, the complexion of the case can be changed dramatically if the opt-outs become the real drivers of the litigation.

In the *Sanofi-Aventis* trial, the defendant decided not to challenge class certification, despite anticipating that the case would proceed to trial. There were a number of issues that ultimately led to the decision, but because there were no opt-outs from the class, our defense verdict applied across the board.

Even if a class is not certified, the attraction of trying individual cases may not be so great because of collateral estoppel issues. If a defendant loses an individual case, the damages would not be as significant as losing a class case, but it could open the floodgate to additional claims that may no longer even be triable on critical issues.

Plaintiffs also have to be careful not to take a class certification decision as the precursor to an ultimate victory. I am not convinced that jurors adequately understand the significance of a class without careful attention from counsel. If the class distinction is not adequately explained and emphasized, jurors may be skeptical about awarding large amounts of damages, particularly when the class representative is a very small member of the class. For this reason, the class representatives should be carefully vetted, and it is probably helpful to have more than one. If the representatives cover a wide range of the class members, the jury can more easily understand why a substantial award might be warranted.

Although class actions are usually settled, I do not think the class nature of the claims is what drives the decision. The substantive issues in the case are the same for class and non-class cases alleging the same conduct. The damages analyses and presentations are markedly different, but few cases go to trial just on damages issues. If the substantive defenses are strong, the class nature of the case should not keep it from a jury trial.

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<sup>3</sup> No. 07 CV 7343 (HB) (S.D.N.Y. 2008).

<sup>4</sup> See, e.g., *Morelock Enters. v. Weyerhaeuser Co.*, No. 3:04-cv-00583-PA (D. Or. 2008); *In re Tableware Antitrust Litig.*, No. C-04-3514 (VRW) (N.D. Cal. 2007).

**MYTH NO. 5:** Jurors are looking for ways to punish greedy corporations.

**The Reality:** Jurors will certainly punish corporations when wrongdoing has been proven, but the greed theme can easily be overplayed.

*Many corporate defendants are concerned that they will not get a fair shot from a jury because it will be biased, or at a minimum, susceptible to an argument that corporate greed will lead companies to do anything to maintain profits, including illegal activity.*

Many corporate defendants are concerned that they will not get a fair shot from a jury because it will be biased, or at a minimum, susceptible to an argument that corporate greed will lead companies to do anything to maintain profits, including illegal activity. That concern is augmented by populist approaches on the political front that often attempt to deflect blame for policy decisions onto everybody's favorite villain: faceless corporations. Plaintiffs, of course, are happy to take up that mantle, and from a tactical standpoint, rightly so. But even though that theme may resonate, it can be diminished.

The first way to do it is by acknowledging that the company is indeed trying to earn as much money as it can. In fact, it owes that obligation to its employees and their families, who rely on the company to support them, and to its shareholders (in the case of a public company). Most jurors similarly work (or rely on someone) for enterprises that they hope are trying to make as much money as possible. The corollary though, is to further demonstrate that your client is guided by ethics and legitimate competition.

From a plaintiff's perspective, it is generally a pretty good tactic to play the "greed" card, particularly because most studies have shown that the majority of jurors have some predisposition to believing it. But it obviously needs more. In fact, if too much emphasis is placed on the label without sufficient underlying facts to prove anticompetitive conduct, some jurors can be left feeling like the lawyer is trying to manipulate their feelings and make an award based only on that motivation. It is possible that some jurors will nonetheless be inclined to do that, but others in the jury room will bring them into line, particularly if you arm them for the argument.

**MYTH NO. 6:** A per se case faces a far greater risk to defendants than does a rule of reason case.

**The Reality:** It all depends. Some per se cases can actually be easier to try because the issues tend to be narrower and are often easier for a jury to understand.

Per se and rule of reason cases come in a wide variety of types. For example, a per se price-fixing case that follows on the heels of a criminal plea for the same conduct is a much different animal than a case with similar allegations but no related criminal plea. If the principal liability issue is the existence and scope of an agreement, the case may actually be presented quite readily to a jury. Indeed, many of the issues discussed in this article about a juror's capacity to understand economics and antitrust legal principles may not be that critical if the issues can be distilled into whether an agreement on prices had been reached.

It is probably safe to say that a criminal plea is almost always followed by settlements in the related civil cases, but even then, significant triable issues can remain. Civil plaintiffs may allege a conspiracy that is broader in scope than what has been admitted in the plea. Often there is a question about whether a criminal conspiracy can be shown to have been longer in duration than what is established in the plea, or plaintiffs may allege that it affected geographic areas that are wider than what the plea specifies. And, of course, damages are always an issue that would not be addressed in the plea.

Even though significant triable issues may remain for the civil case, defendants who have already pled guilty face some daunting challenges that make settlement the more palatable option. For example, although there may be a significant gap in the damages position of each

side, plaintiffs will be sure that a trial on damages includes all of the bad conduct issues cemented in the plea. Having to try issues, such as damages or the scope of a conspiracy, relegates defendants to fighting with a hand tied behind their back because plaintiffs will always have the argument of “Are you really going to believe what they’re saying when they’ve already admitted to fixing prices?”

Rule of reason cases would seem to present better opportunities to defendants because they are not accompanied by guilty pleas, but they can present difficult analytical questions. Jurors will be asked to balance competitive versus anticompetitive effects of the alleged conduct. The successful litigant will be the side that is best able to simplify the case for the jury, so that when it collectively asks why certain conduct occurred, it is put in the correct context. If one side does not effectively resolve those “why” questions during the course of the trial, it will face an unpleasant outcome.

So, is the per se or the rule of reason case the better one to take to a jury? It depends on a range of issues. Neither is a clear winner or loser for either side. As with any litigation, it comes down to the specific facts and the ability to present them effectively and efficiently.

**MYTH NO. 7:** Every company has bad documents that can be used to demonstrate anti-competitive behavior.

**The Reality:** This “myth” is frequently true, but jurors are willing to put documents into context and recognize that authors do not write documents from the perspective of how they might later look if examined at a trial.

While it is often true that defendants will have to explain conduct and communications that on their face can look conspiratorial or anticompetitive, the damage can be limited when the documents are put into context. For example, businesses invariably have documents that appear to have an “insider’s” understanding of a competitor’s pricing. Often, these communications have long been forgotten such that the individual who received or sent them cannot specifically recall their origin. Or even if that information can be presented through a witness, similar situations cannot, leaving the implication that the unexplained ones are problematic. Running down each and every communication becomes a game of “whack-a-mole.”

An alternative, and likely better, approach is to present the broader context. Juries will understand the basic concepts of competitive intelligence (especially if you do not focus exclusively on those particular buzzwords). It is intuitive that any business wants to take note of its competitors’ activities, and it is simple enough to demonstrate that there are less than perfect flows of information in most industries. Few businesses operate in a world like the corner gas stations in which competitive intelligence requires little more than glancing at the large price signs across the street. Often, the implication plaintiffs are trying to paint from unsourced price information can be adequately rebutted with a single witness who can effectively describe the company’s different methods of gathering information, including the fact that customers, distributors, and agents often provide the information when they learn of it.

Plaintiffs have to be careful that if they are going to present a case in which implications from corporate documents must be drawn, the implications are either intuitive or made obvious by subsequent events. Unless a document is prima facie evidence of anticompetitive conduct, the jury is going to give defendants a chance to explain why the document or communication took place. If the explanations are reasonable, I think that the jury will want to see more from the plaintiffs and may be reluctant to make inferential leaps to finding illegal conduct. Documents that may have

supported an inference of illegality sufficient to survive summary judgment often face a more difficult task at trial when you have to convince the jury to actually arrive at those inferences.

### **Conclusion**

Even the most complicated antitrust cases can be presented effectively to a jury. Almost any jury can reach the right conclusion if counsel provides a clear roadmap and avoids cluttering the case with unnecessary and repetitive information or concepts. The stakes are usually high, but that makes success all the sweeter. ●

# Justice Souter's Antitrust Legacy

**Robert A. Skitol and Kenneth M. Vorrasi**

Justice Souter's record in antitrust cases over the past nineteen years belies the conventional wisdom about him as a consistent member of the Supreme Court's "liberal" wing.<sup>1</sup> It is true that he voted with the majority in *Eastman Kodak Co. v. Image Technical Services Inc.*<sup>2</sup> and with the dissenters in *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*,<sup>3</sup> positions consistent with the liberal side of the antitrust world. More often, however, he joined the conservative side of the Court on outcomes that significantly narrowed the scope of antitrust law—including (a) cases with other dissenting voices, such as *City of Columbia v. Omni Outdoor Advertising, Inc.*, *Brooke Group v. Brown & Williamson Tobacco Corp.*, and *Credit Suisse Securites (USA) LLC v. Billing*;<sup>4</sup> and (b) unanimous decisions as in *Spectrum Sports, Inc. v. McQuillan*, *State Oil Co. v. Khan*, *NYNEX Corp. v. Discon*, *Texaco Inc. v. Dagher*, *Illinois Tool Works Inc. v. Independent Ink*, and *Weyerhaeuser v. Ross-Simmons Hardwood Lumber Co.*<sup>5</sup> In two other important 9–0 decisions, Justice Souter joined concurring opinions preferring narrower grounds for the decision in *Verizon Communications, Inc. v. Law Offices of Curtis V. Trinko LLP* and *Pacific Bell Telephone Co. v. LinkLine Communications*.<sup>6</sup> Between 1993 and 2009, he supported six decisions that markedly limit the kinds of conduct or circumstances subject to monopolization or attempted monopolization claims under Section 2 of the Sherman Act.<sup>7</sup>

Two of the four antitrust opinions that Justice Souter authored within the past decade, *California Dental Association v. FTC* and *Bell Atlantic Corp. v. Twombly*,<sup>8</sup> will determine his antitrust legacy.

<sup>1</sup> Justice Souter participated in twenty-two antitrust cases during his tenure since 1990. He took no part in the Court's consideration of *Palmer v. BRG of Georgia, Inc.*, 498 U.S. 46 (1990).

<sup>2</sup> *Eastman Kodak Co. v. Image Technical Servs. Inc.*, 504 U.S. 451 (1992) (tying and monopolization claims in single-product aftermarkets).

<sup>3</sup> *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 551 U.S. 877 (2007) (minimum resale price maintenance).

<sup>4</sup> *City of Columbia v. Omni Outdoor Adver., Inc.*, 499 U.S. 365 (1991) (sham exception to *Noerr-Pennington* immunity); *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993) (predatory pricing); *Credit Suisse Sec. (USA) LLC v. Billing*, 551 U.S. 264 (2007) (implied antitrust immunity).

<sup>5</sup> *Spectrum Sports, Inc. v. McQuillan*, 506 U.S. 447 (1993) (attempted monopolization); *State Oil Co. v. Khan*, 522 U.S. 3 (1997) (maximum resale price maintenance); *NYNEX Corp. v. Discon, Inc.*, 525 U.S. 128 (1998) (group boycotts); *Texaco Inc. v. Dagher*, 547 U.S. 1 (2006) (horizontal restraints within joint ventures); *Illinois Tool Works Inc. v. Indep. Ink*, 547 U.S. 28 (2006) (whether patents confer market power); *Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co.*, 549 U.S. 312 (2007) (predatory bidding).

<sup>6</sup> *Verizon Commc'ns, Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398 (2004) (refusal to deal); *Pac. Bell Tel. Co. v. linkLine Commc'ns*, 129 S. Ct. 1109 (2009) (price squeeze claims).

<sup>7</sup> See *Brooke Group*, 509 U.S. 209 (1993); *Spectrum Sports*, 506 U.S. 447 (1993); *NYNEX*, 525 U.S. 128 (1998); *Weyerhaeuser*, 549 U.S. 312 (2007); *Trinko*, 540 U.S. 398 (2004); *linkLine*, 129 S. Ct. 1109 (2009).

<sup>8</sup> *California Dental Ass'n v. FTC*, 526 U.S. 756 (1999); *Bell Atl. Corp. v. Twombly*, 550 U.S. 544 (2007). His two other antitrust opinions, both rendered in 1993, are (a) *Hartford Fire Insurance Co. v. California*, 509 U.S. 764 (1993), in which he wrote for the majority on the scope of the antitrust exemption for the insurance business and the scope of Sherman Act jurisdiction in a case involving foreign defendants and foreign conduct; and (b) *Professional Real Estate Investors, Inc. v. Columbia Pictures Industries, Inc.*, 508 U.S. 49 (1993) (Souter, J., concurring), in which he wrote a concurring opinion to clarify one aspect of Justice Thomas's majority opinion on the scope of the sham exception to *Noerr-Pennington* immunity.

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Both opinions were highly controversial and have materially altered antitrust jurisprudence. *California Dental Association* has made it more difficult for plaintiffs to prevail or even to survive the summary judgment stage on challenges to many kinds of horizontal restraints; *Twombly* has made it more difficult for plaintiffs to survive the initial pleading stage and thus to begin any discovery process in a broad range of antitrust and non-antitrust cases. These two opinions are the focus of this article.

### ***California Dental Association v. FTC***

Justice Souter's 1999 majority opinion in *California Dental Association v. FTC (CDA)* concerned a code of ethics promulgated and enforced by a nonprofit association of 19,000 California dentists that prohibited members from engaging in broad categories of price and quality advertising.<sup>9</sup> The FTC's Administrative Law Judge, in his Initial Decision after trial, held the prohibitions to be the kind of "inherently suspect" horizontal restraints that warranted condemnation under the agency's so-called *Mass. Board* standard.<sup>10</sup> On appeal, the Commission held the price advertising restraint to be illegal per se and, in the alternative, both the price and quality advertising restraints illegal under a somewhat abbreviated rule of reason analysis.<sup>11</sup> On CDA's appeal from those determinations, the Ninth Circuit rejected the per se illegality holding but upheld the alternative rule of reason holdings.<sup>12</sup> In the Ninth Circuit's view, the Commission had properly "applied an abbreviated, or 'quick look,' rule of reason analysis designed for restraints that are not per se unlawful but are sufficiently anticompetitive on their face that they do not require a full-blown rule of reason inquiry."<sup>13</sup> On CDA's appeal from the latter holding, a 5–4 majority reversed it because, as Justice Souter explained at some length, the Ninth Circuit's "quick look" was too quick for restraints of the kind at issue.

Justice Souter distinguished all three of the Court's prior decisions blessing quick-look analysis on the ground that in those cases "an observer with even a rudimentary understanding of economics could conclude that the arrangements in question would have an anticompetitive effect on customers and markets."<sup>14</sup> However, in the Souter majority's view, the case before the Court "fail[ed] to present a situation in which the likelihood of anticompetitive effects is comparably obvious."<sup>15</sup> This was explained in terms of what the majority saw to be special attributes of professional advertising that presented considerable risk of consumer deception so that the restraints there at issue "might plausibly be thought to have a net procompetitive effect, or possibly no effect at all on competition."<sup>16</sup> Thus, in this context, more than a " cursory treatment" was required to determine

*In the Souter majority's view, the case before the Court "fail[ed] to present a situation in which the likelihood of anticompetitive effects is comparably obvious."*

<sup>9</sup> *CDA*, 526 U.S. at 759–61.

<sup>10</sup> *California Dental Ass'n*, 121 F.T.C. 190, 268–72 (1996) (Initial Decision) (referring to *Mass. Bd. of Registration in Optometry*, 110 F.T.C. 549 (1988) (Opinion of the Commission)). In *Mass. Board*, the Commission set forth the following framework for analyzing horizontal restraints: if the restraint is "inherently suspect," the burden shifts to the defendant to establish a "plausible efficiency justification." If the justification is plausible, then a rule of reason analysis is conducted; but if it is not plausible, the restraint is condemned as unreasonable under the rule of reason "without further inquiry" because "there are no likely benefits to offset the threat to competition." *Mass. Board*, 110 F.T.C. at 604.

<sup>11</sup> *California Dental Ass'n*, 121 F.T.C. 190, 300–22 (1996) (Opinion of the Commission).

<sup>12</sup> *California Dental Ass'n v. FTC*, 128 F.3d 720 (9th Cir. 1997).

<sup>13</sup> *Id.* at 727.

<sup>14</sup> *CDA*, 526 U.S. at 770 (referring to *Nat'l Soc'y of Prof'l Eng'rs v. United States*, 435 U.S. 679 (1978), *NCAA v. Board of Regents of Univ. of Okla.*, 468 U.S. 85 (1984), and *FTC v. Indiana Fed'n of Dentists*, 476 U.S. 447 (1986)).

<sup>15</sup> *Id.* at 771.

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

whether the restraints at issue were anticompetitive and whether the association's arguably "plausible" justifications were valid; these questions called for "empirical" analysis.<sup>17</sup>

Justice Souter concluded with several observations seemingly intended to narrow or at least qualify the import of the majority's rejection of quick-look analysis in this case: holding the restraints at issue "required a more extended examination of the possible factual underpinnings than [they] received is not, of course, necessarily to call for the fullest market analysis";<sup>18</sup> "our categories of analysis of anticompetitive effect are less fixed than terms like 'per se,' 'quick look,' and 'rule of reason' tend to make them appear";<sup>19</sup> there "is always something of a sliding scale in appraising reasonableness";<sup>20</sup> what "is required . . . is an enquiry meet for the case, looking to the circumstances, details, and logic of a restraint";<sup>21</sup> the "object is to see whether the experience of the market has been so clear, or necessarily will be, that a confident conclusion about the principal tendency of the restriction will follow from a quick (or at least quicker) look, in place of a more sedulous one."<sup>22</sup>

There was voluminous commentary on the decision over the year immediately following its issuance, including a great variety of predictions about its impact on the antitrust treatment of horizontal restraints generally in the years ahead.<sup>23</sup> Of most interest for present purposes is the way three former FTC officials closely associated with the agency's development of horizontal restraints policy found silver linings in Justice Souter's opinion: its "clear affirmation of the legitimacy of the flexible approach to the rule of reason, which can be truncated in appropriate cases";<sup>24</sup> its "set-back for market power screens" and "the call for application of a 'sliding scale' of antitrust analysis";<sup>25</sup> and recognition "that the rule of reason [is] a continuum, allowing for many levels of scrutiny," acknowledgement that the Court's earlier decisions in *BMI*, *NCAA*, and *IFD* established the legitimacy of a "quick look" approach in some cases, and "rejection of a rigid bipolar approach [per se versus full rule of reason] to analyzing restraints among competitors."<sup>26</sup>

Both enforcement agencies effectively adopted that "positive" spin on the Souter opinion by citing to it no less than four times in support of central aspects of the 2000 DOJ-FTC Antitrust

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<sup>17</sup> *Id.* at 773, 774.

<sup>18</sup> *Id.* at 779.

<sup>19</sup> *Id.*

<sup>20</sup> *Id.* at 780 (internal quotations omitted).

<sup>21</sup> *Id.* at 781.

<sup>22</sup> *Id.* Justice Breyer authored a dissenting opinion in which three other Justices joined. While expressing agreement with the general principles stated at the conclusion of Justice Souter's opinion, he presented his own extended analysis of how "a traditional application of the rule of reason to the facts as found by the Commission require[d] affirming the Commission—just as the Court of Appeals did below." *Id.* However, Justice Souter in his majority opinion noted that the Breyer analysis was "no 'quick look'" and that it offered "little to demonstrate the sufficiency of the Court of Appeals's review." *Id.* at 779.

<sup>23</sup> See, e.g., Stephen Calkins, *California Dental Association: Not a Quick Look but Not the Full Monty*, 67 ANTITRUST L.J. 495 (2000); Marina Lao, *Comment: The Rule of Reason and Horizontal Restraints Involving Professionals*, 68 ANTITRUST L.J. 499 (2000); Alan J. Meese, *Farewell to the Quick Look: Redefining the Scope and Content of the Rule of Reason*, 68 ANTITRUST L.J. 461 (2000); Timothy J. Muris, *The Rule of Reason After California Dental*, 68 ANTITRUST L.J. 527 (2000); Willard K. Tom & Chul Pak, *Toward a Flexible Rule of Reason*, 68 ANTITRUST L.J. 391 (2000); David Balto, *Some Observations on California Dental Association v. FTC*, ANTITRUST, Fall 1999; William J. Kolasky, *California Dental Association v. FTC: The New Antitrust Empiricism*, ANTITRUST, Fall 1999; James A. Meyers & Robert A. Skitol, *Supreme Court Muddies the Waters of Horizontal Restraints Analysis*, 524 FTC WATCH 2 (1999).

<sup>24</sup> Balto, *supra* note 23, at 64.

<sup>25</sup> Calkins, *supra* note 23, at 496–97.

<sup>26</sup> Muris, *supra* note 23, at 529–31.

Guidelines for Collaborations Among Competitors: twice for the proposition that rule of reason analysis “entails a flexible inquiry and varies in focus and detail depending on the nature of the agreement and market circumstances”;<sup>27</sup> once for the proposition that rule of reason analysis “focuses on only those factors, and undertakes only the degree of factual inquiry, necessary to assess accurately the overall competitive effect of the relevant agreement”;<sup>28</sup> and once in support of the proposition that “where the likelihood of anticompetitive harm is evident from the nature of the agreement, . . . then, absent overriding benefits that could offset the anticompetitive harm, the Agencies challenge such agreements without a detailed market analysis.”<sup>29</sup> The Guidelines avoid any use of the “quick look” label but adopt the essence of the quick look approach in many places throughout them (with citations to the decisions Justice Souter blessed as creating the quick look doctrine—*Professional Engineers, NCAA, and Indiana Federation of Dentists*).<sup>30</sup>

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Carefully applying those guidelines over the past decade, the Commission has found that its citations to *CDA*’s language allowing less than “full” rule of reason scrutiny in appropriate cases actually helped it win affirmances in two significant horizontal restraints cases: the D.C. Circuit’s 2005 decision in *PolyGram Holding, Inc. v. FTC*, upholding the agency’s order against an agreement between music distributors to refrain from advertising and discount pricing on their concert albums;<sup>31</sup> and the Fifth Circuit’s decision in *North Texas Specialty Physicians v. FTC*, upholding the agency’s conclusion that physicians’ joint negotiation of contracts with payers through their association was anticompetitive.<sup>32</sup> Both cases, however, were tried and decided on the basis of relatively extensive analysis of the effects of the restraints at issue and detailed consideration of proffered justifications. In short, they are not “quick look” cases as that term generally was understood prior to *CDA*.

More instructive is the role *CDA* has played in defeating private plaintiffs’ reliance on the quick look idea in recent years. Prominent examples in which decisions based on quick look analysis were reversed are the Fourth Circuit’s 2002 decision in *Continental Airlines v. United Airlines*, reversing a decision condemning an agreement among airlines limiting the size of carry-on baggage;<sup>33</sup> the Sixth Circuit’s 2004 decision in *Worldwide Basketball & Sports Tours, Inc. v. NCAA*, reversing a decision against a rule restricting intercollegiate men’s basketball teams to two certified tournaments over four years;<sup>34</sup> and the Second Circuit’s 2008 decision in *Major League Baseball Properties, Inc. v. Salvino, Inc.*, affirming a decision rejecting a challenge to an agreement among baseball teams on an exclusive trademark licensing arrangement and upholding the agreement under the rule of reason.<sup>35</sup>

Those decisions reflect the core problem that Justice Souter’s opinion introduced into horizontal restraints law: the absence of any meaningful guidance on how courts should apply the “slid-

<sup>27</sup> U.S. Dep’t of Justice & Fed. Trade Comm’n, Antitrust Guidelines for Collaborations Among Competitors 3, 10 (2000), available at <http://www.ftc.gov/os/2000/04/ftcdojguidelines.pdf>.

<sup>28</sup> *Id.* at 7–8.

<sup>29</sup> *Id.* at 10–11.

<sup>30</sup> *Id.* at 3, 8–12.

<sup>31</sup> *PolyGram Holding, Inc. v. FTC*, 416 F.3d 29 (D.C. Cir. 2005).

<sup>32</sup> *N. Texas Specialty Physicians v. FTC*, 528 F.3d 346 (5th Cir. 2008).

<sup>33</sup> *Cont’l Airlines, Inc. v. United Airlines, Inc.*, 277 F.3d 499 (4th Cir. 2002).

<sup>34</sup> *Worldwide Basketball & Sports Tours, Inc. v. NCAA*, 388 F.3d 955 (6th Cir. 2004).

<sup>35</sup> *Major League Baseball Properties, Inc. v. Salvino, Inc.*, 542 F.3d 290 (2d Cir. 2008).

ing scale” concept. More specifically, how is one to know as a practical matter when “full” rule of reason scrutiny is required; or when the anticompetitive nature of a restraint is sufficiently “obvious” to dispense with extended market analysis; or when proffered justifications are sufficiently “plausible” to require “empirical” evidence of net effects; or what actually constitutes an “enquiry meet for the case”? Given the amorphous nature of these terms, it is now perilous at best for any plaintiff to rely on a quick look approach to anything other than restraints pretty close to horizontal price-fixing or market division, “naked” restraints of the sort long treated as per se illegal.

### ***Bell Atlantic Corp. v. Twombly***

Justice Souter’s 2007 majority opinion in *Bell Atlantic Corp. v. Twombly* is his most significant contribution to antitrust jurisprudence. At issue was whether the plaintiffs had pled sufficient facts for an alleged antitrust conspiracy among the four leading telecommunication carriers in the United States. It led the Court to a fresh consideration of its holding of fifty years earlier in *Conley v. Gibson*, the leading precedent on pleading requirements.<sup>36</sup>

The plaintiffs had filed a putative class action complaint for injunctive and monetary relief, alleging that four incumbent local exchange carriers (ILECs) unlawfully conspired to inflate prices for local telephone and high-speed Internet services in violation of Section 1 of the Sherman Act.<sup>37</sup> The plaintiffs proffered two theories of harm: first, they alleged that the ILECs “engaged in parallel conduct” to restrict the growth of competitive local exchange carriers (CLECs) in their territories, conduct that included “making unfair agreements with the CLECs for access to ILEC networks, providing inferior connections to the networks, overcharging, and billing in ways designed to sabotage the CLECs’ relations with their own customers”;<sup>38</sup> second, that the ILECs agreed not to compete against one another—agreements that could be “inferred” from, for example, the ILECs’ “common failure” to pursue “attractive business opportunities in contiguous markets where they possessed substantial competitive advantages.”<sup>39</sup>

The district court granted the defendants’ motion to dismiss on the ground that the allegations of conscious parallel business conduct, without more, did not state a claim for conspiracy under Section 1 of the Sherman Act.<sup>40</sup> In the court’s view, the plaintiffs were required to allege additional facts that “‘ten[d] to exclude independent self-interested conduct as an explanation for defendants’ parallel behavior.’”<sup>41</sup> The Second Circuit reversed, holding that “‘plus factors are not required to be pleaded to permit an antitrust claim based on parallel conduct to survive dismissal.’”<sup>42</sup> Invoking *Conley v. Gibson*, the court of appeals stated that “‘to rule that allegations of parallel anticompetitive conduct fail to support a plausible conspiracy claim, a court would have to conclude that there is no set of facts that would permit a plaintiff to demonstrate that the particular parallelism asserted was the product of collusion rather than coincidence.’”<sup>43</sup> The Supreme

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<sup>36</sup> *Conley v. Gibson*, 355 U.S. 41, 45–46 (1957) (holding that “a complaint should not be dismissed for failure to state a claim unless it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief”).

<sup>37</sup> *Bell Atl. Corp. v. Twombly*, 550 U.S. 544 (2007).

<sup>38</sup> *Id.*

<sup>39</sup> *Id.* at 551 (internal quotations omitted).

<sup>40</sup> *Id.* at 552.

<sup>41</sup> *Id.* (quoting *Twombly v. Bell Atl. Corp.*, 313 F. Supp. 2d 174, 179 (2003)).

<sup>42</sup> *Id.* at 553 (quoting *Twombly v. Bell Atl. Corp.*, 425 F.3d 99, 114 (2d Cir. 2005)).

<sup>43</sup> *Id.* (quoting *Twombly*, 425 F.3d at 114 (2d Cir. 2005)).

Court granted certiorari “to address the proper standard for pleading an antitrust conspiracy through allegations of parallel conduct.”<sup>44</sup>

The Supreme Court reversed, holding that the complaint did not state a claim and therefore should have been dismissed.<sup>45</sup> Writing for the seven-justice majority, Justice Souter emphasized that plaintiffs must set forth “plausible” grounds at the pleading stage: “While a complaint attacked by a Rule 12(b)(6) motion to dismiss does not need detailed factual allegations, a plaintiff’s obligation to provide the ‘grounds’ of his ‘entitle[ment] to relief’ requires more than labels and conclusions, and a formulaic recitation of a cause of action’s elements will not do.”<sup>46</sup> Justice Souter explained that the plaintiff’s allegations “must be enough to raise a right to relief above the speculative level”;<sup>47</sup> must be “suggestive enough to render a [claim] plausible”;<sup>48</sup> and must surpass the “line between possibility and plausibility of entitlement to relief.”<sup>49</sup> This “requirement of plausibility” ensures that “there are enough fact[s] to raise a reasonable expectation that discovery will reveal evidence of [a claim].”<sup>50</sup>

In demanding that a plaintiff’s allegations be plausible, the Court was mindful of the high cost of antitrust discovery. Justice Souter recognized that “the threat of discovery expense will push cost-conscious defendants to settle even anemic cases before reaching those proceedings.”<sup>51</sup> By requiring plausibility, courts would be able “to avoid the potentially enormous expense of discovery in cases with no reasonably founded hope that the [discovery] process will reveal relevant evidence” to establish a claim.<sup>52</sup>

The Court thus abandoned the *Conley v. Gibson* standard under which “a complaint should not be dismissed for failure to state a claim unless it appears beyond doubt that the plaintiff can provide *no set of facts* in support of his claim which would entitle him to relief.”<sup>53</sup> This “no set of facts” language, Justice Souter explained, can be interpreted “as saying that any statement revealing the theory of the claim will suffice unless its factual impossibility may be shown from the face of the pleadings.”<sup>54</sup> Under that approach, “a wholly conclusory statement of claim would survive a motion to dismiss whenever the pleadings left open the possibility that a plaintiff might later establish some ‘set of [undisclosed] facts’ to support recovery.”<sup>55</sup> In Justice Souter’s view, the “no set of facts” phrase “is best forgotten as an incomplete, negative gloss on an accepted pleading standard: once a claim has been stated adequately, it may be supported by showing any set of

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<sup>44</sup> *Id.*

<sup>45</sup> *Id.* at 570.

<sup>46</sup> *Id.* at 555 (quoting Fed. R. Civ. P. 8(a)(2) and *Conley v. Gibson*, 355 U.S. 41, 47 (1957)).

<sup>47</sup> *Id.* at 555.

<sup>48</sup> *Id.* at 556.

<sup>49</sup> *Id.* at 557 (quotations and citations omitted).

<sup>50</sup> *Id.* at 556, 560.

<sup>51</sup> *Id.* at 559.

<sup>52</sup> *Id.* (quotations and citations omitted).

<sup>53</sup> *Conley v. Gibson*, 355 U.S. 41, 45–46 (1957) (emphasis added).

<sup>54</sup> *Twombly*, 550 U.S. at 561.

<sup>55</sup> *Id.* (citing *Conley*, 355 U.S. at 45–46).

facts consistent with the allegations in the complaint.<sup>56</sup> In short, a plaintiff must allege sufficient facts “to state a claim to relief that is plausible on its face.”<sup>57</sup>

Applying these principles to the plaintiffs’ allegations, the Court held that stating a Section 1 claim “requires a complaint with enough factual matter (taken as true) to suggest that an agreement was made” and “allegations plausibly suggesting (not merely consistent with) agreement.”<sup>58</sup> More specifically, “an allegation of parallel conduct and a bare assertion of conspiracy will not suffice. Without more, parallel conduct does not suggest conspiracy, and a conclusory allegation of agreement at some unidentified point does not supply facts adequate to show illegality.”<sup>59</sup> The Court thus concluded that, “[b]ecause the plaintiffs here have not nudged their claims across the line from conceivable to plausible, their complaint must be dismissed.”<sup>60</sup>

In the two years since *Twombly* was decided, there have been thousands of pages of commentary on the implications of Justice Souter’s opinion on not only antitrust cases but federal litigation practice generally.<sup>61</sup> Many predicted that the decision’s new “plausibility” standard would “impose a substantially higher burden on plaintiffs to allege facts that support their claim than a literal application of the old *Conley* ‘no set of facts’ standard would have required.”<sup>62</sup> As one article noted, “*Twombly* should send a clear signal to lower court judges that they should not allow the enormously burdensome discovery inherent in any antitrust case to proceed before they determine whether the plaintiff has alleged a plausible claim for relief.”<sup>63</sup> With regard to Section 1 conspiracy claims, *Twombly* “replace[d] the old ‘plus factors approach’ to inferring an agreement from parallel competitive behavior with a “no alternative explanation” test,<sup>64</sup> examining—in accord-

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<sup>56</sup> *Id.* at 563.

<sup>57</sup> *Id.* at 570.

<sup>58</sup> *Id.* at 545, 556.

<sup>59</sup> *Id.* at 556–57.

<sup>60</sup> *Id.* at 570. Justice Stevens argued in dissent that Justice Souter’s majority opinion “is the first by any Member of this Court to express any doubt as to the adequacy of the *Conley* formulation.” *Id.* at 578 (Stevens, J., dissenting). Justice Stevens also speculated about the potential reach of the majority’s decision: “Whether the Court’s actions will benefit only defendants in antitrust treble-damages cases, or whether its test for the sufficiency of a complaint will inure to the benefit of all civil defendants, is a question that the future will answer.” *Id.* at 596.

Interestingly, in *Ashcroft v. Iqbal*, the Supreme Court’s first case applying *Twombly*, Justice Souter dissented from the majority’s ruling that a prisoner failed to state a claim for constitutional violations asserted against the former Attorney General and the Director of the Federal Bureau of Investigation. *Ashcroft v. Iqbal*, 129 S. Ct. 1937 (2009). Justice Souter argued that the majority “misapplied” *Twombly* and contended that the Court’s finding that the plaintiff’s claims were implausible rested on a “fundamental misunderstanding of the enquiry that *Twombly* demands.” *Id.* at 1955, 1959 (Souter, J., dissenting). He explained that “*Twombly* does not require a court at the motion-to-dismiss stage to consider whether the factual allegations are probably true;” rather, “a court must take the allegations as true, no matter how skeptical the court may be.” *Id.* at 1959.

<sup>61</sup> See Manfred Gabriel, *Twombly: A Journey from the Conceivable to the Plausible*, ANTITRUST SOURCE, June 2007, <http://www.abanet.org/antitrust/at-source/07/06/Jun07-Gabriel6-21f.pdf>; James A. Keyte, *Twombly: How Courts Are Interpreting and Extending Its Principles*, ANTITRUST, Fall 2008; William Kolasky & David Olsky, *Bell Atlantic Corp. v. Twombly: Laying Conley v. Gibson to Rest*, ANTITRUST, Fall 2007; Randall C. Picker, *Twombly, Leegin, and the Reshaping of Antitrust*, 2007 Sup. Ct. Rev. 161; Gerald A. Stein, *Bell Atlantic Corp. v. Twombly: Requiring a Plausible Analysis at the Pleadings Stage*, ANTITRUST SOURCE, Dec. 2008, <http://www.abanet.org/antitrust/at-source/08/12/Dec08-Stein12-22F.pdf>; Scott Dodson, *Pleading Standards After Bell Atlantic v. Twombly*, 93 VA. L. REV. (IN BRIEF) 135 (2007) <http://www.virginialawreview.org/inbrief/2007/07/09/dodson.pdf>.

<sup>62</sup> Kolasky & Olsky, *supra* note 61, at 27. See also A. Benjamin Spencer, *Plausibility Pleading*, 49 B.C. L. REV. 431 (2008).

<sup>63</sup> Kolasky & Olsky, *supra* note 61, at 27. See also Douglas G. Smith, *The Twombly Revolution*, 36 PEPPERDINE L. REV. (forthcoming 2009), available at <http://ssrn.com/abstract=1147862>.

<sup>64</sup> Kolasky & Olsky, *supra* note 61, at 30. See also Stein, *supra* note 61.

dance with *Monsanto v. Spray-Rite*<sup>65</sup> and *Matshusita v. Zenith Radio*<sup>66</sup>—whether the alleged conduct is consistent with independent behavior.

Case law applying *Twombly* over the past two years reflects four themes. First, courts are grappling with the meaning of the plausibility standard, some calling it “vague” or “less than pellucid.”<sup>67</sup> As the Second Circuit has observed, *Twombly* has created “[c]onsiderable uncertainty concerning the standard for assessing the adequacy of pleadings”;<sup>68</sup> and “conflicting signals” from the Supreme Court have “create[d] some uncertainty as to the intended scope of the Court’s [*Twombly*] decision.”<sup>69</sup>

Second, some pre-*Iqbal* courts suggested limiting the application of the plausibility standard to antitrust cases,<sup>70</sup> while others indicated that the standard applies in all complex civil cases.<sup>71</sup> Most pre-*Iqbal* courts were unwilling to circumscribe *Twombly*’s interpretation of Rule 8 to the antitrust context, asserting it would be “cavalier to believe that the Court’s rejection of the ‘no set of facts’ language from *Conley* . . . applies only to section 1 antitrust claims.”<sup>72</sup>

Third, *Twombly* specifically examined what facts needed to be plausibly pled in addition to conscious parallel conduct to establish a conspiracy under Section 1 of the Sherman Act. Courts examining these Section 1 claims on motions to dismiss have applied *Twombly* with mixed results. In *In re OSB Antitrust Litigation*, for example, the plaintiffs alleged a price fixing conspiracy among nine manufacturers of oriented strand board.<sup>73</sup> Denying the defendants’ motion to dismiss, the district court held that “Plaintiffs have made specific factual allegations of Defendants’ wrongdoing—including actions in furtherance of the conspiracy, Defendants’ purported motive, the approximate time and manner of their agreement, and the mechanism by which Defendants fixed prices. *Twombly* requires no more.”<sup>74</sup>

Other courts have been much tougher on conspiracy allegations. In *In re Elevator Antitrust Litigation*, for example, the Second Circuit affirmed dismissal of plaintiffs’ conspiracy claims against elevator manufacturers and service providers.<sup>75</sup> The court found that the complaint’s enumeration of “every type of conspiratorial activity that one could imagine . . . in entirely general

<sup>65</sup> *Monsanto Co. v. Spray-Rite Serv. Corp.*, 465 U.S. 752 (1984).

<sup>66</sup> *Matsushita Elec. Indus. Co., Ltd. v. Zenith Radio Corp.*, 475 U.S. 574 (1986).

<sup>67</sup> See *Wilkerson v. New Media Tech. Charter Sch., Inc.*, 522 F.3d 315, 322 (3d Cir. 2008) (noting that “the exact parameters of the *Twombly* decision are not yet known”); *Robbins v. Okla. ex rel. Dep’t of Human Servs.*, 519 F.3d 1242, 1247 (10th Cir. 2008) (“We are not the first to acknowledge that the new formulation is less than pellucid.”); *Anderson v. Sara Lee Corp.*, 508 F.3d 181, 188 n.7 (4th Cir. 2007) (“In the wake of *Twombly*, courts and commentators have been grappling with the decision’s meaning and reach.”).

<sup>68</sup> *Iqbal v. Hasty*, 490 F.3d 143, 155 (2d Cir. 2007), *rev’d*, *Ashcroft v. Iqbal*, 129 S.Ct. 1937 (2009).

<sup>69</sup> *Id.* at 157. The Third Circuit stated that the decision is “confusing,” finding that the “issues raised by *Twombly* are not easily resolved, and likely will be a source of controversy for years to come.” *Phillips v. County of Allegheny*, 515 F.3d 224, 234 (3d Cir. 2008).

<sup>70</sup> See, e.g., *Kendall v. Visa U.S.A., Inc.*, 518 F.3d 1042, 1047 n.5 (9th Cir. 2008) (“At least for the purposes of adequate pleading in antitrust cases, the Court specifically abrogated the usual ‘notice pleading’ rule, found in Federal Rule of Civil Procedure 8(a)(2) and *Conley v. Gibson*.”).

<sup>71</sup> See, e.g., *Robbins*, 519 F.3d at 1249 (“The *Twombly* standard may have greater bite” in cases that “include complex claims against multiple defendants.”).

<sup>72</sup> *Iqbal v. Hasty*, 490 F.3d at 157 n.7. See also *Phillips*, 490 F.3d at 234 (“[W]e decline at this point to read *Twombly* so narrowly as to limit its holding on plausibility to the antitrust context.”); *ATSI Commc’ns, Inc. v. Shaar Fund, Ltd.*, 493 F.3d 87, 98 n.2 (2d Cir. 2007) (“We have declined to read *Twombly*’s flexible ‘plausibility standard’ as relating only to antitrust cases.”).

<sup>73</sup> *In re OSB Antitrust Litig.*, No. 06-826, 2007 U.S. Dist. LEXIS 56573 (E.D. Pa. Aug. 3, 2007).

<sup>74</sup> *Id.* at \*1.

<sup>75</sup> *In re Elevator Antitrust Litig.*, 502 F.3d 47 (2d Cir. 2007).

terms without any specification of any particular activities by any particular defendant” constituted conclusory allegations that could not survive *Twombly*.<sup>76</sup> It also criticized plaintiffs’ allegations of parallel conduct, which included similarities in contractual language, pricing, and equipment design, as deficient because “while that conduct is ‘consistent with conspiracy, [it is] just as much in line with a wide swath of rational and competitive business strategy unilaterally prompted by common perceptions of the market.’”<sup>77</sup>

Fourth, *Twombly*’s plausibility standard has been applied beyond Section 1 conspiracy cases to other elements of antitrust claims. The Tenth Circuit in *Christy Sports v. Deer Valley Resort* affirmed dismissal of the plaintiff’s claims for monopolization and attempted monopolization because the plaintiff was unable sufficiently to plead market power in a relevant market and anti-competitive conduct.<sup>78</sup> Courts also have relied on *Twombly* to affirm dismissal based on insufficient allegations of antitrust injury. In *NicSand v. 3M*, for example, the Sixth Circuit affirmed dismissal of the plaintiff’s Section 2 claims because “NicSand’s speculations show at most the ‘possibility’ of an entitlement to relief, which is just what *Bell Atlantic [Twombly]* said would not suffice at the pleading stage.”<sup>79</sup>

Given these developments, there is little doubt that the impact of Justice Souter’s *Twombly* opinion on antitrust litigation has been significant. The Court’s plausibility standard has required plaintiffs to allege facts that articulate logical claims for relief and has empowered judges to act as gatekeepers to curtail the exorbitant costs associated with discovery in antitrust cases. The result has been an increase in dismissals of antitrust claims.

## Conclusion

Justice Souter’s opinion in *CDA* ten years ago and his opinion in *Twombly* two years ago share two features that define his overall antitrust legacy. First, both opinions introduced a significant degree of complexity and thus uncertainty into antitrust jurisprudence—the “enquiry meet for the case” for horizontal restraints analysis and the “plausibility” principle for antitrust pleading requirements. Second, both opinions have become significant setbacks for private antitrust plaintiffs—making it harder for them to get to a jury on horizontal restraint claims and harder to survive initial motions to dismiss in antitrust claims of all kinds. Justice Souter’s legacy in these respects appears likely to remain a central feature of the antitrust landscape for many years. ●

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<sup>76</sup> *Id.* at 50–51.

<sup>77</sup> *Id.* at 51 (quoting *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 554 (2007)).

<sup>78</sup> *Christy Sports, LLC v. Deer Valley Resort Co., Ltd.*, 555 F.3d 1188, 1196 (10th Cir. 2009).

<sup>79</sup> *NicSand, Inc. v. 3M Co.*, 507 F.3d 442, 458 (6th Cir. 2007) (en banc) (quoting *Twombly*, 550 U.S. at 557).

# “The Rules of Professional Conduct Are Not Aspirational”: Joint Representation of Corporations and Their Employees

**Kathryn M. Fenton and Ryan C. Thomas**

Two recent high profile matters involving Broadcom Corporation and Stanford Financial Group highlight the potential ethical pitfalls that confront attorneys who represent both corporations and individual officers or employees in government investigations or litigation. For antitrust lawyers retained to conduct internal investigations or to defend private or governmental lawsuits, these cases reaffirm the need to assess potential conflicts of interest and to obtain informed written consent before undertaking dual representation.

The benefits of designating one lawyer or law firm as counsel to both the company and one of its employees can be significant. Companies can save considerable expenses by avoiding payments to separate counsel. Dual representation can also facilitate a coordinated legal strategy between the company and individual, allowing for more efficient use of resources and time. Together these factors can facilitate favorable outcomes for both the company and individual, sooner, and at lower costs than a scenario in which the company and individual have separate counsel.

On the other hand, dual representation poses several potentially significant detriments for both the company and the individual, most importantly the potentially divergent interests between the company and the individual company employee. At the outset of the representation, insufficient information may be available to assess such potential risks. If conflicts of interest emerge, they may require terminating the lawyer's continued representation of either or both clients, increasing the costs and potentially derailing the anticipated coordinated position. The corporation itself and the individual employee may not fully appreciate the sometimes complex relationships inherent in sharing counsel, including the treatment of confidential information provided to the attorney. Finally, if joint representation ends poorly for the individual, he likely will look for someone to blame—and the company's in-house and outside lawyers may well end up in the crosshairs.

Many of these downsides, and especially the ethical risks that lawyers take in accepting retention in a joint representation, present themselves front-and-center in two recent cases that offer cautionary tales for both clients and lawyers. In *United States v. Nicholas*,<sup>1</sup> the U.S. District Court for the Central District of California held that a law firm that represented Broadcom and its chief financial officer in separate matters involving alleged manipulation of stock options acted unethically when it interviewed the executive as part of the internal investigation and subsequently

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<sup>1</sup> No. SACR 08-00139-CJC, 2009 WL 890633 (C.D. Cal. Apr. 1, 2009) (order suppressing privileged communications), *appeal docketed*, No. 09-50161 (9th Cir. Mar. 2, 2009). The government filed a notice of appeal on March 26, 2009, after the court issued a minute order on March 2 ruling that Ruehle's statements were privileged. The court issued its written opinion on April 1.

turned his statements over to the government during SEC and criminal investigations. Similar allegations of ethical misconduct underpin a pending malpractice complaint filed by the former Chief Investment Officer for Stanford Financial Group against the company, its general counsel, its outside law firm, and one of the partners at that law firm.

Given the conflicts and ethical pitfalls often associated with joint representation, antitrust lawyers must consider the implications of representing both a corporation and individual officers or employees. Starting with the specific ethics rules in the jurisdictions in which they practice, counsel need to focus on identifying potential conflicts of interest that might prevent them from properly discharging their duty of loyalty, the disclosures necessary to ensure informed consent to a joint representation, and how information received in the course of the joint representation will be handled vis-à-vis third parties, especially the government.<sup>2</sup>

### **Ethical Issues of Joint Representation**

Joint representation of a corporation and individual employees raises complex ethical issues relating to counsel's duty of loyalty and maintenance of client confidences. All clients, regardless of their size or the duration of their relationship with a law firm, are entitled to the same duty of loyalty and zealous representation.<sup>3</sup> Similarly, both current and former clients have a right to expect their lawyers not to reveal confidential information provided in the course of the attorney-client relationship.<sup>4</sup> These obligations may come into conflict if counsel represents multiple parties, especially in the same matter.

The starting point in analyzing potential conflicts of interest is identifying the client, which in itself may be a complicated question in the corporate setting. ABA Model Rule 1.13(a) provides that, when retained by corporations and similar organizations, an attorney represents the organization only, "acting through its duly authorized constituents." Thus, individual officers, directors, and employees generally do not become clients of the corporation's attorney simply by reason of the attorney's work for the company, unless a specific, separate representation is undertaken.

In practice, however, counsel for companies often have previously represented the company's owners, executives, or officers in other matters, and unless a crystal-clear line is drawn showing that the representation ended, they may be deemed to still be clients of the attorney. Furthermore, in practice, counsel for companies tend to find that the company's employees believe the company lawyer represents them individually as well. For these reasons it is important for company counsel to ensure that the employee knows who the lawyer is, and is not, representing. This is often accomplished through providing a so-called *Upjohn* warning,<sup>5</sup> which, at the outset of an interview, emphasizes that: (1) the lawyer represents the company, not the individual employee; (2) information disclosed by the employee to the lawyer is privileged, but the privilege belongs to the company; and (3) the company may unilaterally decide to waive the privilege and disclose information discussed during the interview with third parties, including the government. These disclosures seek to satisfy a lawyer's ethical obligation under ABA Model Rule 1.13(f), which requires,

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<sup>2</sup> This article principally relies on the current (2008) version of the American Bar Association Model Rules of Professional Conduct (ABA Model Rule), [http://www.abanet.org/cpr/mrpc/model\\_rules.html](http://www.abanet.org/cpr/mrpc/model_rules.html). While the ABA Model Rules serve as models for the ethics rules of most states, individual state rules can vary and should be reviewed for guidance in a particular case.

<sup>3</sup> ABA Model Rule 1.7.

<sup>4</sup> ABA Model Rule 1.6.

<sup>5</sup> The warning is derived from the Supreme Court's decision in *Upjohn Co. v. United States*, 449 U.S. 383 (1981), which held that communications by employees to counsel for the company are covered by the attorney-client privilege.

when dealing with an organization's employees, "a lawyer shall explain the identity of the client when the lawyer knows or reasonably should know that the organization's interests are adverse to those of the constituents with whom the lawyer is dealing."<sup>6</sup>

In communicating with employees, company lawyers must also be sensitive to their ethical obligations respecting contacts with "unrepresented persons," including the requirement that the lawyer "shall not give legal advice to an unrepresented person, other than the advice to secure counsel, if the lawyer knows or reasonably should know that the interests of such a person are or have a reasonable possibility of being in conflict with the interests of the client."<sup>7</sup>

The lawyer next needs to determine whether a conflict of interest would exist by undertaking to represent both the corporation and an individual employee. ABA Model Rule 1.7(a) prohibits an attorney from undertaking a representation that involves a "concurrent conflict of interest," and defines a concurrent conflict as any situation where "the representation of one client will be directly adverse to another client" or "there is a significant risk that the representation of one or more clients will be materially limited by the lawyer's responsibilities to another client."

An exception to the rule allows joint representation despite concurrent conflicts, if the lawyer satisfies four conditions, as specified in ABA Model Rule 1.7(b):

- (1) the lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client;
- (2) the representation is not prohibited by law;
- (3) the representation does not involve the assertion of a claim by one client against another client represented by the lawyer in the same litigation or other proceeding before a tribunal; and
- (4) each affected client gives informed consent, confirmed in writing.

As to this fourth condition, while some states do not require that clients consent to conflicts of interest in writing,<sup>8</sup> other jurisdictions that follow ABA Model Rule 1.7(b) do, including California, New Jersey, and, effective April 1, 2009, New York.<sup>9</sup> Even in a jurisdiction in which a written consent is not mandatory, it is generally prudent to confirm client consent in writing because the burden will be on the attorney to establish that consent in fact was given. Consideration should be

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<sup>6</sup> In some cases, counsel may be ethically required to provide additional *Upjohn* disclaimers, for example, informing the employees that they may wish to obtain independent representation. See ABA Model Rule 1.13, cmt. 10 ("There are times when the organization's interest may be or become adverse to those of one or more of its constituents. In such circumstances the lawyer should advise any constituent, whose interest the lawyer finds adverse to that of the organization of the conflict or potential conflict of interest, that the lawyer cannot represent such constituent, and that such person may wish to obtain independent representation.").

<sup>7</sup> ABA Model Rule 4.3. The company lawyer faces two possibilities in dealing with employees: either the employee is not represented, which triggers ABA Model Rule 4.3, or the employee is represented, which means the attorney must act through the employee's counsel. See ABA Model Rule 4.2 ("In representing a client, a lawyer shall not communicate about the subject of the representation with a person the lawyer knows to be represented by another lawyer in the matter, unless the lawyer has the consent of the other lawyer or is authorized to do so by law or a court order.").

<sup>8</sup> See ABA/BNA LAWYERS' MANUAL ON PROFESSIONAL CONDUCT 51:311 (2003).

<sup>9</sup> CAL. RULES OF PROF'L CONDUCT R. 3-310(A) (2009) (defining informed written consent to mean "the client's or former client's written agreement to the representation following written disclosure"); N.J. RULES OF PROF'L CONDUCT R. 1.7(b)(1) (2009) (requiring that "each affected client gives informed consent, confirmed in writing, after full disclosure and consultation"); N.Y. RULES OF PROF'L CONDUCT R. 1.7(b)(4) (2009) (requiring written consent; replacing former N.Y. Code of Prof'l Responsibility DR 5-101 & 5-105(C) (2007), which did not refer to written consent).

given to providing written disclosures and securing, in the written consent, acknowledgment of the receipt of those disclosures.<sup>10</sup>

If the attorney has determined that there is no conflict, or that the conflict can be waived in accordance with ABA Model Rule 1.7, the attorney can accept retention by both clients. Once an attorney-client relationship is formed with either client, and regardless of the size or the specific nature of the representation, each client, both the company and the individual, is entitled to the same duty of loyalty; the least significant employee client, in other words, is entitled to the same protections as the largest corporate client of the firm.<sup>11</sup> This consideration becomes particularly relevant where counsel represents the employee in connection with the same matter as the corporate employer, and where the employer is paying for the representation—the employee client's interests cannot be sacrificed or subordinated for the good of the employer client.<sup>12</sup>

*Once an attorney-client relationship is formed with either client, and regardless of the size or the specific nature of the representation, each client, both the company and the individual, is entitled to the same duty of loyalty . . .*

Even when lawyers have adhered to these ethical rules for accepting joint representation, they must remain mindful of their continuing obligation to take appropriate action, including withdrawal of the representation, should unforeseen conflicts develop in the future.<sup>13</sup>

### Broadcom

All these factors came into play in a recent district court ruling, *United States v. Nicholas*,<sup>14</sup> which arose from SEC inquiries into Broadcom's option practices and an ensuing criminal case against individual officers, including William Ruehle, Broadcom's former CFO. The district court found that Broadcom's outside law firm committed ethical violations by representing both Ruehle and Broadcom. Because the misconduct compromised both the rights of Ruehle and the integrity of the legal process, the court prohibited any use of Ruehle's statements by the government prosecutors and made an ethics referral to the California State Bar.<sup>15</sup>

Following a series of newspaper articles questioning its stock option practices, Broadcom retained an outside law firm to conduct an internal investigation. Shortly thereafter, shareholders commenced lawsuits against the company, its directors, and Ruehle personally as CFO. The retained law firm entered appearances in court for both the company and Ruehle.<sup>16</sup> Over the next several weeks, Ruehle had multiple contacts with Broadcom's general counsel, who confirmed that the law firm would represent Ruehle personally in the two actions.<sup>17</sup> During this period, the

<sup>10</sup> *E.g.*, D.C. RULES OF PROF'L CONDUCT R. 1.7, cmt. 28 (2007) ("It is ordinarily prudent for the lawyer to provide at least a written summary of the considerations disclosed and to request and receive a written informed consent, although the rule does not require that disclosure be in writing or in any other particular form in all cases. . . . [U]nder the District of Columbia substantive law, the lawyer bears the burden of proof that informed consent was secured.").

<sup>11</sup> This conflicts potential has caused some corporations to adopt policies that preclude their primary outside law firms from agreeing to represent individual directors, officers, or employees of the corporation.

<sup>12</sup> While ethics rules permit legal fees to be paid by third parties, such fee arrangements also can present ethical issues. The ABA Model Rules provide that fee arrangements must be approved by the client, after disclosure, and cannot compromise the lawyer's duty of loyalty or inhibit the lawyer's ability to exercise independent judgment on the client's behalf. ABA Model Rule 1.7, cmt. 13.

<sup>13</sup> ABA Model Rule 1.7, cmt. 29; ABA/BNA LAWYERS' MANUAL ON PROFESSIONAL CONDUCT 51:313 (2003) ("a lawyer generally must withdraw from representing all joint clients once an unconsented conflict arises between the clients").

<sup>14</sup> No. 08-00139-CJC, 2009 WL 890633 (C.D. Cal. Apr. 1, 2009) (order suppressing privileged communications), *appeal docketed*, No. 09-50161 (9th Cir. Mar. 2, 2009).

<sup>15</sup> *Id.* at \*10.

<sup>16</sup> *Id.* at \*2.

<sup>17</sup> *Id.* at \*2-\*3.

retained lawyers also interviewed Ruehle regarding Broadcom's stock option granting practices and obtained other information from him to prepare a joint defense of the shareholder actions.<sup>18</sup>

When the SEC launched an investigation, however, the outside law firm, acting on behalf of Broadcom, disclosed key statements from Ruehle's interviews, initially to the company's outside auditors, and later to the SEC and the United States Attorney's Office.<sup>19</sup> Ruehle later learned that the government intended to use these disclosures in a criminal prosecution against him. He promptly objected and asserted that his conversations with the firm were privileged communications.<sup>20</sup> The government maintained Ruehle's statements were not protected by the attorney-client privilege because he had been given an *Upjohn* warning by the company's lawyers.<sup>21</sup>

After conducting an evidentiary hearing, the court found that Ruehle's statements to the outside lawyers were protected attorney-client communications and that the firm had breached its duty of loyalty to Ruehle by disclosing those communications to the SEC without his consent.<sup>22</sup> The issues of adequate disclosure and informed consent to joint representation proved essential to the trial court's ruling. The court rejected the government's reliance on *Upjohn*, expressing "serious doubts" about whether Ruehle ever actually received such a warning.<sup>23</sup> Even assuming he did, however, the court concluded that the warning was "woefully inadequate" because the outside lawyers never told Ruehle that his statements could be shared with third parties, including the government.<sup>24</sup> Finally, the court found that whether an *Upjohn* warning was given was "irrelevant" because such a warning is given to a non-client, not someone with whom a lawyer has an existing attorney-client relationship. Since the firm was already representing Ruehle in the shareholder litigation, "[a]n oral warning, as opposed to a written waiver of the clear conflict presented by [the firm's] representation of both Broadcom and Mr. Ruehle, is simply not sufficient to suspend or dissolve an existing attorney-client relationship and to waive the privilege."<sup>25</sup>

Having determined that Ruehle's statements were privileged, the court found that the firm's actions breached its ethical duties to him in three ways. First, the firm had failed to obtain Ruehle's informed written consent to the joint representation, as required under Rule 3-310 of the California Rules of Professional Conduct.<sup>26</sup> Second, the firm breached its duty of loyalty by interrogating Ruehle on behalf of Broadcom without first obtaining his "free and intelligent consent."<sup>27</sup> Third, by

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<sup>18</sup> *Id.* at \*3, \*5. The court found that the law firm had provided Ruehle individually, not merely as part of the entire board of directors, with progress reports and its defense strategy and asked him to review and obtain specific information that would help to facilitate the defense. *Id.* at \*2-3, \*5.

<sup>19</sup> *Id.* at \*3.

<sup>20</sup> *Id.* at \*4.

<sup>21</sup> *Id.* at \*6. See also Government's Memorandum of Law Concerning the Attorney-Client Privilege at 1 (Feb. 20, 2009).

<sup>22</sup> *Nicholas*, 2009 WL 890633, at \*4-7. According to the court, sustaining a claim of privilege requires the moving party to establish three elements: (1) "the existence of an attorney-client relationship," which "depends on the reasonable expectations of the client"; (2) that the communication in question "was made in order to obtain legal advice"; and (3) the communication was "intended to remain confidential." *Id.* at \*4. The court found "no serious question" that each of these elements was satisfied. *Id.* at \*5.

<sup>23</sup> *Id.* at \*6 (citing Ruehle's testimony and the lack of contemporaneous notes from the firm lawyers).

<sup>24</sup> *Id.*

<sup>25</sup> *Id.*

<sup>26</sup> While the firm had properly obtained such consent in connection with an unrelated representation years earlier, it failed to do so respecting the stock options matter. *Id.* at \*2.

<sup>27</sup> *Id.* at \*8 (quoting *Gilbert v. Nat'l Corp. for Hous. P'ships*, 84 Cal. Rptr. 2d 204, 212 (Ct. App. 1999)).

disclosing Ruehle's privileged communications to Broadcom's outside auditors and the government without his consent, the firm violated the duty to preserve client confidences.<sup>28</sup>

The court held that the firm's misconduct required it to suppress all evidence reflecting Ruehle's statements to his counsel regarding Broadcom's stock option practices. Further, noting that "[t]he Rules of Professional Conduct are not aspirational,"<sup>29</sup> the court referred the entire firm to the California State Bar for discipline, asserting that the firm's misconduct "compromised the rights of Mr. Ruehle, the integrity of the legal profession, and the fair administration of justice."<sup>30</sup>

The government is appealing the court's suppression order.<sup>31</sup>

## Stanford

Similar ethical issues are raised in a pending lawsuit by Laura Pendergest-Holt, the former Chief Investment Officer for companies controlled by Robert Allen Stanford. Following her arrest in February 2009 for obstruction of justice for providing allegedly false testimony during an SEC fraud investigation of Stanford and three of his companies, Holt filed a complaint against Stanford's outside lawyer and his law firm for legal malpractice and breach of fiduciary duty.<sup>32</sup> Holt alleges in her complaint that the outside lawyer and his firm never advised her that (a) they represented the company only; (b) she needed to retain separate counsel prior to providing testimony to the SEC; (c) she had a Fifth Amendment right against self-incrimination; (d) she could choose not to speak to the SEC; (e) there were potential criminal penalties associated with providing sworn testimony to the SEC; (f) that the company's interests were adverse to hers; and (g) that there was no attorney-client privilege for communications between her and the other defendants.<sup>33</sup>

Holt claims she has been wrongfully accused of a crime as a "direct and proximate result of Defendants' wrongful conduct and malpractice."<sup>34</sup> She has sought damages in excess of \$20 million, punitive damages, and disgorgement.<sup>35</sup> Her lawsuit remains pending.<sup>36</sup>

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<sup>28</sup> *Id.* at \*10.

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

<sup>30</sup> *Id.*

<sup>31</sup> The government's opening brief on appeal maintains that the district court's privilege ruling was erroneous for three reasons: (1) the court applied the wrong standard to determine whether Ruehle, a corporate officer, had a personal claim of attorney-client privilege over his statements to the law firm; (2) even assuming an attorney-client relationship existed between Ruehle and the law firm, Broadcom had the unilateral right to waive the privilege for all communications except those relating to Ruehle's personal liability; and (3) Ruehle understood his statements would be shared with the company's auditor, and thus had no expectation that the statements would remain confidential. Government's Opening Brief at 18–20, *United States v. Ruehle*, No. 09-50161 (9th Cir. May 27, 2009).

<sup>32</sup> Plaintiff's Original Petition, *Pendergest-Holt v. Stanford Group Co.*, No. 2009-22392, 2009 WL 1030825 (Tex. Dist. Ct. Apr. 9, 2009).

<sup>33</sup> *Id.* at 5–6.

<sup>34</sup> *Id.* at 2.

<sup>35</sup> *Id.* at 6.

<sup>36</sup> Unlike the *Broadcom* case involving Ruehle, there is a dispute whether the law firm ever represented Holt in a personal capacity. Holt's claim appears to revolve around the firm's actions (or omissions) in connection with its representation of her in her role as an officer of the company. To support her allegations of the law firm lawyer's misconduct, Holt identified what she characterized as "contradictory answers," *id.* at 6, given by him during her sworn testimony before the SEC respecting whom the lawyer represented. On the one hand, Holt stated that the lawyer told the SEC lawyers present that he "represent[ed] the company Stanford Financial Group and affiliated companies." On the other hand, she alleged that the lawyer later contradicted that statement in response to a question from one of the SEC lawyers: "Q: Just so we're clear. As I understand your statement, you do not as far as you're concerned, represent the witness here today? A: **I represent her** insofar as she is an Officer or director of one of the Stanford affiliated companies." *Id.* The complaint does not mention the very next exchange. "Q: Ms. Holt, are you ready to proceed? A: Yes. Q: Okay. Would you like to have personal representation of counsel before proceeding. A: No." Sworn Testimony of Laura Pendergest-Holt at 7, *In re Stanford Group Co.*, No. FW-02973-A (SEC Feb. 10, 2009) (emphasis added).

## Application to Antitrust Representation

Although both the Broadcom and Stanford cases arose in the securities law context, the issues they present regarding the pitfalls of dual representation are readily transferable to criminal and civil antitrust matters. Consider the common example of retention to investigate suspected cartel activity. In some cases, the company lawyer will be able to assess early on that there is not likely to be direct adversity between the company and an employee—for example, when dealing with a custodian of records or an employee who obviously had no contacts with competitors during the period under scrutiny. In other cases, the company lawyer may have indirect evidence of diverging interests, for example, a newspaper article identifying the employee as a participant in a price-fixing conspiracy. In still other cases, the company lawyers may be simply unable to assess the question of direct adversity due to a lack of information and until after they have had an opportunity to conduct interviews, review documents, or speak to government attorneys.

Throughout these early stages, there are ethical issues that must be considered before interacting with the employees. When is it necessary to give an *Upjohn* warning? Always? At what stage of the discussion? Assuming you do provide an *Upjohn* warning, should you obtain written acknowledgement from the individual that the cautions were provided? Will any of these steps unduly chill the ability to get timely information?

If employees are prepared to be represented by the company's lawyer, either at their own request or, more likely, the company lawyer's urging, when and how do you explore whether the employees need independent counsel (even to decide if the employees need independent counsel)? Do you advise them to consult their own separate counsel to ensure informed consent? Do you retain "shadow" counsel for them in an effort to minimize adverse consequences in the event a conflict arises in the future?

As previously noted, there are numerous arguments why joint representation may be desirable: reduced costs, coordinated strategy, and greater control, among others. If you do undertake a joint representation, what do you say to a company employee when you set out to prepare that employee for a government interview? Does the advice differ if that employee is your client? Do you recommend that the individual employee retain separate counsel for purposes of that interview? How would the analysis change if you learn that the employee engaged in conduct that might give rise to personal liability for price fixing? If the company has not obtained conditional leniency, the corporation and the individual may have divergent interests for example, because the company may find it beneficial to provide the government with incriminating information about the individual pursuant to a plea agreement.<sup>37</sup>

What if you have obtained conditional leniency, thus protecting the company and its employees from criminal exposure for violating the Sherman Act?<sup>38</sup> How does this affect the company's and the individual's interests—are they aligned or still potentially adverse? What about the prospect of legal exposure for the individual based on violations of state antitrust laws?

While comparatively less frequent, ethical issues involving multiple representation also arise in civil antitrust matters. A company that has been sued based merely on a newspaper story may need to conduct an internal investigation to assess the merits of the plaintiffs' claims. Additionally,

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<sup>37</sup> Scott D. Hammond, Measuring the Value of Second-In Cooperation in Corporate Plea Negotiations, Speech Before the ABA Antitrust Section 2006 Spring Meeting (Mar. 29, 2006), available at <http://www.usdoj.gov/atr/public/speeches/215514.htm>.

<sup>38</sup> Antitrust Division, Dep't of Justice, Model Corporate Conditional Leniency Letter at (a), (d) (2008), available at <http://www.usdoj.gov/atr/public/criminal/239524.htm> (footnote omitted).

defendants who settle with plaintiffs typically agree as part of the settlement to cooperate with plaintiffs' requests for company documents, information, and testimony so plaintiffs can proceed against the non-settling defendants. Can outside counsel for the company, which is contractually obligated to cooperate with plaintiffs, represent an employee personally in connection with plaintiffs' request to depose that individual in the ongoing civil case? What if the individual simply wants to put the matter behind him and take no part in the civil action? Is there any adversity between the company and the individual?

Even in the merger context, joint representation may pose potential conflicts issues. During merger reviews, the federal antitrust agencies sometimes issue civil investigative demands (CIDs) to third parties for the purpose of gathering additional information. With increasing frequency, such CIDs are targeted to consultants who have been retained by the merging parties such as an investment firm that issued a synergies analysis. Can outside counsel for one of the merging parties also represent the consultant for purposes of responding to a government CID asking the consultant to produce documents and provide testimony?

Finally, in virtually all cases, there is at least the potential that individual employees may face employment discipline or sanctions up to and including dismissal from the company, for their failures to abide by the company's code of ethics. If such potential exposure exists, is outside counsel for the company conflicted from representing an individual employee when the underlying conduct, if proven, would violate the company's code of ethics? If such potential conflicts are not foreseeable at the outset of the representation, can the lawyer withdraw from representing the individual once an actual conflict arises? What disclosures and waivers are necessary or effective to permit such representation?<sup>39</sup>

### Best Practices

The potential conflicts issues associated with dual representation should always be top-of-mind for in-house counsel and their outside lawyers before taking on joint representation of the company and its employees. In determining whether joint representation is possible in a particular case, the lawyer should ask:

- Is it possible zealously to represent both the corporation and employee? Questions that should be considered include: Would a disinterested lawyer, given the facts at hand, conclude that multiple representation is in the interest of both the corporation client and the individual client? Will new information or changed circumstances render continuation of multiple representation impermissible?
- If one or the other proposed client believes joint representation could be advantageous, is it possible to obtain the informed consent of all clients after full disclosure of the advantages and risks of multiple representation? Is it necessary to use translators or engage independent counsel to advise the individual in order to ensure that the individual employee fully understands the implications of giving consent?
- If counsel undertakes the joint representation, what steps should be taken at the outset to structure the representation so as to minimize potential adverse consequences if an actual conflict between the clients arises? Can the lawyer seek a prospective waiver from both clients permitting continued representation of the corporate client and termination of the rela-

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<sup>39</sup> These potential conflict issues are, of course, heightened to the extent the lawyer represents multiple individuals in the same investigation or matter.

tionship with the employee client? Should co-counsel or “shadow” counsel be maintained in order to minimize possible disruption if withdrawal is ever required?<sup>40</sup>

- How should the disclosures of the potential risks of joint representation and the parties’ consent be memorialized? If written disclosures and consent are not possible, there should be, at a minimum, some witness to any oral discussions, and a contemporaneous record created.
- In particular circumstances, multiple representation will require discussions of how attorney-client confidences will be treated—for example, will they be shared with other commonly represented parties? What steps will be taken to obtain consent of both clients before any client confidences are revealed outside the jointly represented parties?

*Other than avoiding all joint representations, the keys to avoiding ethical pitfalls are properly assessing the potential for conflicts and then assuring adequate disclosure to, and informed consent by, each affected client or potential client.*

Other than avoiding all joint representations, the keys to avoiding ethical pitfalls are properly assessing the potential for conflicts and then assuring adequate disclosure to, and informed consent by, each affected client or potential client. An attorney can represent multiple parties only with the consent of each client after “full disclosure of the advantages and risks involved in multiple representation,”<sup>41</sup> which means the provision of information “reasonably sufficient, giving due regard to the sophistication of the client, to permit the client to appreciate the significance of the potential conflict.”<sup>42</sup> This may require “disclosure of any and all defenses and arguments that a client will forgo because of the joint representation, together with the lawyer’s fair and reasoned evaluation of such defenses and arguments, and the possible consequences to the client of failing to raise them.”<sup>43</sup>

Such evaluations clearly involve very fact-intensive analysis, so it is not possible to catalog all the issues that should be discussed in making this decision in a particular context. A lawyer should make the fullest disclosure possible to ensure informed client decision making, including how the attorney will address client confidences received in the course of the representation. Because of differences as to how the issue of confidences involving joint clients may be treated in a particular jurisdiction,<sup>44</sup> it is prudent at the outset of the representation for the lawyer to enter

<sup>40</sup> See, e.g., N.Y.C. Bar Ass’n Comm. on Prof’l and Judicial Ethics, Formal Op. 2004-2 (2004) at 6 (“[A]n attorney contemplating multiple representation can, and often should, consider whether the attorney-client relationship can be structured to minimize potential drawbacks to multiple representation. Such structuring may include obtaining prospective waivers of conflict, contractually limiting representation to minimize the possibility of conflicts, having a written understanding with regard to confidential information learned during the representations, and providing for co-counsel or shadow counsel.”). Although this opinion applies the New York Disciplinary Rules of the Code of Professional Responsibility, which were superseded effective April 2009 by the New York Rules of Professional Conduct, the reasoning contained therein remains sound.

<sup>41</sup> N.Y.C. Bar Ass’n Comm. on Prof’l and Judicial Ethics, Formal Op. 2004-2 (2004) at 2.

<sup>42</sup> *Id.* at 5 (citing N.Y. Code of Prof’l Responsibility EC 5-16 (2007)).

<sup>43</sup> *Id.* at 5 (citing N.Y. County Lawyers’ Ass’n Prof’l Ethics Op. 707 (1995)). See also D.C. RULES OF PROF’L CONDUCT R. 1.7, cmt. 7 (2007) (“The underlying premise [of Rule 1.7(b)] is that disclosure and informed consent are required before assuming a representation if there is any reason to doubt the lawyer’s ability to provide wholehearted and zealous representation of a client or if a client might reasonably consider the representation of its interests to be adversely affected by the lawyer’s assumption of the other representation in question. Although the lawyer must be satisfied that the representation can be wholeheartedly and zealously undertaken, if an objective observer would have any reasonable doubt on that issue, the client has a right to disclosure of all relevant considerations and the opportunity to be the judge of its own interests.”); D.C. Prof’l Ethics Op. 269 (1997) (obligations of company lawyer to clarify role in internal investigations); D.C. Prof’l Ethics Op. 296 (2000) (joint representation and confidentiality of information).

<sup>44</sup> See *Tekni-Plex, Inc. v. Meyner & Landis*, 674 N.E.2d 663, 670 (N.Y. 1996) (“Generally, where the same lawyer jointly represents two clients with respect to the same matter, the clients have no expectation that their confidences concerning the joint matter will remain secret from each other . . .”). *But see* ABA Comm. on Ethics and Prof’l Responsibility, Formal Op. 08-450 (2008) (in joint representation, lawyer must protect the confidential information of each co-client).

into an agreement with all potential clients that confidential information provided to the lawyer by any of them will be disclosed to the others.<sup>45</sup>

### Conclusion

Given the current economic climate and the accompanying pressures it places on companies to control legal costs, dual representation can offer attractive economic options as well as strategic benefits that allow the company and the individual more efficiently to mount a defense against third parties.

Despite these economies and efficiencies, however, dual representation raises a host of thorny ethical issues. Lawyers who fail to follow the relevant ethics rules with respect to joint representation—assessing potential conflicts of interest, obtaining and documenting a client's informed consent, and preserving client confidences—do so at their peril. ●

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<sup>45</sup> See ABA Model Rule 1.7, cmt. 31 (“The lawyer should, at the outset of the common representation and as part of the process of obtaining each client's informed consent, advise each client that information will be shared and that the lawyer will have to withdraw if one client decides that some matter material to the representation should be kept from the other.”).

# Reforming the HSR Act Notification and Report Form: A Modest Call to Substance

## Robert S. Schlossberg

The notification and review process required by the Hart-Scott-Rodino Antitrust Improvements Act of 1976<sup>1</sup> (HSR Act) is commenced by the filing of one or more Notification and Report Forms (the Form).<sup>2</sup> Since the Form was first promulgated over thirty years ago,<sup>3</sup> it has been meaningfully amended only a handful of times.<sup>4</sup> The Item 4(c) requirement has been much debated but never amended.<sup>5</sup> The Form remains solely a product of the Federal Trade Commission and the Antitrust Division of the Department of Justice pursuant to authority delegated to them under the HSR Act; it has never been subject to judicial interpretation.

Relatively little has been written about the initial notification required by the HSR Act,<sup>6</sup> although Item 4(c) of the Form has generated some commentary.<sup>7</sup>

<sup>1</sup> Pub. L. No. 94-435, § 201, 90 Stat. 1383, 1390–94 (codified as amended at 15 U.S.C. § 18a).

<sup>2</sup> The Form and its Instructions are published at 16 C.F.R. pt. 803 app. (2009); the Form, Instructions and the antitrust enforcement agencies' recommended Style Sheet for Hart-Scott-Rodino Filings are also available from the Premerger Notification Office (PNO) at <http://www.ftc.gov/bc/hsr/hsrform.shtm> (Form and Instructions) and <http://www.ftc.gov/bc/hsr/pnostyl2.shtm> (Style Sheet).

<sup>3</sup> The Form was first made public as part of the 1976 Proposed Rules. The original Report Form can be found in Mergers and Acquisitions, 41 Fed. Reg. 55,488, 55,495–55,501 (proposed Dec. 20, 1976). Section 7A(d)(1) of the Clayton Act, 15 U.S.C. § 18a(d)(1) (added by Section 201 of the HSR Act), authorizes the FTC to determine the nature of the notification to be required under the HSR Act and to designate for inclusion “such documentary material and information relevant to a proposed acquisition as is necessary and appropriate” to a determination of the legality of the proposed acquisition. 15 U.S.C. § 18a(d)(1); *see also* S. REP. NO. 94-803, at 67 (1976).

<sup>4</sup> *See, e.g.*, Marian R. Bruno, Ass't Dir., Premerger Notification Office, Bureau of Competition, Fed. Trade Comm'n, Hart-Scott-Rodino at 25, Prepared Remarks before the ABA Conference on Mergers & Acquisitions: Getting Your Deal Through the New Antitrust Climate (June 13, 2002), available at <http://www.ftc.gov/speeches/other/brunohsr25.htm>.

<sup>5</sup> The instructions to Item 4(c) of the Form mandate the submission of “all studies, surveys, analyses and reports which were prepared by or for any officer(s) or director(s) . . . for the purpose of evaluating or analyzing the acquisition with respect to market shares, competition, competitors, markets, potential for sales growth or expansion into product or geographic markets.” Antitrust Improvements Act Notification and Report Form for Certain Mergers and Acquisitions, Instructions, Item 4(c), 16 C.F.R. § 803 app. at 666, 670 (2009) [hereinafter Instructions to FTC Form C4]. The Instructions to FTC Form C4 are also available at <http://www.ftc.gov/bc/hsr/P989316PMNRulesandFormalInterpretationsElectronicSubmission-Instructions.pdf>.

<sup>6</sup> *See* Malcolm R. Pfunder, *Some Reflections on, and Modest Proposals for Reform of, the Hart-Scott-Rodino Premerger Notification Program*, 65 ANTITRUST L.J. 905, 923–25 (1997) (proposing a number of modifications to the HSR Form, some of which were ultimately adopted by the FTC). Recently, a proposal has been made for the program to be expanded to include voluntary filings of transactions that do not satisfy the filing thresholds. *See* Robert B. Bell, *Voluntary HSR Filings: A Modest Proposal*, ANTITRUST, Spring 2009, at 69. *See generally*, *Symposium: Twenty Years of Hart-Scott-Rodino Merger Enforcement*, 65 ANTITRUST L.J. 813 (1997).

<sup>7</sup> *See, e.g.*, Malcolm R. Pfunder, *U.S. v. Iconix: A Recent Hart-Scott-Rodino Act Civil Penalty Case Emphasizes the Need for Thorough “Item 4(c)” Document Production—A Brief Item 4(c) Primer*, ANTITRUST REP., Issue 3, Fall 2007, at 9; William J. Baer & Deborah Feinstein, *Item 4(c): The Next Step in HSR Reform*, ANTITRUST, Spring 2002, at 43; Marian R. Bruno, Brian C. Mohr & Bruce J. Prager, *Some Practical Guidance for the HSR Practitioner: Locating and Identifying Item 4(c) Documents*, ANTITRUST, Spring 2002, at 46.

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This article suggests reforming the Form, modifying it in ways that may reduce the burden on the notifying parties, and, at least as importantly, will better serve the substantive inquiry required under Section 7 of the Clayton Act<sup>8</sup>—in short, this is a modest call to substance. The article will not discuss the 4(c) requirements of the Form, but instead will suggest that the agencies abandon Item 5 of the Form, and by consequence Item 7 of the Form, and replace them with one or more questions designed to have the parties address directly the issue of horizontal competition between them.

### The Logic of the Form

The approach or philosophy of the current Form is, in a word, objective, not subjective. To overstate (slightly) the point, the Form implicitly proceeds from the premise that the notifying parties are not to be trusted or at least what they might say in a discursive way in response to open ended questions is not worth anything—or at least not as much as their response to objective questions. Thus, the Form seeks to ferret out or discover the horizontal competition between the parties<sup>9</sup> in two ways: Item 7 of the Form has the parties identify in which NAICS codes,<sup>10</sup> if any, they both report revenue for the current year;<sup>11</sup> and (in)famous Item 4(c) requiring the production of certain documents prepared for the transaction that discuss competition or the elements of competition.<sup>12</sup>

There are a number of problems with this approach. The reporting of revenue in Item 5 of the Form for the so-called base year—now 2002—and the current year by NAICS (formerly SIC) codes has the twin evils of being more burdensome and far less informative than probably originally envisioned.<sup>13</sup> More burdensome because extensive anecdotal evidence shows that parties rarely have that information readily available—notwithstanding that Item 5 builds on a classification system derived from a U.S. company's obligation to report revenue by those codes to the

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<sup>8</sup> 15 U.S.C. § 18.

<sup>9</sup> In 2001, among other changes, the FTC amended its premerger notification rules by eliminating former Item 8, which had asked for information about any vendor-vendee relationships. Premerger Notification; Reporting and Waiting Period Requirements, 66 Fed. Reg. 8680, 8686–87 (Feb. 1, 2001).

<sup>10</sup> As of July 1, 2001, all revenues reported in the Form must utilize North American Industry Classification System (NAICS) codes rather than Standard Industrial Classification (SIC) Codes. See Premerger Notification; Antitrust Improvements Act Notification and Report Form, 66 Fed. Reg. 23,561, 23,562–65 (May 9, 2001); Premerger Notification; Antitrust Improvements Act Notification and Report Form, 66 Fed. Reg. 35,541, 35,541–42 (July 6, 2001). The NAICS system classifies economic units with similar production processes in the same industry. NAICS was developed jointly by Canada, Mexico, and the United States in response to criticism about the SIC system, to reflect changes in the global economy, including the rapid growth of service and technology-based industries, and to provide a comparable classification system for the three countries. NAICS divides the economy into 20 sectors and identifies 9 new service industry sectors and 358 new national industries. In 1997, the United States Office of Management and Budget (OMB) adopted NAICS for use by all statistical agencies of the Federal Government. See Premerger Notification, 66 Fed. Reg. at 23,562–63; see also B. Michael Verne, Premerger Notification Office, Bureau of Competition, Fed. Trade Comm'n, *Surviving the Shift to NAICS*, Presentation at the Mergers and Acquisitions Conference in New York City (June 13, 2002), available at <http://www.ftc.gov/speeches/other/naics.shtm>.

<sup>11</sup> The Form provides:

If, to the knowledge or belief of the person filing notification, the acquiring person filing notification derived dollar revenues in the most recent year from operations in industries within any 6-digit NAICS industry code in which any acquired person that is a party to the acquisition also derived dollar revenues in the most recent year . . . then for each such 6-digit NAICS industry code [supply the following].

Instructions to FTC Form C4, *supra* note 5, Item 7, 16 C.F.R. § 803 app. at 671.

<sup>12</sup> See *id.* Item 4(c), 16 C.F.R. § 803 app. at 670.

<sup>13</sup> The FTC responded to contemporaneous public comments criticizing the use of SIC codes in 1978 by stating that “the use of SIC-based categories should not be unduly burdensome. Reporting persons are presumably required to compile SIC-based data for submission to the Bureau of the Census.” Premerger Notification; Reporting and Waiting Period Requirements, 43 Fed. Reg. 33,450, 33,527 (July 31, 1978).

Census Bureau.<sup>14</sup> For whatever reason or myriad reasons, it is not that common for a company to answer Item 5 by simple reference to a form completed for, or recently filed with, the Census Bureau.<sup>15</sup> This of course is even more true for overseas companies that are exempt from<sup>16</sup> or ignorant of Census Bureau reporting requirements.

The burden of Item 5 NAICS reporting is real, although it has never been quantified in the aggregate. Equally important, however, its utility appears to range from marginal to zero, because the NAICS codes are too blunt an instrument from which to gauge the horizontal overlaps, if any, between the parties, being both over- and under-inclusive—and of course the Item 5 burden is imposed on all parties whether or not the parties to the transaction are indeed competitors.<sup>17</sup> The simple point is that the NAICS code will rarely define a relevant antitrust market, and in those rare instances when it does, it is unlikely to yield useful information at all or such information that justifies the burden imposed on all filers.<sup>18</sup>

*NAICS codes are too blunt an instrument from which to gauge the horizontal overlaps, if any, between the parties, being both over- and under-inclusive . . .*

Although there are many examples that can be offered, one glaring deficiency in the Item 5 reporting is that the NAICS system is not well suited for a global economy, or more precisely, where the relevant geographic market includes products manufactured outside the United States, an increasingly common occurrence. Assume the following:

- Company A manufactures widgets only in the United States and is seeking to acquire Company B, a widget manufacturer with no U.S. manufacturing facilities
- There are no meaningful barriers to exporting widgets to the United States and twenty percent of U.S. widget demand is satisfied by imports
- Company B has been targeting U.S.-based widget customers, who account for 30 percent of its sales
- Company A has complained about Company B's U.S. pricing in its own internal strategic plans but not in the 4(c) documents for this transaction.

What useful information does the current form yield? Not much. The NAICS codes will not be revealing: “sales of products manufactured by the reporting person in its own plants located outside the United States should not be shown as manufacturing revenues under Item 5, regardless of where or to whom they are sold.”<sup>19</sup> Therefore, under Item 5, Company B will not report that rev-

<sup>14</sup> See *id.*; see also Premerger Notification; Antitrust Improvements Act Notification and Report Form, 66 Fed. Reg. 23,561, 23,565 (May 9, 2001) (stating that “many companies that currently file HSR notifications have submitted economic information to the Bureau of the Census using NAICS codes since 1997”).

<sup>15</sup> But see Antitrust Modernization Comm’n, Public Hearing on Merger Enforcement, Tr. at 191 (Nov. 17, 2005) [hereinafter AMC Hearing Tr.], available at [http://govinfo.library.unt.edu/amc/commission\\_hearings/pdf/051117\\_Mergers\\_Transcript\\_combined\\_reform.pdf](http://govinfo.library.unt.edu/amc/commission_hearings/pdf/051117_Mergers_Transcript_combined_reform.pdf) (Wayne Dale Collins, of Shearman & Sterling, stated: “I don’t consider [NAICS codes] to be a particularly large burden on the companies . . .”).

<sup>16</sup> See U.S. Census Bureau, Economic Census, <http://www.census.gov/econ/overview/mu0000.html> (defining the coverage of the Economic Census as “[a]ll domestic non-farm business establishments” (emphasis added)).

<sup>17</sup> See AMC Hearing Tr., *supra* note 15, at 184 (prepared statement of David Wales) (“[M]any of our clients spend a lot of time putting together the revenue information that is required. And we have been told by staff on numerous occasions that they rarely look at the rest of the HSR form,” [referring to Items 5–8]).

<sup>18</sup> Cf. Ken Heyer, *Predicting the Competitive Effects of Mergers by Listening to Customers* 3 n.4 (Economic Analysis Group Discussion Paper 06-11, Sept. 2006), available at <http://www.abanet.org/antitrust/at-committees/at-mergers/pdf/past-programs/heyser-paper.pdf> (“Convenient ‘industry classification codes’ . . . seldom provide adequate clarity.”).

<sup>19</sup> ABA SECTION OF ANTITRUST LAW, PREMERGER NOTIFICATION PRACTICE MANUAL 334 (4th ed. 2007).

enue in the 6-digit and 10-digit manufacturing codes in which Company A will report the revenue.<sup>20</sup>

All of this Item 5 effort in theory serves two purposes: the so-called base year—the last year for which the Census Bureau has collected information on sales—provides the staff a denominator from which it can calculate market share; and Item 5 allows an identification of product or service overlap between the parties in Item 7. Because the NAICS code is rarely if ever a relevant antitrust market, this exercise is unjustified. In addition, if the NAICS code is in fact relevant, the base year (the current base year is 2002) has historically been four or more years out of date (currently, it is seven years out of date) and thus a not terribly relevant denominator; and, coming to one of the principal points, if in fact the parties are competitors, there are more efficient ways to test that proposition and produce more useful information.

*Although there are many developments of note and relevance since the Form was promulgated decades ago, two in particular inform this proposal: the prevalence of international merger control filings and the Internet.*

In testimony before the Antitrust Modernization Commission (AMC), senior FTC and DOJ officials asserted that the NAICS codes were “indispensable” to an efficient functioning of the initial thirty-day screening process. The (then) Director of the Bureau of Competition said:

[T]he NAICS revenues are absolutely indispensable to the review that the pre-merger notification office does: determining whether there are overlaps and making the determination whether we can grant early termination within a week and a half or so.

And so, far from accelerating the process of our review, I think eliminating that information would greatly extend the time that it took us to make a determination with respect to the 90 plus percent of deals in which we’re able to grant early termination simply on the basis of the parties’ information [contained] in the parties’ filings.<sup>21</sup>

It must be acknowledged that, as there are historically 100–150 HSR filings per month, agency staff needs an efficient way to sort the wheat from the chaff and identify quickly whether the parties are horizontal competitors.<sup>22</sup> Taken at face value, the testimony before the AMC discussed above can be interpreted as saying that Items 5 and 7 are “indispensable” to that effort. Assuming that is true does not of course mean that there is not a more efficient method—less burdensome on the private sector—that is likely to be at least as informative.

### Times Have Changed

Although there are many developments of note and relevance since the Form was promulgated decades ago, two in particular inform this proposal: the prevalence of international merger control filings and the Internet.

<sup>20</sup> See Fed. Trade Comm’n, Bureau of Competition, Hart-Scott-Rodino Premerger Notification Program, Item 5(a), (b), (c)—Some general observations on reporting revenues (2008), <http://www.ftc.gov/bc/hsr/item5notes.shtm>:

Revenues derived from sales by a foreign entity of goods directly to customers in the U.S. (i.e. the order is placed with the foreign entity and title and risk of loss for the product sold passes to the U.S. customer outside of the U.S.) are not reported in item 5. Revenues derived from sales by a foreign manufacturing entity which are made through a U.S. establishment included within the same person as the foreign entity are reported as wholesale revenues in item 5. *Goods of foreign manufacture are never reported under manufacturing codes in item 5.* (emphasis added).

<sup>21</sup> AMC Hearing Tr., *supra* note 15, at 189 (testimony of Susan Creighton). Similarly, Bob Kramer, the Antitrust Division’s Director of Operations, asserted that “the NAICS codes are very important” and “very valuable.” *Id.* at 190 (testimony of Bob Kramer).

<sup>22</sup> For the fiscal year 2008, the agencies reported 1,656 filings. Fed. Trade Comm’n, Performance and Accountability Report—Fiscal Year 2008, at 59, available at <http://www.ftc.gov/opp/gpra/2008parreport.pdf>. The HSR thresholds were raised significantly effective February 1, 2001. For the succeeding seven full fiscal years, the number of HSR filings averaged 1568 per year or 131 per month. *Id.*; Fed. Trade Comm’n & U.S. Dep’t of Justice, Hart-Scott-Rodino Annual Report: Fiscal Year 2007, at 2 (Fig. 1), available at <http://www.ftc.gov/os/2008/11/hsrreportfy2007.pdf>.

**ICN.** To their credit, the U.S. agencies were founding members of and remain staunch supporters of the International Competition Network (ICN), which now counts over ninety countries as members.<sup>23</sup> In June 2009, the ICN concluded its eighth annual conference in Zurich, Switzerland, attended by over eighty jurisdictions.<sup>24</sup> One of the areas of early focus and success for the ICN was mergers, for which it generated a set of Recommended Practices.<sup>25</sup> At its most recent annual conference, the ICN also issued a report discussing the information requirements for merger notification of a number of jurisdictions.<sup>26</sup> The purpose of the report is to “assist agencies in evaluating their approaches to initial notification” and to advocate adoption of “mechanisms for flexibility in the content of the initial notification.”<sup>27</sup>

For the United States to maintain a credible “bully pulpit” and sufficient moral authority to improve the worldwide merger control process in part by encouraging adherence to the Recommended Practices, it, of course, has to be seen to be following them. The Recommended Practices encourage “flexibility” in the initial notification as a way of not imposing unnecessary burdens,<sup>28</sup> yet the HSR Form is virtually inflexible. Unlike many other countries, for instance, the United States has no short form or alternate form available to be used in those transactions where the parties are not (meaningful) competitors.<sup>29</sup> The Item 5 burden exists for transactions where it obviously serves no purpose. Amending the HSR form can align it more with ICN Recommended Practices.

### Why Not Ask the Parties?

The myriad forms of merger control filings around the world—a phenomenon largely post-dating the creation of the Form with its reliance on its NAICS code reporting mechanism—helps us gain some perspective on the Form and suggest a simple reform: Why not ask the parties if they are horizontal competitors? As the HSR Act and Form are intended only to provide the government with advance notice of and information about deals that should be reviewed under Clayton Act Section 7, it is curious at least that the Form does not even request the parties to state whether they are competitors. Other countries pursuing similar premerger notification goals are not so reluctant.<sup>30</sup> For instance:

- **European Union:** For transactions triggering notification requirements (based on the parties’ revenue), the notifying party must (i) identify overlapping products, (ii) define relevant geographic and product markets for those overlapping products, and (iii) calculate the parties’

<sup>23</sup> See Int’l Competition Network, Members, <http://www.internationalcompetitionnetwork.org/index.php/en/members>.

<sup>24</sup> Information concerning the conference, held June 3–5, 2009, may be found at <http://www.icn-zurich.org/Home.aspx>. Documents from the conference are available at <http://www.icn-zurich.org/Materials.aspx>.

<sup>25</sup> Int’l Competition Network, Recommended Practices for Merger Notification Procedures, available at <http://www.internationalcompetitionnetwork.org/media/archive0611/mnprecpactices.pdf>.

<sup>26</sup> See Int’l Competition Network, Notification & Procedures Subgroup, Information Requirements for Merger Notification, Presented at the 8th Annual Conference of the ICN (June 2009), available at [http://www.icn-zurich.org/Downloads/Materials/ICN\\_MergerWG\\_Notification&Procedures.pdf](http://www.icn-zurich.org/Downloads/Materials/ICN_MergerWG_Notification&Procedures.pdf).

<sup>27</sup> *Id.* at 3.

<sup>28</sup> Recommended Practices for Merger Notification Procedures, *supra* note 25, § V(B) cmt. 1, at 11.

<sup>29</sup> INT’L COMPETITION NETWORK, IMPLEMENTATION HANDBOOK 38-41 (2006), available at [http://www.internationalcompetitionnetwork.org/media/library/conference\\_5th\\_capetown\\_2006/ImplementationHandbookApril2006.pdf](http://www.internationalcompetitionnetwork.org/media/library/conference_5th_capetown_2006/ImplementationHandbookApril2006.pdf) (providing examples of seven jurisdictions which laudably implement the Recommended Practices on flexibility through such an approach).

<sup>30</sup> See Information Requirements for Merger Notification, *supra* note 26, at 8 (reporting that the “vast majority of jurisdictions surveyed indicated that their initial merger notification forms require parties to provide information about competitive effects”).

combined market share.<sup>31</sup> If the parties' combined market share is 15 percent or more in any of the relevant markets, additional information must be provided. Similarly, the notifying party must also provide additional information for vertical relationships if the parties' individual or combined vertical market share is 25 percent or more. In analyzing vertical relationships, it is irrelevant whether there is an existing supplier/customer relationship between the merging parties.

- **Brazil:** For transactions triggering notification requirements (based on the parties' revenue or market share), the notifying party must (i) identify overlapping products, (ii) define relevant markets for those overlapping products, and (iii) calculate the parties' combined market share.<sup>32</sup> In addition, the notifying party must estimate market shares of competitors as well as provide information about customers, barriers to entry, and other market conditions.<sup>33</sup>
- **Korea:** For transactions triggering notification requirements (based on the parties' assets or revenue), the notifying party is required to describe the market characteristics of all overlapping products or services produced or offered by the merging parties.<sup>34</sup> In addition, the notifying party must identify the major competitors (including importers) in the relevant markets and provide their respective market shares as well as identify local and overseas market barriers.<sup>35</sup>

One need not, of course, endorse the practice of asking the parties for detailed market shares or other information in recognizing the wisdom of simply asking the parties whether they are horizontal competitors or sell overlapping products. What accounts for the failure of the U.S. authorities to ask whether the parties are competitors? Maybe it is too much faith in revenue reporting by code and not enough faith in the parties.<sup>36</sup> It also appears to be consistent with a view of the process as more adversarial than cooperative. It is not a satisfactory answer to say competition is in the eye of the beholder or that, given how frequently market definition is the subject of fierce debate between the parties and the agencies, the parties cannot be relied upon to admit to competition between them but will always or often define markets to eliminate the possibility that they will be deemed to be competitors.

This view is not, experience tells us, supported by the practice in other jurisdictions. In addition, the Form will still need to be certified, any discussion would need to be consistent with the 4(c) documents, and there is the natural self-preservation motive of at least "repeat customers" not to be caught by the agencies with taking liberties with sensible market definition.

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<sup>31</sup> See Commission Regulation (EC) No 802/2004 of 7 April 2004 Implementing Council Regulation (EC) No 139/2004 on the Control of Concentrations Between Undertakings, Annex I, 2004 O.J. (L 133) 1, 9–22, available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2004:133:0001:0039:EN:PDF>.

<sup>32</sup> The Brazilian merger authority is in the process of introducing a new pre-merger notification form that will require the notifying party to provide more information than is currently required.

<sup>33</sup> See GLOBAL COMPETITION REVIEW, GETTING THE DEAL THROUGH—MERGER CONTROL 2009 at 70–72 (13th ed. 2009).

<sup>34</sup> See Korean Fair Trade Comm'n, (Re)Notification of the Acquisition (or Ownership) of the Shares of a Company 4–5, available at [http://ftc.go.kr/data/english/0511244\\_attached\\_form.doc](http://ftc.go.kr/data/english/0511244_attached_form.doc) (last visited June 2, 2009).

<sup>35</sup> *Id.*

<sup>36</sup> For example, the FTC argued in 1978 that "the submission of data according to SIC-based categories is necessary and appropriate in order to make a preliminary determination of the lawfulness of reported acquisitions under the antitrust laws." Premerger Notification; Reporting and Waiting Period Requirements, 43 Fed. Reg. 33,450, 33,528 (July 31, 1978).

## What Has the Internet Wrought?

Divining competitive issues from the NAICS code overlap predates the Internet: it harkens back to that time of yesteryear—over thirty years ago—before an almost unmanageable amount of data and information was at our fingertips: with a few mouse clicks, it is often quite easy to see whether the “public record” suggests any issues worth exploring. The Internet resource plus 4(c) documents are highly likely to yield more than enough information on point, or, at a minimum, sufficient information to cross-check the parties’ narrative responses. Indeed, casual conversations with current and former agency staffers suggest that 4(c) documents and the Internet are the primary tools used to determine whether a transaction is worthy of further investigation.

## Reforming the Form

*This proposal, then—  
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substance—has the  
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competition between  
them.*

This proposal, then—this modest call to substance—has the agencies abandoning Item 5 of the Form, and by consequence Item 7 of the Form,<sup>37</sup> to be replaced by one or more questions designed to have the parties address the issue of horizontal competition between them. This proposal has much to recommend it, and is a logical next step to the second request reforms that the agencies issued in 2006.<sup>38</sup> The direct questions and answers will cause the parties to focus on the Section 7 issues, if any, that are raised by the transaction, and implicitly will start the relevant dialog with the agencies sooner than might otherwise occur under any type of a “file and pray” strategy.

Consider the following: Items 5 and 7 are eliminated and replaced with a short set of questions:

1. Is the Acquiring Person currently a horizontal competitor of the Acquired Entity(ies)?<sup>39</sup>

Yes                       No
2. Does the Acquiring Person manufacture or offer for sale a product or service anywhere in the world that is (a) identical to, (b) substantially similar to, or (c) that at least a not insignificant number of customers would regard as reasonably interchangeable with a product or service manufactured or offered for sale by the Acquired Entity(ies) anywhere in the world?

Yes                       No
3. If the answer to question 2 is “Yes,” please list the products and/or services as commonly described by the relevant business.

List below                       N/A
4. If the answer to question 1 is “No” and to question 2 is “Yes,” briefly explain why the parties should not be considered horizontal competitors.

Brief explanation                       N/A

The object of these four questions is to solicit the bare minimum of information sufficient to let the staff determine whether any issues of horizontal competition are raised. The answers should also facilitate review of the 4(c) documents and make for more efficient staff research on the Internet. The intent of the questions is not to begin a major battle or debate over market definition, but rather to have the parties address the issue in simple business terms. For instance, if both par-

<sup>37</sup> A further consequence would be to modify the instructions for Item 8; instead of basing Item 8 on NAICS code overlaps in Item 7, filing parties would be required to identify previous acquisitions based on markets where the parties are horizontal competitors.

<sup>38</sup> See Fed. Trade Comm’n, Reforms to the Merger Review Process 9–30 (Feb. 16, 2006) (announcement by Deborah Platt Majoras, Chairman), available at <http://www.ftc.gov/os/2006/02/mergerreviewprocess.pdf>; U.S. Dep’t of Justice, Antitrust Div., Merger Review Process Initiative 4–10 (Oct. 12, 2001, revised Dec. 14, 2006) [hereinafter U.S. DOJ Merger Review Process Initiative], available at <http://www.usdoj.gov/atr/public/220237.pdf>.

<sup>39</sup> In an asset deal, this would be limited to the assets being acquired.

ties manufactured widgets on different continents and where for reasons that may include transportation costs there was no international commerce and therefore no competition, such an explanation would be provided in response to question 4, after question 1 was answered in the negative and question 2 was answered in the affirmative.

Reviewing the answers to these questions should not materially lengthen the time staff devotes to each filing, and the answers will be at least as informative as Items 5 and 7.

Consider how this Proposal compares to Items 5 and 7 of the Form under various scenarios:

- **Financial buyer:** Q1 and Q2 are answered “No”; Item 7 would show no overlap. The results are the same, but in responding to the proposed questions, the parties did not have to undertake a timely and costly process of providing an Item 5 response in order to determine there was no overlap in Item 7.
- **Direct competitors:** The Proposal yields more useful information than the Form, which would show an overlap and geographic information (Item 7(c)).
- **Potential competitors:** Neither the Proposal nor current Items 5 and 7 provide useful information.
- **Vertical relationships:** Neither the proposal nor current Items 5 and 7 provide useful information.
- **Previous hypothetical with widget manufacturers:** The Proposal yields more useful information than the Form and identifies an overlap that would not be readily evident in Item 5. The “Yes” responses to proposed Q1 and Q2 and the response to Q3 will provide specific information about the competitive products between the two companies, even though one company’s products are made outside the United States. The Item 7 response will not identify any geographic overlap because the Item 5 codes will not overlap.

As Item 4(c) under this proposal remains unchanged, and as the Internet is unlikely to become less efficient and less informative, it is difficult to see how under this proposal staff will do a less efficient job of screening filings.

Moreover, the agencies, of course, are not limited to the Form and accompanying documents in seeking to determine whether to issue a Request for Additional Information. The investigating staff routinely follow up with the notifying parties, either through phone calls or slightly more formal “access letters” asking for such things as strategic plans, sales, and lists of competitors and customers.<sup>40</sup> Thus, were such a revised form to raise questions through the parties’ narrative answers—either because the parties have been direct about being competitors or seemingly evasive on the point—the agencies can quickly inquire further.

## Conclusion

Item 5 of the Form generates appreciable burden and expense without a corresponding benefit. There are better, more efficient ways to solicit information from filing parties to assist in the determination of whether the transaction raises horizontal competition issues. It also does not appear that Item 5 is necessary for the Premerger Notification Office to process effectively the HSR filings.

This article has suggested substituting four direct questions for Item 5 (and Item 7); the questions are designed to drive to the heart of the merger review inquiry, thereby clarifying, not obfuscating, the ultimate issue. Although there may be room to improve these questions, the time has come to eliminate Item 5, bring the Form into conformity with international best practices, and recognize one of the many benefits of the Internet age. ●

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<sup>40</sup> See, e.g., U.S. DOJ Merger Review Process Initiative, *supra* note 38, at 1–3.

# Major Changes to the Competition Act (Canada) and the Competition Bureau's Enforcement Policies

**Paul Crampton**

## Overview

On March 12, 2009, major amendments to Canada's Competition Act<sup>1</sup> (Act) received Royal Assent as part of the passage of the Budget Implementation Act, 2009.<sup>2</sup> Most of those amendments are now in force, although the amendments relating to agreements between competitors will not come into force until March 12, 2010.

The highlights of the amendments are as follows:<sup>3</sup>

- The former criminal provisions dealing with price discrimination, promotional allowances, and predatory pricing have been repealed.
- The former criminal price maintenance provision has been replaced with a new civil "reviewable practice" provision.
- The existing criminal conspiracy provisions will be replaced on March 12, 2010, with (i) a per se criminal offense for hard-core cartel agreements between competitors that provides for maximum sanctions of fourteen years imprisonment (up from five years) and \$25 million in fines (up from \$10 million); and (ii) a civil provision to deal with other types of agreements between competitors that prevent or lessen competition substantially, or are likely to do so.
- The former merger review process regime has been replaced with a new U.S.-style, two-stage regime; the "size of transaction" threshold for notification has been increased from \$50 million to \$70 million (with annual adjustments to reflect inflation); and the period of time within which an application can be made to the Tribunal following the substantial completion of a merger has been reduced from three years to one year.
- The Competition Tribunal (Tribunal) has been granted a new power to impose an administrative monetary penalty (AMP) up to a maximum of \$10 million (\$15 million for subsequent orders) under the civil abuse of dominance provisions of the Act.
- There are now higher maximum fines, prison terms, and AMPs for criminal and civil deceptive marketing practices and misleading advertising.

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<sup>1</sup> R.S.C., ch. C-34 (1985).

<sup>2</sup> 2009 S.C., ch. 2 (Can.). This legislation also included significant amendments to the Investment Canada Act. R.S.C., ch. 28 (1985). Those amendments, which are beyond the scope of this article, include the creation of a new national security regime; a substantial increase in the monetary review threshold for acquisitions of control of a Canadian business (other than a cultural business) by a non-Canadian; the elimination of the (lower) threshold applicable to transactions in the transportation, financial services, and uranium sectors; new prescribed timelines for the issuance of written opinions; and a new requirement for the Minister to issue "reasons" in prescribed circumstances. Some of the amendments to the ICA (e.g., relating to the new thresholds for review) will not come into force until a date fixed by the Governor-in-Council. However, the new national security review regime is now in force.

<sup>3</sup> Other amendments include a broadening of the bid-rigging provisions to include arrangements to withdraw bids or tenders and the repeal of the special abuse of dominance provisions applicable to the airline sector.

The repeal of the price discrimination, promotional allowance, and predatory pricing provisions, and the replacement of the criminal provisions governing price maintenance with a new civil standard, will provide businesses with considerably more flexibility in structuring their pricing and distribution strategies and practices. However, to the extent that dominant firms will now face significant financial penalties if a practice is found to be anticompetitive and likely to prevent or lessen competition substantially, they will need to more carefully assess the underlying rationale for their pricing and other practices and how they may affect the market.

The new per se criminal provisions applicable to hard-core cartel agreements create significantly increased exposure for engaging in such conduct and remove the requirement to establish that such conduct has prevented or lessened competition unduly, or is likely to do so. These provisions should lead firms to be much more vigilant in adopting serious and effective compliance programs. They also should lead firms contemplating legitimate conduct that may unavoidably or unintentionally raise issues under the new per se provisions to carefully consider how to restructure their plans to reduce the increased risk that will exist as of March 12, 2010.

With respect to mergers, the amendments do not change the substantive provisions of the Act. However, they may require companies contemplating notifiable transactions to adapt their closing conditions and they will require merging parties to prepare for substantially increased filing requirements where there is a material risk of the issuance of a “supplementary information request” (SIR, which is similar to a U.S. Second Request). They also will require parties to such transactions to build into their transaction timelines much more time for the completion of the Bureau’s merger review process.

Regarding deceptive marketing practices, the amendments increase the maximum prison term under the criminal misleading advertising provisions to fourteen years (from five years) and increase the maximum AMPs for corporations under the civil provisions to \$10 million—\$15 million for each subsequent violation (up from \$100,000 and \$200,000, respectively). For individuals, the maximum AMPs have been increased to \$750,000—\$1 million for each subsequent violation (up from \$50,000 and \$100,000, respectively).

After providing a brief background to these amendments, I discuss the repeal of the criminal pricing practices and the new civil provision dealing with price maintenance. I then address the new two-track approach to agreements between competitors and the Draft Competitor Collaboration Guidelines released by the Bureau for public comment on May 8, 2009.<sup>4</sup> Next, I discuss the amendments to the merger review process, together with the proposed amendments to the Notifiable Transactions Regulations<sup>5</sup> and the draft guidelines issued by the Bureau, “The Revised Merger Review Process.”<sup>6</sup> Finally, I briefly address the new power to impose administrative monetary penalties under the abuse of dominance provisions and the increased penalties for deceptive marketing practices.

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<sup>4</sup> Competition Bureau Canada, Draft Competitor Collaboration Guidelines (May 8, 2009) [hereinafter Draft CC Guidelines], available at <http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/03051.html>.

<sup>5</sup> Regulations Amending the Notifiable Transactions Regulations, 143 CANADA GAZETTE (No. 14), Apr. 4, 2009, available at <http://www.gazette.gc.ca/rp-pr/p1/2009/2009-04-04/html/reg2-eng.html>.

<sup>6</sup> Competition Bureau Canada, Enforcement Guidelines—The Revised Merger Review Process, Draft for Public Consultation (Mar. 24, 2009) [hereinafter Draft Process Guidelines], available at <http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/02986.html>.

*As a result of these amendments, non-dominant businesses now will be free to negotiate different deals with different customers and generally grant or offer discounts, rebates, allowances, and other advantages as they see fit.*

## Background

Over the course of the last decade there have been two full-blown reviews of the Act,<sup>7</sup> numerous attempts to amend the Act, a number of relatively minor amendments to the Act, recommendations by the Organization for Economic Cooperation and Development to strengthen the conspiracy and abuse of dominance provisions of the Act,<sup>8</sup> at least three independent reports that have recommended a dual civil/criminal approach to horizontal agreements,<sup>9</sup> and an independent report that recommended repeal of the criminal pricing practices.<sup>10</sup> This culminated in Bill C-19,<sup>11</sup> introduced by the former Liberal government in 2004, which proposed many of the same reforms that recently were given Royal Assent and are discussed in this article. However, Bill C-19 died on the Order Paper when Parliament was dissolved on November 29, 2005.

In July 2007, the Conservative government announced the establishment of the Competition Policy Review Panel (Panel) and gave it a mandate to review Canada's competition and foreign investment policies, and to develop recommendations on how to make Canada more globally competitive. In June 2008, the Panel issued its final report<sup>12</sup> recommending essentially all of the changes that are discussed in this article.

## Repeal of the Criminal Pricing Practices

**Price Discrimination and Promotional Allowances.** The repeal of the criminal price discrimination and promotional allowances provisions, formerly in paragraph 50(1)(a) and section 51 of the Act, respectively, was widely welcomed and uncontroversial. As a result of these amendments, non-dominant businesses now will be free to negotiate different deals with different customers and generally grant or offer discounts, rebates, allowances, and other advantages as they see fit. However, dominant firms still will have to be careful not to engage in any practices that could be

<sup>7</sup> See HOUSE OF COMMONS CANADA, A PLAN TO MODERNIZE CANADA'S COMPETITION REGIME—REPORT OF THE STANDING COMMITTEE ON INDUSTRY, SCIENCE AND TECHNOLOGY (Apr. 2002), available at <http://cmte.parl.gc.ca/Content/HOC/committee/371/inst/reports/rp1032077/indurp08/indurp08-e.pdf>; COMPETITION POLICY REVIEW PANEL, COMPETE TO WIN—FINAL REPORT (June 2008) [hereinafter Wilson Report], available at [http://www.ic.gc.ca/epic/site/cprp-gepmc.nsf/en/h\\_00040e.html](http://www.ic.gc.ca/epic/site/cprp-gepmc.nsf/en/h_00040e.html). These reviews were motivated by different considerations but shared the common concern about whether the Act needed to be modernized to assist Canadian industries to become more competitive.

<sup>8</sup> OECD, CANADA—MAINTAINING LEADERSHIP THROUGH INNOVATION 91–92 (2002), available at [http://www.oecd.org/LongAbstract/0,3425,en\\_2649\\_39863329\\_2510102\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/LongAbstract/0,3425,en_2649_39863329_2510102_1_1_1_1,00.html); OECD, CANADA—REPORT ON COMPETITION LAW AND INSTITUTIONS 3–6 (2004), available at <http://www.oecd.org/dataoecd/51/17/34425393.pdf>. These recommendations were made as part of the OECD's regular peer review program.

<sup>9</sup> Konrad von Finckenstein, Commissioner of Competition, Competition Bureau Canada, Section 45 at the Crossroads, Remarks to 2001 Invitational Forum on Competition Law (Oct. 12, 2001), available at <http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/01187.html>. These reports were motivated by a perception within the Bureau that the existing conspiracy provisions in the Act were too difficult to enforce on the criminal burden of proof ("beyond a reasonable doubt").

<sup>10</sup> J. ANTHONY VANDUZER & GILLES PAQUET, COMPETITION BUREAU CANADA, ANTI-COMPETITIVE PRICING PRACTICES AND THE COMPETITION ACT—THEORY, LAW AND PRACTICE (Oct. 22, 1999), available at <http://www.cb-bc.gc.ca/eic/site/cb-bc.nsf/eng/01770.html>. This report was commissioned after a general perception began to emerge that many of the former criminal pricing provisions in the Act were antiquated and no longer suitable for the Canadian economy.

<sup>11</sup> Bill C-19, An Act to amend the Competition Act and to make consequential amendments to other Acts, 1st Session, 38th Parl. 2004, available at <http://www2.parl.gc.ca/HousePublications/Publication.aspx?Docid=2333899&file=4>.

<sup>12</sup> Wilson Report, *supra* note 7.

found to have an anticompetitive purpose<sup>13</sup> and to be likely to prevent or lessen competition substantially. To the extent that promotional allowances and conventional forms of price discrimination are not likely to have such an anticompetitive purpose or effect, these types of practices should no longer raise a concern, even for dominant firms.

**Resale Price Maintenance.** The amendments replace the former criminal provision in section 61 of the Act with a new civil provision in section 76 of the Act. The former provision made vertical and horizontal price maintenance per se illegal, subject to only very limited statutory defenses and exemptions. As with the repeal of paragraph 50(1)(a) and section 51, the repeal of section 61 was widely welcomed and uncontroversial. Going forward, businesses will no longer need to be concerned about the non-trivial risk that previously existed (with respect to a range of vertical pricing practices and even certain horizontal conduct) of a Bureau investigation that could lead to criminal charges being recommended. As with the other decriminalized practices, businesses also no longer need to be concerned about the possibility of a private action under section 36 of the Act—something that can be initiated only with respect to alleged contraventions of the criminal provisions of the Act.

Instead, businesses will simply have to consider whether any contemplated pricing initiatives fall within the scope of the new civil provisions in section 76 of the Act,<sup>14</sup> including the new requirement that the conduct have or be likely to have “an adverse effect on competition in a market.” If so, they then will have to take into account the possibility that they may be prohibited by the Tribunal (on the application of the Commissioner of Competition or a person who is directly affected by the conduct) from continuing such conduct or be required to accept another person as a customer within a specified period of time on usual trade terms. The Tribunal has no power to award monetary damages, impose a monetary penalty, or issue any other type of order under section 76.

Given that the phrase “adverse effect on competition in a market” has been interpreted by the Tribunal to mean an effect that creates, enhances, or preserves market power, firms with a market share below 35 percent can be fairly comfortable that the risk of being subjected to an order by the Tribunal is quite low.<sup>15</sup> Above this threshold, firms will have to assess the extent to which they are likely to be able to (i) demonstrate that any adverse impact on intrabrand competition that may be associated with any form of resale price maintenance that they are contemplating likely will be offset by a procompetitive impact on interbrand competition, or (ii) establish the elements of one or more of the statutory defenses set forth in the new section 76.

Going forward,  
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investigation that  
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charges being  
recommended.

<sup>13</sup> Conduct will not be found to be “anti-competitive” within the meaning of paragraph 79(1)(b) of the Act unless it has an exclusionary, disciplinary, or predatory purpose, based on an objective test established by the jurisprudence that essentially focuses on the reasonably foreseeable impact of the conduct on one or more competitors. *See, e.g.,* Comm’r of Competition v. Canada Pipe Co., [2006] F.C.A. 233, at ¶ 72.

<sup>14</sup> With the exception of the narrowing of the provisions to apply only to resale price maintenance, the language of the new civil provision closely tracks the former criminal provisions, including with respect to the definition of the three types of price maintenance conduct and the various statutory defenses.

<sup>15</sup> The Bureau has adopted a 35 percent market share safe harbor for the assessment of market power in various enforcement guidelines. *See, e.g.,* Competition Bureau Canada, Predatory Pricing Enforcement Guidelines § 3.3 (2008), available at <http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/02713.html>; Competition Bureau Canada, Merger Enforcement Guidelines § 4.12 (2004), available at <http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/01245.html>.

**Predatory Pricing.** In contrast to the foregoing, the repeal of the criminal predatory pricing provisions formerly in paragraph 50(1)(c) of the Act is not likely to have much practical effect. The Bureau has for many years reviewed predatory pricing primarily under the abuse of dominance provisions of the Act and has not pursued predatory pricing criminally for decades.<sup>16</sup>

### **Agreements Between Competitors: New Two-Track Approach**

The establishment of a dual-track approach to agreements between competitors is arguably the most significant change brought about by the recent amendments. Under this approach, three specifically defined categories of agreements will be subject to a strict per se criminal prohibition under section 45 of the Act while all other types of agreements between competitors will be subject to review under a new non-criminal framework in section 90.1.

In recognition of the fact that some existing agreements may contravene the new criminal prohibition, the amendments provide for a one-year transition period (ending on March 12, 2010) during which the existing provisions in section 45 will continue in force. In the meantime, any party to an agreement or arrangement entered into before March 12, 2009, can apply for an advisory opinion under section 124.1 of the Act regarding the potential applicability of the new criminal and civil provisions to the agreement, without having to pay the usual fee. Given the potential civil and criminal liability risks associated with the issuance of an adverse advisory opinion, however, parties may determine that it is better to self-assess their compliance with the revised law than to risk exposing themselves to an investigation or a civil action under section 36 of the Act.<sup>17</sup>

**The New Criminal Track.** The new criminal prohibition in subsection 45(1) of the Act will apply to agreements between competitors:

- (a) to fix, maintain, increase, or control the price for the supply of [a product in respect of which the agreeing parties are competitors];
- (b) to allocate sales, territories, customers, or markets for the production or supply of the product; or
- (c) to fix, maintain, control, prevent, lessen, or eliminate the production or supply of the product.

The maximum penalties for participating in such agreements will increase to \$25 million and fourteen years of imprisonment, from the current limits of \$10 million and five years of imprisonment.

The Draft CC Guidelines attempt to provide comfort that enforcement activity under the new per se provisions in section 45 of the Act will be limited to hard core cartel conduct. In this regard, they state: "The amended criminal prohibition is reserved for agreements between competitors to fix prices, allocate markets or restrict output that constitute naked restraints on competition

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<sup>16</sup> See Predatory Pricing Enforcement Guidelines, *supra* note 15, ii-iv, § 2.2.1; see also Michael Sullivan, Acting Ass't Deputy Comm'r of Competition, Competition Bureau Canada, Draft Enforcement Guidelines on Illegal Trade Practices: Unreasonably Low Pricing Policies: The Way Ahead, Remarks Before Competition in Difficult Times Conference (Nov. 12, 2002), available at <http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/01757.html>. Note that the prospect of private enforcement of the criminal predatory pricing provisions does not appear to have had much of a chilling effect on businesses.

<sup>17</sup> The amendments did not change the provisions in section 36 of the Act, which allow any person who has suffered loss or damage as a result of any conduct that is contrary to the criminal provisions of the Act to sue for and recover single damages "together with any additional amount that the court may allow not exceeding the full cost to him of any investigation in connection with the matter and of proceedings under this section." However, to the extent that some of the conduct that formally could be pursued under section 45 of the Act now has been decriminalized, section 36 would no longer be available in respect of such conduct.

(restraints that are not implemented in furtherance of a legitimate collaboration, strategic alliance or joint venture).”<sup>18</sup>

A reasonable interpretation of this statement is that the Bureau considers section 45 to be confined to agreements which have as their object one or more of the things described in paragraphs 45(1)(a), (b), or (c), and that agreements which have a different object do not fall within the scope of section 45, even if they incidentally have an effect described in section 45 or contain a restrictive provision that otherwise would be caught by section 45.<sup>19</sup> Of course, private plaintiffs can be expected to take a very broad view of the scope of the new criminal provision and a court may well disagree with positions taken in the Draft CC Guidelines. It likely will take several cases and a number of years before the courts provide significant clarity.

On its face, the standard articulated in the above-quoted statement from the Draft CC Guidelines appears to be less strict than the standard set forth in the ancillary restraints defense, discussed in Part IV(B)(e)(i) below. Notwithstanding the significant effort that has been made in the Draft CC Guidelines to clarify the meaning of these standards and the approach that the Bureau intends to adopt with respect to various types of agreements, uncertainty remains regarding both the interpretation that will be given to the “implemented in furtherance of a legitimate collaboration, strategic alliance or joint venture” standard set forth in the Draft CC Guidelines as well as the standard that is set forth in the ancillary restraints defense.

Accordingly, parties to agreements that may restrict pricing, sales, territories, customers, markets, or output should exercise caution and familiarize themselves with the Draft CC Guidelines before implementing their agreement. And given the significantly increased risk associated with the shift to a *per se* approach and the increases in maximum fines and jail terms in section 45, compliance programs under the Act should be revisited and reinforced, particularly in industries that are experiencing difficulties as a result of the current economic downturn.<sup>20</sup>

**MEANING OF THE TERM “COMPETITOR.”** A “competitor” is defined in the amended subsection 45(8) as including “a person who it is reasonable to believe would be likely to compete with respect to a product in the absence of a conspiracy, agreement or arrangement to do anything” described in paragraphs 45(1) (a) to (c). It is not yet clear how this test will be applied. However, this element of the new offense in subsection 45(1) will have to be established on the criminal burden of proof, namely, “beyond a reasonable doubt.” This may make it difficult for the prosecution to establish that the test is met by two persons who do not actually compete, but who are merely *potential* competitors.

The Draft CC Guidelines note that “where parties compete only with respect to products that are not subject to the agreement, this is not sufficient to establish that the parties are competitors for the purposes of section 45.”<sup>21</sup> That document adds that “the Bureau does not consider a supplier of a customer to be a competitor of a customer in respect of the product being supplied.”<sup>22</sup> This is intended to make it clear that the Bureau will not pursue dual-distribution or franchise

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<sup>18</sup> Draft Process Guidelines, *supra* note 6, at i, § 1.3.

<sup>19</sup> See Melanie L. Aitken, Interim Comm’r of Competition, Competition Bureau Canada, Speaking Notes for an Address, Canadian Bar Ass’n Competition Law 2009 Spring Forum (May 12, 2009), available at <http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/03066.html>.

<sup>20</sup> These difficulties may prompt rivals or employees to succumb to the temptation to pursue cooperative solutions that violate section 45. See Draft CC Guidelines, *supra* note 4, at 40 (within Example 3).

<sup>21</sup> *Id.* § 2.3(a).

<sup>22</sup> *Id.* § 2.3(c).

agreements under section 45, so long as they are “between a single supplier and a single distributor” or between a franchisor and a franchisee, provided that the supplier/franchisor has not been requested or coerced to act by other distributors/franchisees.<sup>23</sup>

Significantly, the Draft CC Guidelines state:

[T]he Bureau may not engage in a detailed definition of the relevant market [and will generally conclude that the parties are in competition with each other where they] are offering, or contemplating the offer of, the same or otherwise competing goods or services in the same or otherwise competing regions.<sup>24</sup>

**PRICE FIXING.** The term “price” is defined in subsection 45(8) to include “any discount, rebate, allowance, price concession or other advantage in relation to the supply of a product.” Regarding the meaning of the words “fix, maintain, increase or control the price for the supply of the product” in paragraph 45(1)(a), the Draft CC Guidelines state:<sup>25</sup>

In the Bureau's view, this [language] includes agreements to fix prices at a predetermined level, to eliminate or reduce discounts, to increase prices, to reduce the rate or amount by which prices are lowered, to eliminate or reduce promotional allowances and to eliminate or reduce price concessions or other price-related advantages provided to customers. For paragraph 45(1)(a) to be applicable, the agreement need not establish an actual price for the relevant goods or services. Rather, this section also prohibits agreements between competitors on methods of establishing prices or other indirect forms of agreements to fix or increase the price paid by customers. Such price-fixing agreements could include agreements between competitors to use a common price list in their negotiations with customers, agreements to apply specific price differentials between grades of products, agreements to apply a pricing formula or scale and agreements not to sell products below cost. In addition, the Bureau interprets paragraph 45(1)(a) as applying to agreements between competitors on a component of a price, such as a surcharge or credit terms.

Importantly, the Draft CC Guidelines confirm that section 45 does not apply to joint purchasing agreements.<sup>26</sup>

In the hypothetical illustrative examples section of the Draft CC Guidelines, it is suggested that output exchange and swap agreements (such as those commonly used in the petroleum sector) will be assessed under the new civil provision in section 90.1 of the Act, rather than under section 45.<sup>27</sup> However, the Draft CC Guidelines do not provide much guidance regarding other types of arrangements that could raise issues under paragraph 45(1)(a), including cooperative advertising or other forms of co-marketing agreements, IP licensing agreements, airline code-sharing agreements, lending syndicates, and the joint underwriting of insurance. In the section of the Draft CC Guidelines dealing with the new civil provision in section 90.1 of the Act, the Draft CC Guidelines caution that information exchange agreements “which assist competitors in monitoring each other's prices or conduct otherwise consistent with the existence of an agreement may be sufficient to prove that an agreement was concluded between the parties for the purpose of subsection 45(1) of the Act.”<sup>28</sup>

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

<sup>24</sup> *Id.*

<sup>25</sup> *Id.* § 2.4(a).

<sup>26</sup> *Id.*

<sup>27</sup> *Id.* at 47–49 (within Examples 10 and 11).

<sup>28</sup> *Id.* § 3.7.

**MARKET, CUSTOMER, SALES, AND TERRITORIAL ALLOCATION.** On their face, the words “allocate sales, territories, customers or markets for the production or supply of the product” are fairly straightforward. According to the Draft CC Guidelines, “[t]he prohibition in paragraph 45(1)(b) applies to agreements to not compete with respect to direct sales to distributors, resellers or customers, as well as agreements entered into by suppliers to not compete in respect of indirect sales that are made through distributors or resellers.”<sup>29</sup> As noted above, the Bureau has confirmed in the Draft CC Guidelines that it does not intend to apply this provision to dual distribution agreements.<sup>30</sup>

**OUTPUT RESTRICTIONS.** Paragraph 45(1)(c) applies to all agreements “to fix, maintain, control, prevent, lessen or eliminate the production or supply of the product.” In the Bureau’s view, in addition to garden-variety output agreements, this language captures agreements that reduce the quantity of products supplied to specific customers or groups of customers as well as agreements to permanently or temporarily close manufacturing facilities.<sup>31</sup>

The Draft CC Guidelines are not particularly helpful regarding agreements that typically would not be considered to constitute hard-core cartel conduct but which could raise issues under this provision, such as standard-setting agreements and JV agreements that place restrictions on the production or supply of products to be produced by the JV.

#### **STATUTORY DEFENSES AND EXEMPTIONS.**

**1. Ancillary Restraints.** To deal with agreements that only incidentally fix prices or otherwise fall within the scope of one of the three categories of agreements described above, a new “ancillary restraints” defense has been included in subsection 45(4). This defense would apply where a party to an impugned agreement can establish, on the balance of probabilities, that the agreement (i) is ancillary to a broader or separate agreement or arrangement that includes the same parties, and (ii) is directly related to, and reasonably necessary for giving effect to, the objective of that broader or separate agreement or arrangement. In addition, it would have to be established that the broader or separate agreement, considered alone, does not itself fall within the scope of any of the three aforementioned categories. The Draft CC Guidelines state that “the broader or separate agreement must include all of the parties to the agreement containing the ancillary restraint.”<sup>32</sup> It may be noted that agreements meeting the requirements of this defense might still be reviewed under the new civil provision in section 90.1, discussed below.

Regarding the requirement that the restraint must be “directly related to, and reasonably necessary for giving effect to the objective of [a] broader or separate agreement or arrangement,” the Draft CC Guidelines note that “it is not adequate merely to establish that the participants would not enter into the broader agreement in the absence of the challenged restraint.”<sup>33</sup> In addition, “[w]here there are significantly less restrictive alternatives available to the parties, the parties must demonstrate why such alternatives were infeasible or inadequate.”<sup>34</sup> In this regard, “[i]f the par-

<sup>29</sup> *Id.* § 2.4(b).

<sup>30</sup> *See also id.*

<sup>31</sup> *Id.* § 2.4(c).

<sup>32</sup> *Id.* § 2.5(b). The Draft CC Guidelines add that the “Bureau interprets ‘ancillary’ to mean that the restraint is a part of an agreement or is a separate agreement that is functionally incidental or subordinate to the main objective of some broader agreement.” *Id.*

<sup>33</sup> *Id.* § 2.5(c).

<sup>34</sup> *Id.*

*To deal with agreements that only incidentally fix prices or otherwise fall within the scope of one of the three categories of agreements described above, a new “ancillary restraints” defense has been included in subsection 45(4).*

ties could have achieved an equivalent or comparable arrangement through practical, less restrictive means that were reasonably available to the parties at the time when the agreement was entered into, then the Bureau will conclude that the restraint was not reasonably necessary.”<sup>35</sup> These means include provisions of lesser duration, narrower product scope, or narrower geographic scope. However, “the Bureau will not ‘second guess’ the parties with reference to some other restraint that may have been less restrictive in some insignificant way” or that may be “theoretically less restrictive . . . [but] not practical given the business circumstances.”<sup>36</sup>

The Draft CC Guidelines attempt to further reduce the ambiguity inherent in the language of the ancillary restraints defense by stating that the following types of restraints will not be assessed under section 45:<sup>37</sup>

- Garden-variety non-compete clauses that are used in employment agreements and asset/share purchase agreements.
- Non-compete provisions between the parent undertakings and a joint venture, where such provisions apply only to the products, services, and territories covered by the joint venture agreement.<sup>38</sup>
- Agreements between competitors to charge a common price in a blanket license agreement for artistic works.
- Provisions in merger agreements that require the vendor to abstain from making material changes to its business pending consummation of the merger.

In addition, the Draft CC Guidelines state that the following types of conduct will not be pursued under the new section 45:

- Bid rigging, which will be assessed under the specific bid-rigging provision in section 47 (which only applies in particular circumstances)<sup>39</sup> or under the new civil provision in section 90.1.<sup>40</sup>
- Mergers—transactions falling within the definition of a “merger” in section 91 of the Act will be assessed under the merger provisions in section 92.<sup>41</sup>
- Conduct that the Bureau communicates to the parties will be reviewed under section 90.1, provided there is no material change in circumstances.<sup>42</sup>

Notwithstanding the efforts made in the Draft CC Guidelines to reduce the uncertainty inherent in the language of the ancillary restraints defense, uncertainty remains.<sup>43</sup>

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<sup>35</sup> *Id.*

<sup>36</sup> *Id.*

<sup>37</sup> *Id.* § 2.5.

<sup>38</sup> However, the part of the Draft CC Guidelines dealing with the new civil provision in section 90.1 of the Act addresses restraints of this type (and others) that may be imposed in joint production agreements. This suggests that the Bureau may not contemplate pursuing restrictive provisions in JV agreements under section 45. *Id.* § 3.9(c). Unfortunately, the part of the Draft CC Guidelines dealing with ancillary restraints is silent with respect to territorial or other restrictions that may be imposed by the parents of the JV upon the joint venture itself.

<sup>39</sup> For example, section 47 does not apply to any agreement that is made known to the person calling for or requesting bids or tenders, at or before the time when any bid or tender is made by any person who is a party to the agreement. Among other things, this “out” allows for consortia to submit bids in response to calls for tenders.

<sup>40</sup> Draft CC Guidelines, *supra* note 4, § 1.2 (d). *Cf. supra* note 3.

<sup>41</sup> *Id.* § 1.2 (a).

<sup>42</sup> *Id.* § 1.3. However, the converse does not apply. If the Bureau refers a matter to the Director of Public Prosecutions (DPP) for prosecution and the DPP declines to prosecute, the Draft CC Guidelines state that “the Bureau may choose to re-evaluate whether the agreement should be subject to a remedy under the civil provisions in Part VIII of the Act.” *Id.*

<sup>43</sup> *See, e.g., supra* text following note 27.

*2. Agreements Between Affiliates.* Paragraph 45(6)(a) provides an exception for agreements that are “entered into only by companies each of which is, in respect of every one of the others, an affiliate.”

The term affiliate is defined in subsection 2(2) of the Act. For corporations, one corporation is affiliated with another corporation if one of them is the subsidiary of the other or both are subsidiaries of the same corporation or each of them is controlled (in the de jure sense) by the same person. If two corporations are affiliated with the same corporation at the same time, they are deemed to be affiliated with each other.

While the provisions in subsection 2(2) dealing with the definition of control address partnerships and sole proprietorships, the exemption in paragraph 45(6)(a) is limited to corporations. Therefore, significant caution needs to be exercised when considering agreements involving one or more non-corporate entities, such as agreements between two or more partnerships within a private equity group. The Bureau appears to recognize the significant potential practical difficulties that may result from this limitation in paragraph 45(6)(a). In this regard, the Draft CC Guidelines state that “the Bureau will consider the nature of any common control or corporate relationship between [other entities such as partnerships or trusts, or between individuals] when determining whether referral of an agreement for prosecution is appropriate.”<sup>44</sup>

*3. Regulated Conduct.* Another new defense, set forth in subsection 45(7) of the Act, states that “the rules and principles of the common law that render a requirement or authorization by or under another Act of Parliament or the legislature of a province a defense to a prosecution under subsection 45(1) of this Act, as it read immediately before the coming into force of this section, continue in force and apply in respect of a prosecution under” the new prohibition. The Draft CC Guidelines state that this “clarifies that the removal of the term ‘unduly’ from section 45 and other changes implemented through the 2009 amendments do not impact upon the availability of the regulated conduct defense.”<sup>45</sup> This statement was specifically directed at the Supreme Court of Canada’s 2003 decision in *Garland v. Consumers’ Gas Co.*,<sup>46</sup> which can be read as suggesting that the regulated conduct defense cannot be invoked in respect of prohibitions (such as those set forth in the amended section 45) which make it per se illegal to enter into certain types of agreements, and which do not contain any “lessening of competition,” “public interest” or other test that would provide “leeway” to a court. The Draft CC Guidelines further note that the Bureau will continue to apply the approach to regulated conduct set forth in its Technical Bulletin on “Regulated” Conduct.<sup>47</sup>

*4. Other Defenses and Exemptions.* The amended section 45 also contains an exemption for agreements between federal financial institutions that are described in subsection 49(1) of the Act<sup>48</sup> and a defense for export agreements. In addition, the general exceptions in sections 4 (collective bargaining), 4.1 (travel agents), 5 (underwriters) and 6 (amateur sport) of the Act continue to exist.

<sup>44</sup> *Id.*

<sup>45</sup> *Id.* § 2.6(d).

<sup>46</sup> *Garland v. Consumers Gas Co.*, [2004] 1 S.C.R. 629, available at <http://csc.lexum.umontreal.ca/en/2004/2004scc25/2004scc25.html>.

<sup>47</sup> Draft CC Guidelines, *supra* note 4, § 2.6(d).

<sup>48</sup> There remains some uncertainty about whether the amended section 45 applies to agreements between federal financial institutions that are described in subsection 49(2) of the Act.

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private equity group.**

**The New Civil Track.** Agreements between competitors that do not fall within one of the three narrowly circumscribed categories of agreement defined in the new criminal prohibition will no longer be subject to criminal liability. Instead, they will be reviewable only under a new civil provision in Section 90.1 of the Act that would require the Commissioner to demonstrate, on the balance of probabilities, that the agreement “prevents or lessens, or is likely to prevent or lessen, competition substantially in a market.” Where this can be established, the Tribunal’s powers will be limited to (i) prohibiting any person, whether or not a party to the agreement or arrangement, from doing anything under the agreement or arrangement; or (ii) requiring any person, whether or not a party to the agreement or arrangement, with the consent of that person and the Commissioner, to take any other action. The Tribunal will not be able to impose any monetary penalty or any other relief.

Significantly, this new civil provision would contain essentially the same non-exhaustive list of assessment criteria, the same prohibition on making a finding solely on the basis of evidence of concentration or market share, and the same exceptions for transactions among affiliates and for gains in efficiency as currently exist in the merger provisions of the Act. Presumably, this is intended to establish a symmetric approach to mergers, strategic alliances, and other forms of cooperation between competitors, without in any way biasing the regulatory framework in favor of a particular form of cooperation. In addition, the new civil provision contains essentially the same exception for “export agreements” as exists in the existing section 45. The term “competitor” is defined in essentially the same terms in the new civil provision as in the new criminal provision.

Consistent with the symmetric approach taken by the Act to mergers and other forms of cooperation between competitors, the Draft CC Guidelines set forth an analytical framework that is very similar to, and often incorporates by reference, the framework set forth in the Bureau’s Merger Enforcement Guidelines.<sup>49</sup> This includes the adoption of the same key test of whether an arrangement is likely to create, maintain, or enhance the ability of the parties to exercise market power, and the adoption of the same market share (35 percent) and concentration (CR4 of 65 percent, and 10 percent for the parties to the arrangement) safe harbors.<sup>50</sup>

The Draft CC Guidelines then provide guidance on the following six “common forms of agreements between competitors”: commercialization agreements, information sharing agreements, research and development agreements, joint production agreements, joint purchasing agreements, and non-compete agreements.<sup>51</sup>

**Vertical and Other Agreements.** The existing wording of the basic conspiracy provisions in section 45 of the Act is not confined to agreements between competitors. It extends to agreements, arrangements, conspiracies, and combinations between any two or more persons. As noted above, the new dual-track approach will be confined to agreements, arrangements, or conspiracies between competitors. Therefore, other types of agreements (e.g., vertical agreements between suppliers and customers, or benchmarking agreements between parties who are not in a vertical or competitive relationship) will no longer be subject to review under the Act unless they fall within the scope of another provision, such as the provisions relating to tied selling, exclusive dealing, market restriction, or abuse of dominance.<sup>52</sup>

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<sup>49</sup> Merger Enforcement Guidelines, *supra* note 15.

<sup>50</sup> Draft CC Guidelines, *supra* note 4, § 3.4(a) and (b).

<sup>51</sup> *Id.* §§ 3.6–3.11.

<sup>52</sup> This is confirmed in the Draft CC Guidelines. *Id.* § 1.1(c).

## The New U.S.-Style Merger Review Process

The adoption of a U.S.-style two-stage merger review process is perhaps the most controversial of the recent amendments to the Act.

The move to a two-stage merger review process reflects the Panel's recommendation that the former premerger review regime in the Act be aligned more closely with the process under the U.S. Hart-Scott-Rodino Antitrust Improvements Act (HSR Act). To effect the Panel's recommendation, the amendments establish an initial waiting period of thirty days following which the parties can close their transaction, provided that the Commissioner has not unilaterally exercised her discretion to extend the waiting period by issuing a notice (SIR) requiring the notifying party "to supply additional information that is relevant to the Commissioner's assessment of the proposed transaction." If a SIR is issued, the waiting period is extended to thirty days after the submission of the responses to the SIR and a certificate stating that the information supplied is, to the best of the certifying person's knowledge and belief, "correct and complete in all material respects." Upon the expiration of this second waiting period, the merging parties are free to close their transaction unless the Commissioner obtains a temporary, interim, or permanent order to prevent or delay the closing.

Senior Bureau officials have stated repeatedly that SIRs will only be sought in respect of a "very few" transactions per year.<sup>53</sup> It would be prudent to expect that a SIR will be sought in respect of any transaction that is likely to be classified as "very complex" under the Bureau's non-binding service standards policy, which currently is under review and may be streamlined from the existing three categories ("non-complex," "complex," and "very complex") to two categories, to reflect the two-stage framework of the new regime.

At this early stage, it would be prudent to expect that the total time required by the Bureau to review transactions in respect of which a SIR is issued may be somewhat greater than the current maximum five-month non-binding period applicable to "very complex" transactions under the Bureau's current service standards.

To minimize the potential that a SIR may be issued, the Draft Process Guidelines strongly encourage merging parties to engage in early consultations with the Bureau.<sup>54</sup> Parties also would be well advised to provide detailed voluntary submissions that include persuasive objective support for important positions being taken in those submissions, in accordance with well-established practice in Canada.

The information to be submitted in the initial notification will be "prescribed" in amendments to the Notifiable Transactions Regulations. Proposed amendments to those regulations were published for public comment on April 4, 2009.<sup>55</sup> Among other things, those amendments propose to eliminate the former long-form notification requirements and expand the former short-form notification requirements (which now become the new initial notification requirements) to include (i) copies of the legal documents, or the most recent drafts of unexecuted documents, that are to

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<sup>53</sup> Aitken, *supra* note 19. This seems to mean approximately four to six transactions per year, although the author understands that there have already been four SIRs issued in the first three months since the amendments were proclaimed into force. *See, e.g.*, Hansard, Proceedings of the Standing Committee on National Finance, Wednesday Mar. 11, 2009, available at [http://www.parl.gc.ca/40/2/parlbus/commbus/senate/Com-e/fin-e/03evb-e.htm?Language=E&Parl=40&Ses=2&comm\\_id=13](http://www.parl.gc.ca/40/2/parlbus/commbus/senate/Com-e/fin-e/03evb-e.htm?Language=E&Parl=40&Ses=2&comm_id=13) (Collette Downie, a former Deputy Commissioner of Competition, stated: "The expectation is that, on average, about four to six transactions [per year] will be affected by [the SIR] process."). *Cf.* Draft Process Guidelines, *supra* note 6, at 4.

<sup>54</sup> Draft Process Guidelines, *supra* note 6, at 4–5, 8.

<sup>55</sup> Regulations Amending the Notifiable Transactions Regulations, *supra* note 5.

be used to implement the proposed transaction, and (ii) documents that currently are described in item 4(c) of the HSR Act form.<sup>56</sup>

As to the content of SIRs, the Act simply states that they “shall specify the particular additional information or classes of additional information that are to be supplied.” Given the Bureau’s resource limitations and its familiarity with the U.S. experience, it is not expected that the scope of SIRs will be as extensive as those typically issued in the United States. The Draft Process Guidelines support this view. Among other things, they state that the “Bureau is committed to minimizing the parties’ burden in complying with a [SIR] by narrowing the issues and/or the requirements for additional data and records to the extent reasonably possible.”<sup>57</sup> To this end, they identify various “steps, evaluative factors, and challenge mechanisms that, subject to certain exceptions, will be followed in all cases.”<sup>58</sup> They also commit to “communicat[ing] initial substantive evaluations of the issues identified” as soon as possible within the initial thirty-day review period.<sup>59</sup>

In addition, the Draft Process Guidelines encourage pre-issuance dialogue to explore how the SIR can reasonably be narrowed before its issuance and to discuss the likely date of its issuance, the anticipated timing for updates on the status of the Bureau’s review and its interim and final assessments, the dates by which the Bureau will identify employees or agencies of the parties that it wishes to interview, the date by which the parties anticipate that they will comply with the SIR, and the date by which the Bureau will provide a preliminary assessment as to whether the parties have complied with the SIR.

The Draft Process Guidelines also identify a number of “generally applicable scope restrictions” for SIRs that will apply “in all but exceptional cases.”<sup>60</sup> These include:

- limiting the number of custodians to be searched in preparing a response to a SIR to thirty individuals—although this will not exempt production of records in central files, employees at the local level where multiple local markets are relevant to the merger review, or predecessors, successors, secretaries, and assistants of the thirty identified custodians;
- limiting the search period for (i) hard copy and electronic records to two years from the date of the SIR; and (ii) data requests to three years from the date of the SIR;<sup>61</sup> and
- not requiring back-up tapes/media where sufficient records can be obtained through less onerous means.

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<sup>56</sup> The language in the draft regulations tracks fairly closely the language of item 4(c) of the HSR Act form and may be further revised to eliminate some or all of the remaining inconsistencies. The two-stage merger review regime is in force even though amended regulations reflecting the new provisions have not yet been issued. Section 124 of the Act requires that any regulations relating to merger notification be published in draft form and be open for comment for at least sixty days. By virtue of the Federal Interpretation Act, since the existing regulations under sections 114 and 116 likely are considered “reasonably workable” for an interim period in the context of the new regime, the fact that amended regulations are not yet available has not delayed the introduction of the new two-stage merger regime.

<sup>57</sup> Draft Process Guidelines, *supra* note 6, at 4.

<sup>58</sup> *Id.*

<sup>59</sup> *Id.* at 6.

<sup>60</sup> *Id.* at 8–11.

<sup>61</sup> The distinction between these two categories remains somewhat unclear. At a public consultation meeting in Toronto on May 4, 2009, senior Bureau officials suggested that the first category contemplates documents and records with written material whereas the second category contemplates documents and records that are essentially “just numbers.”

Moreover, with respect to information and documents provided to a foreign agency, the Draft Process Guidelines state:

The Bureau will accept access to and copies of information and documents produced to a foreign agency as compliance with the relevant terms of a [SIR] (to the extent such information and documents are responsive), provided parties agree that information and documents received in this manner will be treated for all purposes “as if” provided directly to the Bureau and the parties do not impose restrictions on the use of such documents that are unacceptable to the Bureau.<sup>62</sup>

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The Bureau also has committed in the Draft Process Guidelines to establishing an internal review committee to assess the scope of draft SIRs, consider departures from the aforementioned self-imposed restrictions, and generally scrutinize the propriety of the SIR in the circumstances. In addition, the Bureau has committed to establishing an internal appeal procedure to deal with any disputes as to the scope of a SIR or the issue of compliance with the SIR.<sup>63</sup> Where the Bureau remains of the view that the parties have not complied with a SIR, the Commissioner may apply to a court for a determination of this issue. In such a proceeding, the burden presumably would be on the Commissioner to demonstrate non-compliance. Pursuant to section 123.1 of the Act, if non-compliance is established and the court determines that a person “without good and sufficient cause, the proof of which lies on the person, has completed or is likely to complete a proposed transaction before the end of the applicable period,” the court may make an order prohibiting the completion of the transaction, requiring a completed transaction to be dissolved or requiring the payment of an AMP up to a maximum of \$10,000 for each day on which the parties have failed to comply (in the case of a completed transaction).

Importantly, the ability of the Commissioner to issue an advance ruling certificate (ARC) has been retained. If issued, an ARC exempts a transaction from the notification regime and effectively immunizes the transaction from further challenge, unless substantially new facts come to the Bureau’s attention.<sup>64</sup> However, as a practical matter, an ARC typically is issued only where it is very clear that a transaction is not likely to have any adverse impact on competition whatsoever (i.e., in precisely those circumstances in which an ARC arguably is not necessary).<sup>65</sup>

Given that the Commissioner retains the ability to challenge a transaction post-closing, albeit only for one year following the substantial completion of a merger (as opposed to the former three-year period that existed prior to these amendments), merging parties can be expected to continue to seek an ARC in a range of situations (including where their lenders insist on receiving such pre-closing comfort). Indeed, merging parties also may continue the customary practice of seeking a “no action” letter in the event that an ARC is not granted (or even if an ARC is not requested), particularly given that the Bureau has begun under the new system to issue notices at the end of the initial waiting period stating that it has not yet completed its review (even though

<sup>62</sup> Draft Process Guidelines, *supra* note 7, at 12.

<sup>63</sup> Pursuant to this procedure, the “independent” internal reviewer (who will be a Senior Deputy Commissioner or Deputy Commissioner of a branch of the Bureau other than the Mergers Branch) may request additional information from the appealing party within five business days of receipt of the written appeal, and will render a decision within seven days after the party has provided all of the requested information. *Id.* at 13–14.

<sup>64</sup> It does not appear that the Bureau has ever challenged a transaction with respect to which an ARC previously had been issued, although in at least one case the Bureau reopened its file after substantially different facts than those which formed the basis for the issuance of the ARC came to its attention.

<sup>65</sup> COMPETITION BUREAU CANADA, FEE AND SERVICE STANDARDS HANDBOOK (2003), available at <http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/01338.html>.

it has not issued a SIR). Seeking an ARC or “no action” letter also may be considered to be prudent in light of the Interim Commissioner’s commitment to developing a “Made in Canada” approach to the SIR process that incorporates a degree of flexibility not present in the U.S. system.<sup>66</sup>

### AMPs for Abuse of Dominance

Another important change brought about by the amendments is the creation of a new power for the Competition Tribunal to impose AMPs of up to \$10 million—\$15 million for subsequent orders—with respect to any conduct that is found to constitute an abuse of dominance and is the subject of another order under the abuse of dominance provisions. It is not clear why the issuance of such other order (which can include any of the types of order that the Tribunal has been able to impose since the abuse of dominance provisions were added to the Act in 1986) is a precondition to the issuance of an AMP. Perhaps it was simply a case of minimizing the changes to the pre-existing language in paragraph 79(3.1), which allowed the Tribunal to impose an AMP against a dominant airline carrier.

In any event, the factors that the Tribunal was required to take into account under section 79(3.2) in determining the amount of an AMP that might be imposed against a dominant airline carrier have been retained (for general application to all industries) with minor modification. Those factors are as follows:

- a. the effect [of the practice] on competition in the relevant market;
- b. the gross revenue from sales affected by the practice;
- c. any actual or anticipated profits affected by the practice;
- d. the financial position of the person against whom the order is made;
- e. the history of compliance with this Act by the person against whom the order is made; and
- f. any other relevant factor.

Importantly, subsection 79(3.3) states: “The purpose of an order made against a person under subsection 79(3.1) is to promote practices by that person that are in conformity with the purposes of this section and not to punish that person.”

The creation of this new power to impose an AMP of up to \$10 million (\$15 million for subsequent orders) will significantly increase the risk associated with engaging in conduct that may be found to constitute an abuse of dominance.<sup>67</sup> Accordingly, businesses that may be dominant will need to exercise greater caution when contemplating conduct that may later be found to (i) have been intended (on the basis of an objective test) to have an exclusionary, predatory, or disciplinary effect on a competitor, and (ii) have had, or be likely to have, the effect of preventing or lessening competition substantially.

### Increased Penalties for Deceptive Marketing Practices

The amendments increase the maximum prison term that can be imposed under the criminal misleading advertising provisions of the Act from 5 years to 14 years; and for corporations, increase the maximum AMPs under the civil provisions to \$10 million (\$15 for each subsequent violation), from \$100,000 (and \$200,000). For individuals the maximum AMPs have been increased to \$750,000 (\$1 million for each subsequent violation), from \$50,000 (\$100,000). These increases apparently are a response to complaints from U.S. authorities of widespread cross-border activ-

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<sup>66</sup> See Aitken, *supra* note 19.

<sup>67</sup> Note that the Interim Commissioner has observed that AMPs will only be sought in “appropriate” cases. *Id.* at 6.

ities by Canadian-based companies targeting U.S. residents with marketing scams, in particular telemarketing scams. These changes, together with new injunction provisions, are expected to facilitate increased monitoring and prosecution of deceptive telemarketing practices in Canada.

### **Conclusion**

The repeal of the criminal pricing practices formerly in paragraphs 50(1)(a) (price discrimination) and 50(1)(c) (predatory pricing), section 51 (promotional allowances) and section 61 (price maintenance) will provide non-dominant businesses with much greater flexibility to structure their pricing strategies and practices. The same is true regarding vertical and other non-horizontal agreements that may have been caught by the current language in section 45 of the Act, which will be replaced on March 12, 2010, by amended provisions that are confined to agreements between “competitors.” Indeed, the decriminalization of the approach to horizontal agreements other than the specific types of “hard-core” cartel agreements described in the amended section 45 also will give businesses much greater flexibility to pursue arrangements that otherwise may not have been pursued because of the potential criminal liability that they might have attracted.

However, the amendments create substantial new risks for engaging in hard-core cartel conduct and deceptive marketing practices. These risks should lead firms to be much more vigilant in adopting serious and effective compliance programs. They also should lead firms contemplating legitimate conduct that may unavoidably or unintentionally raise issues under the new per se provisions in section 45 to carefully consider how to restructure their plans to reduce the increased risk that now exists.

Similarly, given the new power conferred upon the Tribunal to impose substantial administrative monetary penalties under the abuse of dominance provisions of the Act, dominant firms will have to be careful not to engage in any pricing or other practices that could be found to contravene those provisions. As a practical matter, it is difficult to see how price discrimination or promotional allowances might be found to be likely to prevent or lessen competition substantially, as required by the abuse of dominance provisions. The same is arguably true, although perhaps to a lesser extent, of predatory pricing.

Finally, the amendments to the merger review process may require companies contemplating notifiable transactions to adapt their closing conditions and will require them to prepare for substantially increased filing requirements where there is a material risk of the issuance of a SIR. Those amendments also will require parties to such transactions to build into their transaction timeline much more time for the completion of the Bureau’s merger review process. ●

## Book Review

# Free the Market: Pushing Back on the Chicago School

Gary L. Reback

**Free the Market! Why Only Government Can Keep the Marketplace Competitive**

Penguin • 2009

### Reviewed by Renata Hesse

Gary Reback's first book has as its principal goal the refocusing of governmental antitrust enforcement in high-technology markets so that it better recognizes the unique nature of technology markets and, in particular, the role that network effects can play in those markets. It is an often entertaining romp through Reback's many and varied experiences representing high-technology clients before the government and in private litigation.

The timing for a book that favorably views governmental intervention in markets could not have been better. We are faced with one of the most substantial economic downturns since the Great Depression, and there are calls for more and better regulation of the economy throughout Washington. The ABA Antitrust Section has sponsored two substantial panels (one at this year's Spring Meeting) on whether competition law or policy had any role in causing the crisis or should have a role in fixing it. For the first time in years (at least in the United States), people are talking about whether the concept of "too big to fail" should be revived. Reback's book, which is meant to serve as a kind of rallying cry for reducing the influence of the Chicago School on industrial organization economics and government enforcement decisions, fits perfectly into these current events. In Reback's view, the Chicago School gets it wrong because the rules and tests that it seeks to apply have their genesis in "old economy" markets where, unlike in the world of software, there is a marginal cost associated with producing each additional unit of output.

The book is ambitious. It starts with a history of the Standard Oil trusts that led to the enactment of the Sherman Act in 1890 and works its way up to 2008 by way of a series of stories about cases in which Reback played a substantial role. There is a lot of ground covered, and Reback occasionally digresses from his vignettes to touch on larger issues, such as the relationship between antitrust and intellectual property and an explication of the history of the Merger Guidelines. But the core of the book remains, first and foremost, Reback's often-engaging war stories about some very significant cases in the world of antitrust and high-tech. The book thus provides an animated and very personal window into Reback's thinking on how competition enforcement can and should play a role in making our markets—particularly high-tech ones—function better. Reback, who has represented Silicon Valley companies in antitrust and intellectual property matters for decades, is well positioned to offer his opinions on these issues and does so through the vehicle of an interesting narrative.

The first two sections of the book piece together what Reback views as some "foundational" elements of the eventual "takeover" of government antitrust enforcement philosophy by the Chicago School. He spends several pages on the work of economist Oliver Williamson when he

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*In Reback's view, the Chicago School gets it wrong because the rules and tests that it seeks to apply have their genesis in "old economy" markets where, unlike in the world of software, there is a marginal cost associated with producing each additional unit of output.*

was a "Special Economic Assistant" to then-Assistant Attorney General Donald Turner, crediting an economic evaluation performed by Williamson while he was at the Antitrust Division with "play[ing] a part in transforming antitrust doctrine."<sup>1</sup> According to Reback, Williamson's work, which demonstrated in two narrow cases (perfect competition and monopoly in a newspaper market) that very small reductions in costs can offset very large accumulations of market power in terms of the effect on overall consumer welfare, paved the way for the Chicago School.

Using Williamson's work as a transition element, Reback moves quickly from a period that he describes as largely consisting of battles between the Executive Branch and Congress on just exactly how and to what degree antitrust laws should be enforced (and what the legislation should even say) into the period that he identifies as the time when the Chicago School "came to Washington" (with President Reagan's Assistant Attorney General for Antitrust, William F. Baxter). Reback was a student of Baxter's at Stanford Law School, and clearly admired him. His last vignette involving Baxter, however, describes a lonely scene: Reback trying to bring Baxter around to advocating for a sweeping investigation into Microsoft's early conduct based on game theory economics and Baxter (in Reback's view) simply not getting that game theory had a proper role to play in government enforcement policy. I found it a kind of depressing story. Reback ends up accusing Baxter of refusing to see how game theory better describes the economics of high-technology markets simply because he cannot bring himself to deviate from positions he had taken as Assistant Attorney General, and then drives off in the rain after simply shaking Baxter's hand.

The description of the period where Baxter ran the Antitrust Division weaves some economic theory and some brief stories about significant cases on which Reback did not work (e.g., IBM and AT&T) together with Reback's experiences on several cases, including his early work for Apple. In an interesting twist, he takes a detour during this part of the book to describe how the Silicon Valley (and thus the tech boom more generally) was really one of the largest government works projects of the last fifty years. It is an interesting idea, and one that Reback periodically comes back to in the book: that the tech industry and those who advocate for mild government intervention in it should, as Reback says, "note the Valley's pedigree."<sup>2</sup> That said, it is also a little bit of a non sequitur, but one for which I want to forgive Reback since it allows him to introduce an interesting bit of information to the story.

Reback does a nice job using the cases in which he was involved to illustrate particular points—whether legal, economic, or, in many cases, political—that he wants to make. He uses, for example, an early case involving Apple and one of its distributors (*O.S.C. Corp. v. Apple*)<sup>3</sup> as a vehicle to talk about vertical resale price maintenance and the current political and economic arguments around whether such conduct should be per se illegal or judged under the rule of reason standard. *Lotus v. Borland*<sup>4</sup> is the vehicle through which Reback explores the intersection of antitrust and intellectual property.

The many iterations of *Microsoft*<sup>5</sup> function almost as a catch-all for Reback's fundamental point regarding how the influence of the Chicago School rendered the government too slow to recognize and, ultimately, too ineffective to deal with Microsoft's conduct before it had its anticompeti-

<sup>1</sup> GARY L. REBACK, FREE THE MARKET! WHY ONLY GOVERNMENT CAN KEEP THE MARKETPLACE COMPETITIVE 28–29 (2009).

<sup>2</sup> REBACK, *supra* note 1, at 59.

<sup>3</sup> *O.S.C. Corp. v. Apple Computer, Inc.*, 792 F.2d 1464 (9th Cir. 1986).

<sup>4</sup> *Lotus Dev. Corp. v. Borland Int'l*, 49 F.3d 807 (1st Cir. 1995).

<sup>5</sup> *United States v. Microsoft Corp.*, 253 F.3d 34 (D.C. Cir. 2001).

tive effect. There is much to be said about *Microsoft*, and Reback spends a great deal of time on the case. He provides many interesting factual details about the development of the Netscape story, along with descriptions of the work that he and his colleagues did over the course of several years to bring the story to light. Reback effectively makes *Microsoft* the centerpiece of the book in two fundamental but different ways. First, it is not only a case that virtually everyone knows, but also one where Reback has a tremendous inside track. He uses his detailed factual knowledge to his advantage to spin out his fundamental theme—software markets are different and the application of industrial organization economics to software markets without accounting for those differences will yield incorrect results.<sup>6</sup> Second, he uses the ultimate outcome of the government's case as a stepping stone to the section of the book on *Oracle*,<sup>7</sup> arguing that Oracle was potentially emboldened to test the government's resolve with its hostile takeover of PeopleSoft when it saw the “laughable” (Reback's word) remedy that was ultimately imposed on Microsoft: “Two years later, [Larry] Ellison would show the leaders of the Bush administration's Antitrust Division that the failure to enforce the law has consequences that markets can't correct.”<sup>8</sup>

Interestingly, the section of the book on mergers is the least coherent in terms of its relationship to Reback's basic thesis. Reback's discussion of the two large software mergers that he describes in detail—Thomson's acquisition of West and Oracle's acquisition of PeopleSoft—is his least persuasive discussion of the cases that he covers. He clearly believes that the Chicago School has had a deleterious impact on merger enforcement, but Thomson/West and Oracle/PeopleSoft in the end are not particularly good vehicles for making his point. This is principally because neither case seems to fit with his underlying theme regarding the constraining effect that the Chicago School has had on antitrust enforcement.

Reback devotes a large number of pages to the Thomson/West merger (he represented a complainant, Lexis/Nexis) and is sharply critical of the government's analysis and performance both in evaluating the transaction and in advocating a settlement during the Tunney Act process.<sup>9</sup> It is nevertheless hard to identify the precise doctrinal argument that Reback has with the government's handling of the matter, other than that he believes that the Antitrust Division defined the markets far too narrowly. Perhaps it is simply that he views the Division's arguably somewhat rigid application of the Baxter-refined Merger Guidelines that resulted in the definition of these narrow markets as evidence of the success that Baxter had in imbuing government enforcement with the Chicago School's way of thinking. But, if that is the point, Reback never makes it very clearly and instead begins and ends the story about the merger by making reference to the campaign contributions made by West before the Division's review of the merger. The implication is clear: The Division's analysis of the Thomson/West merger was bought by political contributions. Even if true, while it is obviously not how the Department should evaluate mergers, it does not seem to have very much to do with the influence of the Chicago School.

*Oracle* is an even bigger puzzle in this respect. I know from talking with Reback that he (at least initially) intended part of the book to be about the challenges that government lawyers face in litigation. Reback and I spoke at length about *Oracle*, since it was a case with which I was deeply

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<sup>6</sup> In Reback's view, one of the most significant differences in software markets is that they are susceptible to tipping (that is, they can move quickly towards a single standard) and thus can be subject to monopolization fairly early in their development. Tipping thus increases the risk associated with delaying intervention. Reback, *supra* note 1, at 170.

<sup>7</sup> *United States v. Oracle Corp.*, 331 F. Supp. 2d 1098 (N.D. Cal. 2004).

<sup>8</sup> REBACK, *supra* note 1, at 252.

<sup>9</sup> Reback uses the Thomson/West Tunney Act proceeding as the introduction to a brief digression on the history of the Tunney Act.

*Reback does a nice job of getting behind the scenes in some of the biggest antitrust matters of the last two decades (particularly in the tech space) and provides the reader—in colorful and lively writing—with his perspective on what has gone wrong and right with antitrust during this period.*

involved when I worked at the Antitrust Division. While Reback's recounting of the events from the case is largely accurate (although he left out my favorite story from the day that Larry Ellison testified), I had hoped for a more optimistic narrative to come out of the chapters on the case. It was a painful loss for those of us who worked on the case, particularly given the tone of Judge Walker's opinion, the details of which Reback describes in the book. But many both inside and outside the Antitrust Division believe the decision was legally incorrect, and I have rarely heard someone say that they believe the case the Division put on was somehow theoretically or factually deficient. That is, I have not heard a particular criticism leveled at the Division relating to the *Oracle* case that the Division somehow relied too much on the Chicago School in its analysis. And, to be fair, Reback doesn't make this claim either. So, while it is a natural case for Reback to spend some time on, given his extensive involvement on behalf of PeopleSoft, it does not in the end seem to fit very well into the overall narrative of the book.

Reback closes by covering his experiences with the Division during the Tunney Act proceedings on the SBC/AT&T and Verizon/MCI mergers. For me, it was during this part of the book that Reback's view of the role that politics plays in government antitrust enforcement really stood out. Having been a career Antitrust Division lawyer for almost ten years, with almost half of that time as a Section Chief, I certainly recognize that representatives of different political parties have different enforcement policies and those differences can play a role in the work of the Division. But I was nevertheless surprised at just how political Reback believes the process became. By the end of the book, it seems that most or all of the high profile enforcement decisions that were made by the Antitrust Division after the *Oracle* decision—and even some before it, like Thomson/West—were political decisions. And by that Reback does not mean just that the Bush administration political appointees who ran the Antitrust Division were too tied to the Chicago School way of thinking. He seems to mean, instead, that pure political pressure (including editorials from the *Wall Street Journal*) dictated many of the results. It is a difficult point of view to refute, since there is much that those of us who worked on some of the matters that he references cannot say, but, as someone who was responsible for making enforcement recommendations during the Bush administration, I can say that I do not share Reback's perspective on this issue. Suffice it to say that the factors that go into decisions on whether to take an enforcement action on behalf of American consumers are numerous and varied and the career lawyers in the Antitrust Division who are responsible for recommending cases rarely have politics on their minds.

*Free the Market* is an enjoyable and entertaining read, especially for those of us who like a little inside baseball. Reback does a nice job of getting behind the scenes in some of the biggest antitrust matters of the last two decades (particularly in the tech space) and provides the reader—in colorful and lively writing—with his perspective on what has gone wrong and right with antitrust during this period. You might not always agree with the stories that Reback tells or the perspective that he adds, but they are interesting and provide an opportunity for all of us to get a fresh—and uniquely “Reback”—perspective on some of these very important cases. ●

# Paper Trail: Working Papers and Recent Scholarship

**Editor's Note:** This edition features two papers that assess Robert Pitofsky's volume of essays, *How the Chicago School Overshot the Mark: The Effect of Conservative Economic Analysis on U.S. Antitrust*. 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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**Joshua D. Wright, *Overshot the Mark? A Simple Explanation of the Chicago School's Influence on Antitrust***

[http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1370641](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1370641)

**Daniel A. Crane, *Chicago, Post-Chicago, and Neo-Chicago***

[http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1375026](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1375026)

These two papers assess Robert Pitofsky's new volume of essays, *How the Chicago School Overshot the Mark: The Effect of Conservative Economic Analysis on U.S. Antitrust* (Oxford University Press 2008). As this title suggests, the essays in Pitofsky's book argue that the Chicago School provided a much-needed economic basis for antitrust policy, but has gone too far in inhibiting necessary interventions in the market.<sup>1</sup> Its pervasive influence in the courts and the agencies has enfeebled antitrust enforcement, at least in the United States.<sup>2</sup> The essays endorse the post-Chicago School, which uses sophisticated game-theoretic models that identify conditions under which such practices as predatory pricing, tying, and exclusive dealing can be anticompetitive.

The Wright and Crane reviews take different approaches, but both conclude that the book fails to make the case that the post-Chicago School should displace the Chicago School. The points of disagreement between the reviewers and the essayists are interesting in themselves. But they also give us a glimpse of what future debates over antitrust policy may look like because the reviewers, although already recognized scholars, are still in the first decade of their careers.

Wright challenges the book's repeated claims that the Chicago School's anti-interventionist policy program rests not on the best available economic theory or empirical studies, but on a conservative political ideology. While not denying the obvious ideological dimension in antitrust con-

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<sup>1</sup> Wright endorses the distinction between the Chicago School of industrial organization economics, which challenged the structure-conduct-performance paradigm of the 1960s, and the Chicago School of antitrust analysis, which challenged the prevailing view that certain practices, such as tying arrangements, were always anticompetitive. See Jonathan B. Baker & Timothy F. Bresnahan, *Economic Evidence in Antitrust: Defining Markets and Measuring Market Power* 23–26 (Stanford Law School, Working Paper No. 328, 2006).

<sup>2</sup> For European perspectives, see *POST-CHICAGO DEVELOPMENTS IN ANTITRUST LAW* (Antonio Cucinotta, Roberto Pardolesi & Roger van den Bergh eds., 2002).

troversies, Wright argues that the debates over the welfare effects of particular practices often can be resolved by data. The book's authors, he argues, ignore data that supports Chicago policy positions and oddly fail to offer data to support their arguments for expanded liability for such practices as resale price maintenance, exclusive dealing, and predatory pricing.

Wright notes that, from its inception, the Chicago School has emphasized the importance of empirical inquiry. Chicago School economists like Harold Demsetz relied on data to challenge the simplistic claims of the structure-conduct-performance paradigm that prevailed during the Warren Court years. George Stigler, the Nobel Prize-winning Chicago economist, measured the validity of theories by their empirical support. Wright also notes that the Chicago School was responsible for the error-cost framework that typically structures the consideration of evidence in modern antitrust cases.

Wright then turns to specific instances in which the available theory and empirical evidence support the Chicago approach. The first is resale price maintenance, or RPM. In *Leegin*,<sup>3</sup> the Supreme Court overturned the century-old rule of per se illegality for the practice, observing that the practice could enhance interbrand competition by, for example, controlling free riding by dealers on the sales efforts of other dealers. The book's authors argue that this ruling was incorrect, because manufacturers sometimes impose RPM even when there is no evidence of or prospect for free riding by dealers. Wright points out, however, that Ben Klein and Kevin Murphy, Chicago School economists, have noted this phenomenon, and have offered a convincing procompetitive explanation for it: the disparity in the profit margins of manufacturers and dealers on incremental retail sales.<sup>4</sup> Manufacturers have a higher profit margin on incremental sales of their differentiated profits than do their dealers; consequently, dealers, even in the absence of free riding, have an insufficient incentive to incur the costs of making manufacturer-specific sales efforts. Compounding the problem, a dealer's manufacturer-specific promotional efforts may increase sales of that manufacturer's goods at the expense of sales of other goods the retailer handles. The manufacturer can profit by providing an incentive to dealers to provide those services. There are various ways to provide the appropriate incentive, but RPM may be the least costly.

Wright also directly disputes the claims of some of the essayists that there is little empirical evidence that RPM is procompetitive. There is evidence that RPM raises prices, but that is hardly surprising because the very reason for the practice is to provide dealers with higher margins, at least initially; the real issue is whether the price increase is accompanied by a reduction in welfare (as in the case of a dealer cartel) or an increase. Wright points to a substantial literature that suggests that, in the vast majority of instances of RPM, it benefits consumers by assuring that they receive services that they want.<sup>5</sup> The authors of the book, Wright notes, do not respond to this evidence.

Wright offers a similar critique of the essayists' treatment of exclusive dealing. Post-Chicago scholars have shown that exclusive contracts with dealers can be exclusionary if a manufacturer can sign up enough dealers to deny rivals the outlets they need to achieve minimum efficient scale. Wright provides a helpful review of the various models that show when market conditions make this sort of strategy possible in the face of its obvious problems—especially the incentive of dealers

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<sup>3</sup> *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 551 U.S. 877 (2007).

<sup>4</sup> Benjamin Klein & Kevin M. Murphy, *Vertical Restraints as Contract Enforcement Mechanisms*, 31 J.L. & Econ. 265 (1988).

<sup>5</sup> See, e.g., James C. Cooper, Luke M. Froeb, Dan O'Brien, & Michael G. Vita, *Vertical Antitrust Policy as a Problem of Inference*, 23 INT'L J. INDUS. ORG. 639 (2005); Francine Lafontaine & Margaret Slade, *Empirical Assessment of Exclusive Contracts*, in HANDBOOK OF ANTITRUST ECONOMICS (Paolo Buccirossi ed., 2008).

to avoid creating an upstream monopoly. In response to these possibility theorems, Wright points to the models of Klein and others that show the many ways in which exclusive dealing can be efficient. For example, a manufacturer may use the practice to assure that dealers will not simply pocket its payments or use them to promote rival products. Again, according to Wright, the available evidence, though limited, suggests that exclusive dealing is frequently output-enhancing.<sup>6</sup>

In a final section, Wright challenges the notion that the Chicago School's success in recent Supreme Court decisions is evidence of the overwhelming pernicious influence of what some essayists call conservative economics. He notes that the vast majority of the Supreme Court's recent antitrust decisions have been decided by supermajorities, a fact he attributes to the acceptance of Chicago School approach by both liberal and conservative justices. There is a real ideological divide in antitrust, but it only imperfectly reflects the conventional, broad-brush classifications of conservative and liberal on fiscal and social issues.<sup>7</sup>

Dan Crane makes some of the same points as Wright. He objects to the suggestion that the Chicago School is merely ideological. He particularly criticizes Pitofsky's chapter introductions as overstating the arguments of the essayists, most of which make more limited criticisms of particular Chicago positions. Like Wright, he criticizes the repeated characterizations of Chicago as lacking empirical foundation and notes that post-Chicago antitrust is, if anything, less empirical than Chicago. He suggests that, where there is no definitive evidence about the effects of a practice, the courts understandably prefer not to impose liability. He echoes Wright's point that "it takes a theory to beat a theory," observing that post-Chicago has failed thus far because "its major contribution has been to grouse about Chicago rather than to articulate a clear and appealing vision about what antitrust should do and why." (p.20)

He notes that the differences between the policy recommendations of the leaders of the two schools can be overstated. He rejects the claim that the mainstream of the Chicago School, represented by Richard Posner and William Baxter, is uniformly non-interventionist. He suggests also that much of the success of defendants in the Supreme Court can be laid at the feet of the Harvard School's emphasis on institutional competence in the exercise of the judicial function. As an illustration, he points to Herbert Hovenkamp, an early advocate of post-Chicago antitrust,<sup>8</sup> who has inherited the Areeda antitrust treatise, the great expression of Harvard School antitrust. Hovenkamp, he notes, despite his post-Chicago credentials, is one of the leading critics of *Kodak v. Image Technical Services*,<sup>9</sup> the Supreme Court's most clearly post-Chicago decision.

Despite his criticism of the broader claims of the book, Crane is impressed by the specific theoretical challenges that post-Chicago theorists have made to a range of Chicago positions. He suggests that the challenges warrant a renewed effort by Chicago scholars to reconstitute their approach as a Neo-Chicago school. A large part of this effort will be to improve the empirical basis of antitrust and to refocus attention on the capacities of courts to improve market outcomes.

In making his call for a Neo-Chicago School, Crane is on solid ground. Much work remains to be done within the traditional framework. Yet I believe he overstates the challenge ahead. He char-

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<sup>6</sup> Jan B. Heide et al., *Exclusive Dealing and Business Efficiency: Evidence from Industry Practice*, 41 J.L. & ECON. 387 (1988); John Asker, *Diagnosing Foreclosure Due to Exclusive Dealing* (NYU Working Paper No. EC-04-36, 2005); Tim R. Sass, *The Competitive Effects of Exclusive Dealing: Evidence from the US Beer Industry*, 23 INT'L J. INDUS. ORG. 203 (2005).

<sup>7</sup> William H. Page, *The Ideological Origins and Evolution of U.S. Antitrust Law*, 1 ISSUES IN COMPETITION LAW AND POLICY 1 (ABA Section of Antitrust Law 2008).

<sup>8</sup> Herbert Hovenkamp, *Antitrust Policy After Chicago*, 84 MICH. L. REV. 213, 225 (1985).

<sup>9</sup> *Eastman Kodak Co. v. Image Technical Servs., Inc.*, 504 U.S. 451 (1992).

acterizes post-Chicago as “lean, hungry, and spoiling for a fight,” (p.22) particularly with this new volume of essays as a manifesto. (He might have added that post-Chicago antitrust is dominant in Europe.) The Chicago School, in contrast, is moribund. Its “fire . . . has gone out,” (p.22) and its founders are “dead, bored with the field, or complacent.” (p.21) I hope this characterization is a bit of hyperbole to match that of the volume under review. While the founders may have moved on, there are others carrying the torch, not least the authors of these reviews. The Chicago School (or Neo-Chicago School) is in good hands. ●

—WHP