

Interview with FTC Commissioner Pamela Jones Harbour



Pamela Jones Harbour

Editor's Note: In this interview with The Antitrust Source, Commissioner Pamela Jones Harbour discusses her broad-ranging interests and goals for her tenure on the Commission, including the role of the Commission and the courts in merger enforcement, analysis of innovation markets, enforcement of vertical restraints, and petroleum industry regulation. She also provides interesting insights into the staff and workings of the Commission.

Commissioner Harbour, an independent, was sworn in as a Commissioner of the Federal Trade Commission on August 4, 2003, to a term that expires in September 2009. She joined the Commission from Kaye Scholer LLP, where she served as a partner in the litigation department, handling antitrust matters, counseling clients on Internet privacy, e-commerce, consumer protection, and a variety of competition-related matters.

Prior to joining Kaye Scholer, Commissioner Harbour was a New York State Deputy Attorney General and Chief of the Office's 150-attorney Public Advocacy Division. During her 11-year term in the Attorney General's office, she argued before the U.S. Supreme Court on behalf of 35 states in *State Oil v. Khan*, a landmark price-fixing case, and also successfully represented numerous states, in *New York v. Reebok*, *States v. Keds*, and *States v. Mitsubishi*, each resulting in multimillion-dollar national consumer settlements.

The Antitrust Source conducted this interview on February 15, 2006.

—LISL DUNLOP

THE SOURCE: You have been at the Commission now for two-and-a-half years. What do you consider to be your greatest accomplishments over that period of time?

COMMISSIONER HARBOUR: Everything I do as a Commissioner is driven by a single guiding principle: that it is my job to protect consumers. They deserve the absolute highest quality of work from those appointed to serve their interests. I owe it to consumers to be extremely vigilant on their behalf, every time a new matter lands on my desk. I believe I have developed a reputation for taking a consumer-oriented perspective, and I am proud of that. Commission staff, the other Commissioners, and outside parties all know that I'm going to ask the bottom-line question—how does this affect consumers?—and hopefully they will be able to give me a good answer when I ask.

As a Commissioner, I enjoy the freedom to express my own views and stand by my convictions, coupled with the ability to say exactly what I think through concurring statements or dissenting statements. I am proud of the separate statements that I've issued—including *Genzyme*,¹ *KFCC*,² *Arch Coal*,³ and *Time Warner/Comcast*,⁴ to name a few. I've worked hard to craft meaningful statements that clearly identify the issues of greatest importance to me. I'm hopeful that my statements have provided useful and thought-provoking guidance to Commission staff as well as to outside parties.

¹ Available at <http://www.ftc.gov/os/2004/01/harbourgenzymestmt.pdf>.

² Available at <http://www.ftc.gov/os/caselist/0423033/040603statementharbour0423033.pdf>.

³ Available at <http://www.ftc.gov/os/adjpro/d9316/050613harbourstatement.pdf>.

⁴ Available at http://www.ftc.gov/os/closings/ftc/0510151twadelphialeibowitz_harbour.pdf.

I am also pleased with my ability, on occasion, to influence the Commission's agenda. As a non-majority Commissioner, I can't set the agency's agenda. I can, however, influence it—and I take that role seriously. As I go along during this interview, I'll probably think of some examples where I have been able to influence the agenda, so I will circle back to that in a moment or two.

On a personal note, I'm also proud of my relations with Commission staff. I truly believe that our staff is very talented and that they're the Commission's greatest asset. I do my best to treat them with respect and to let them know how much I value their opinions, even if I'm constantly pushing them to do more, and even though I sometimes disagree with their ultimate recommendations.

From a micro perspective, I am very proud of my work as the Compulsory Process Commissioner. I have been delegated authority by the Chairman to rule on behalf of the Commission on all petitions to quash or modify compulsory process, CIDs, or subpoenas that are issued to obtain information during our investigations. Sometimes these petitions appear to be little more than attempts to slow down an investigation. At other times, complex and difficult issues of fact, law, and policy need to be evaluated and balanced, in order to ensure that the Commission's investigations are effectively conducted without any unwarranted injury to equally important social values. I take great satisfaction in being able to provide this kind of guidance during our investigations, usually at an early and formative stage of the process. A recent example involving Exxon Mobil and the confidentiality of sensitive corporate information illustrates the type of issues that are sometimes addressed.⁵

Another area that I view as an accomplishment is the December 2004 peer-to-peer (P2P) workshop. This is an area where I believe I was successful in influencing the agenda, as I just mentioned. By way of background, P2P file-sharing technology allows individuals to share files, including music, video, or software applications. Because the files don't rest or reside in a central location, the P2P file-sharing technology allows for faster file transfer and conservation of bandwidth. Music industry executives were concerned that peer-to-peer file sharing might impede or destroy their business model, while on the other hand, P2P representatives were concerned that the industry might attempt to destroy this nascent technology due to concerns about copyright. Congress indicated that they were thinking of possible legislation in this area. I had identified this as an area in which the Commission should be more involved. In keeping with my desire to help shape the Commission's agenda, and also because I thought this would be an excellent application of the Commission's research and scholarship function, I advocated for some sort of workshop. The Commission ultimately held a two-day workshop and issued a report. I see this as an important area where consumer protection, competition, and intellectual property intersect; I think it's very important to nurture nascent technologies, while at the same time protecting IP rights.

One other area that I'm proud of is the result in the *Aloha* acquisition. At the direction of myself and Commissioner Leibowitz, the Commission voted to send staff into court to pursue a preliminary injunction to block a potentially anticompetitive merger. Staff ultimately negotiated a settlement that allowed the deal to go forward with conditions that are beneficial to consumers, which would not have happened otherwise.⁶

⁵ See Letter from Donald Clark, Secretary, FTC, to Exxon Mobil Corp. (Jan. 10, 2006), available at http://www.ftc.gov/os/quash/0510243/responsetoexxonmobilpetition_text.pdf.

⁶ See News Release, FTC, FTC Resolves Aloha Petroleum Litigation (Sept. 6, 2005), available at <http://www.ftc.gov/opa/2005/09/alohapetrol.htm>.

THE SOURCE: What have been your biggest surprises over your two-and-a-half years as a Commissioner?

HARBOUR: I have been surprised and quite pleased by the number of current and former staff members who have been at the Commission for 25, 30, or even more years. This includes staffers at all levels, from administrative staff all the way up through senior managers. Their vast knowledge and their institutional memory is invaluable to the Commission. A few people come to mind. At the staff level, a gentleman named Stan Harewood retired in January after 33 years of service. *FTC Watch* called him the “Dean of Information Specialists” because he was so effective as a consumer response specialist. Elaine Kolish recently left the Commission after being here for 25 years. For a number of years, she was the Associate Director of the Division of Enforcement in the Bureau of Consumer Protection. Rhett Krulla of Mergers II comes to mind; he recently retired after more than 30 years of service. Ann Malester, the former Assistant Director of the Mergers I shop, also comes to mind; she was here for more than 20 years. So what surprised me is how long talented employees stay at the Commission and how devoted they are to the agency.

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THE SOURCE: What are your short-term and long-term goals as a Commissioner and how have they changed since you've been there?

HARBOUR: In the short term, I will continue to take a principled, substantive approach to the law. In each matter we address, as I see it, the Commission has two choices. One would be to enforce and promote the law as it currently stands; the other would be to use the tools available to us to push the law to evolve in a way that will better address the current realities of the marketplace. As always, I will continue to ask how each recommended course of action ultimately will affect consumers. Also, the Commission currently has several fascinating Part 3 matters on its agenda, and I look forward to working with my colleagues to resolve these cases by issuing thoughtful, well-written opinions.

As a long-term goal on the competition side, I will continue to advocate for the Commission to develop and bring vertical cases, where appropriate. Smoothly operating channels of distribution are very important to our economy. We know that vertical restraints may be procompetitive or anti-competitive, and this depends on numerous factors. It also depends on a complex analysis of interrelationships and incentives among various distribution channel participants. There is a need for more empirical research in this area.

The current state of empirical research makes it more difficult to distinguish procompetitive from anticompetitive vertical restraints. I strongly suspect that distribution channel participants' incentives and interests conflict and clash to a far greater extent than most of the economic models predict or account for. There appear to be strongly held views by economists on both sides of this issue, but little effort has been directed toward finding empirically valid resolutions. I have repeatedly called upon antitrust scholars, both lawyers and economists, to take the time and invest the resources and the efforts necessary to shed more light on these important issues. There are credible economists on both sides of the debate making conflicting claims. On one side there's concern at the prospect of too much enforcement and on the other side there's concern at the risk of too little.

I tend to identify with the “too little” side of the debate, but I make no prediction about which side is more likely to find empirical validation if the inquiry is done in a rigorous manner. I would prefer to be able to make enforcement decisions that are solidly grounded in an informed under-

standing of the probable consequences of taking or not taking an enforcement action. What I don't want to see is enforcement decisions being made just because we are afraid of what we don't know, especially if nothing is being done to make us better informed. As I said earlier, I will continue to advocate for the Commission to develop and bring vertical cases where appropriate. I believe that the Commission would further enhance its ability to distinguish between procompetitive and anticompetitive vertical restraints if we were to conduct more investigations, closely analyze more vertical restraints, and bring cases when we believe there is a risk of anticompetitive harm. By taking no enforcement actions at all against vertical restraints, we send a message to the marketplace that all vertical practices are legal, even though some are anticompetitive.

I would like the Commission to develop more cases that will flesh out the application of the [1992 FTC/DOJ] Horizontal Merger Guidelines in cases involving pure innovation markets.

Another long-term goal I would like to pursue would be to develop policies related to the antitrust implications of standard setting. During my term I have become increasingly interested in the issue of standard setting in high-technology industries. Due to a pending Part 3 matter, I can't say very much about this. But the Commission was very deeply involved in the joint FTC/DOJ intellectual property hearings that took place over 24 days back in 2002,⁷ and then in 2003 the Commission issued a detailed report that discussed many of the findings from those earlier hearings.⁸ The Commission has amassed a great deal of expertise on issues relating to the intersection of antitrust and intellectual property law; in particular, we have individuals at the Commission who have done a lot of studying and a lot of thinking about standard-setting issues. I'm hopeful that we will find a way to convey some of that knowledge to the outside world, especially to those who have to make day-to-day decisions in fast-paced, high-technology industries.

Another long-term goal that I want to mention is that I would like the Commission to develop more cases that will flesh out the application of the [1992 FTC/DOJ] Horizontal Merger Guidelines⁹ in cases involving pure innovation markets. I raised this issue in my separate *Genzyme* statement.¹⁰

Another area of interest is the federal/state relationship. As a former state enforcer, I am constantly on the lookout for ways to further enhance the relationship between state and federal enforcers, especially with respect to industries that matter most to consumers. One example is a joint federal/state petroleum seminar that I am currently working to organize. At the recent ABA Antitrust Section Mid-Winter Meeting in Canada, I found myself sitting around the fireplace with two long-time colleagues: my fellow Commissioner, Bill Kovacic; and Bob Hubbard from the New York AG's office, who currently serves as the Chair of the NAAG Antitrust Task Force. We came up with the idea for a joint federal/state seminar on petroleum issues. We quickly expressed our ideas to Chairman Majoras, and she shared our interest. Planning is now underway and we are hopeful that that seminar will take place in the fall of 2006. I will continue to look for additional areas for federal/state cooperation, including joint training programs and greater case coordination.

Not to leave out the other side of our mission—consumer protection—as a long-term goal I am very interested in the area of privacy. One of the first speeches I gave as a Commissioner was on the subject of identity theft. I've paid very close attention to privacy issues throughout my term,

⁷ Federal Trade Comm'n & U.S. Dep't of Justice, Hearings on Competition and Intellectual Property Law and Policy in the Knowledge-Based Economy (Feb. 6–Nov. 6, 2002), available at <http://www.ftc.gov/opp/intellect/index.htm>.

⁸ See News Release, FTC, FTC Issues Report on How to Promote Innovation Through Balancing Competition with Patent Law and Policy (Oct. 28, 2003), available at <http://www.ftc.gov/opa/2003/10/cpreport.htm>.

⁹ U.S. Dep't of Justice & Federal Trade Comm'n, Horizontal Merger Guidelines (1992, revised 1997) [Guidelines], available at <http://www.ftc.gov/bc/docs/horizmer.htm>.

¹⁰ See *supra* note 1.

and I will continue to make that a top priority. Also on the consumer protection side, I would be interested in developing more national advertising cases against well-known advertisers, when appropriate. During my term thus far, the Commission has brought cases against two well-known advertisers who made unsubstantiated express health claims for their products. One of the claims was that eating fried chicken is healthy,¹¹ and another was that drinking two glasses of orange juice each day can cause specific reductions in cholesterol and blood pressure.¹² I would like to see the Commission staff look carefully to determine whether we should bring more of these cases, especially if deceptive health claims are involved. I know when Commissioner Rosch was Director of the Bureau of Consumer Protection, the Commission brought a number of significant national advertising cases involving large, nationally known companies.

Another area of interest I just want to touch on is media violence. As a parent, I am particularly concerned about issues that affect our children. Congress had asked the Commission to issue a number of reports on whether the motion picture industry, the music recording industry, and the electronic gaming industry are marketing violent entertainment to children. Our latest report was issued in the summer of 2004.¹³ While progress has been made, the Commission found that, unfortunately, all three of these industries continue to advertise violent R-rated movies, explicit content-labeled recordings, and mature-rated games in media with large teen audiences. Over the past couple of years, I've met with members of these industries. Some of them are committed to changing their practices and making them better, but I would like to continue to encourage the industry to change these practices.

THE SOURCE: Have any of your goals, short or long term, evolved during your two-and-a-half years at the Commission?

HARBOUR: I would say that during the first two years of my term I was more of a generalist. As I became more acquainted with our statutes, our cases, and our policies, as well as the capabilities and resources at the agency, my interests have become more focused, and would tend to track the long-term goals that I just articulated.

THE SOURCE: There have been a number of changes at the Commission during your two-and-a-half years there. There was a new Chairman and a Commissioner appointed in 2004. Commissioner Leary and Commissioner Swindle left in 2005, and Commissioners Kovacic and Rosch have recently been appointed. What do you see as the impact of these changes at the Commission?

HARBOUR: I believe that each Commissioner who has served during my term has left his or her own indelible mark on the Commission. Since you've asked me this, I'm not going to be able to leave out anyone who has served with me, so I'm going to start with Tim Muris. He will be forever known as the creator and proponent of the Do-Not-Call Registry, ridding us of those pesky and intrusive

¹¹ See News Release, FTC, KFC's Claims that Fried Chicken Is a Way to "Eat Better" Don't Fly (June 3, 2004), available at <http://www.ftc.gov/opa/2004/06/kfccorp.htm>.

¹² See News Release, FTC, FTC Puts The Squeeze on Tropicana's Orange Juice Claims (June 2, 2005), available at <http://www.ftc.gov/opa/2005/06/tropicana.htm>.

¹³ FEDERAL TRADE COMMISSION, MARKETING VIOLENT ENTERTAINMENT TO CHILDREN: A FOURTH FOLLOW-UP REVIEW OF INDUSTRY PRACTICES IN THE MOTION PICTURE, MUSIC RECORDING & ELECTRONIC GAME INDUSTRIES (2004), available at <http://www.ftc.gov/os/2004/07/040708kidsviolencrpt.pdf>.

telemarketing calls during dinner and other inconvenient times. I believe the Registry to date has more than 110 million registrants. Tim jokes that “Do Not Call” will be the epitaph on his tombstone, and he’s probably right about that. On the antitrust front, one of the most important aspects of Tim’s legacy, I think, will be the number of Part 3 cases that were litigated during his term, as well as the number of important Part 3 opinions that the Commission generated. I think it’s important to get more cases up to appellate judges so we can shape and clarify the law.

Mozelle Thompson’s mark was his leadership role in the OECD, where he served as head of the U.S. delegation on consumer policy and helped spearhead the adoption of the OECD consumer protection guidelines for e-commerce.

Orson Swindle left the Commission having created a culture of security with respect to information systems. His legacy is that good security practices helped build consumer trust and create consumer confidence. Also, as the only non-lawyer on the Commission, Orson brought a certain common sense approach to our deliberations, which I very much appreciated. He had a way of cutting to the chase and honing in on key issues, especially when it came to asking the fundamental question about how a practice will affect consumers.

Tom Leary’s legacy is simply being Tom Leary. He was the model and quintessential Commissioner, beloved by all, inside and outside of the FTC. To date, I believe that he is the most cited Commissioner for his many articles, speeches, legal insights, and witticisms. He was also part of an historic FTC/DOJ delegation that traveled to China to share U.S. competition law with Chinese officials who were, at the time, working on their own law.

Chairman Majoras brings to the Commission a diverse and well-rounded set of skills. I appreciate her intellect and her highly ethical approach to her work. She is the only FTC Chairman who has served as an official at both of the federal antitrust agencies. I believe that her litigation skills and background in both the government and in private practice will become a critical part of her legacy as Chairman. She has observed some of the recent FTC and DOJ losses in litigated cases—and when we bring cases she wants to win them. She is instilling a litigation mindset from the outset of every investigation. From day one, staff are encouraged to think about how they would frame the issues for a judge and what types of evidence they would need to present. No doubt, this will lead to better enforcement recommendations to the Commission, as well as better litigation outcomes when we do authorize staff to bring challenges. The Chairman has announced some of her major projects, which should further enhance the Commission’s reputation and effectiveness. Some of these initiatives include reviewing and improving the merger review process; issuing an in-depth commentary on the Guidelines, holding a series of joint FTC/DOJ public hearings on single-firm conduct that might raise antitrust concerns; and a brand-new consumer protection initiative, which the Chairman announced recently, which will be a set of hearings on the ways new technologies, convergence, and globalization of commerce impact consumer protection.

Jonathan Leibowitz has an excellent ability to spot issues that affect competition and are important to consumers. He has been instrumental in influencing the Commission to focus on the issue of authorized generics and to seek greater use of its civil penalty authority. Jonathan is also a true Washington insider in the best sense of the term. He understands the interplay of our various constituencies. He has excellent lines of communication with people on the Hill and various interest groups. This no doubt will help the Commission to be better-educated and more responsive to concerns and problems within our jurisdiction.

As for Bill Kovacic and Tom Rosch’s recent appointments, we all expect great things from them both. Bill, as we know, was a renowned law professor at George Washington University (and George Mason before that). He was the FTC’s highly regarded General Counsel from 2001

through 2004. He worked in the agency's Bureau of Competition planning office in the late '70s and early '80s.

Tom Rosch has a national reputation and is highly regarded for his antitrust expertise. He has more than 40 years of practice before the Bar and has led more than 100 federal and state antitrust cases. He was also the director of the agency's Consumer Protection Bureau in the late 1970s.

We all look forward to Bill's and Tom's ideas, their energy, enthusiasm, and intellect. I will say that their vast substantive knowledge in various areas of antitrust, consumer protection, and international antitrust law not only will be a tremendous asset to the Commission but also a tremendous asset to me as their colleague. It is also just plain fun to be on a Commission of this caliber. It is already apparent that the level of discourse and debate will be absolutely top-notch, and I feel privileged to be a part of it.

THE SOURCE: You previously mentioned your dissenting statements in *Genzyme* and *Arch Coal*, as well as in the *KFCC* consumer protection matter. What in your view are the role and importance of dissenting statements?

HARBOUR: Dissenting statements can provide notice to the particular company or companies involved in the case. For example, a dissent could let them know that I might have wanted a stronger remedy. Dissents can also send signals to various groups that I might prefer stronger relief in future cases. This includes the other Commissioners, Commission staff, and sometimes even other agencies, as well as the private bar, other industry participants, and companies in general. And sometimes a dissent can be used to begin or continue a debate about the propriety of a particular remedy or policy decision. The *Genzyme* dissent was a good example. My goal was to tee up some of the key issues relating to the analysis of competitive effects and innovation markets. The *Arch* dissent was intended to do the same thing with respect to coordinated interaction.

THE SOURCE: Let's turn for just a minute to federal/state antitrust enforcement. You previously mentioned your long experience with the New York State Attorney General's office. What do you see as the appropriate role of state antitrust enforcement?

HARBOUR: I have always been a strong believer in the concept of federalism. As I've said in my speeches, I view federalism as a system where state and federal governments each strive to protect the interests of their joint constituents. When Congress passed the Sherman Act in 1890, the intent was to supplement state enforcement, not supplant it. So to me federalism means more, much more, than just redundant state and federal law enforcement resources. It implies an elaborate system of checks and balances—which is just as important to our country as are the horizontal checks among the three branches of the federal government, particularly in the context of antitrust enforcement. The more individuals or agencies looking out for consumers's interests, in my view, the better.

THE SOURCE: What lessons have you taken from your many years as a state enforcer that you apply now in your role as a federal enforcer?

HARBOUR: My years as a state enforcer have given me key lessons. One that has stayed with me, and which very much influences my attitude as a Commissioner, is that all antitrust enforcement

agencies have one primary goal: to protect consumer welfare by ensuring that consumers have choices in the marketplace, as well as the ability to make informed market decisions. The other lesson is that cooperation between law enforcement agencies, either state/state or federal/state, normally produces better outcomes for consumers.

THE SOURCE: Let's turn for a minute to merger enforcement. What are your views on judicial review of mergers in a preliminary injunction context?

HARBOUR: There are many extremely intelligent and competent federal district court judges who have never tried an antitrust case before, and while I certainly would not say that antitrust is rocket science, I will say it can take awhile for judges to get up to speed, especially with respect to the nuances of merger analysis. I think the challenge for us at the federal level is to educate the judge about what the antitrust laws require us to prove, and with what degree of certainty, and to present a convincing story of why our facts are worthy of a preliminary injunction—with the emphasis on preliminary, so that we can bring the case back in-house and conduct a very detailed Part 3 adjudication. This can be difficult at times, especially with judges who are not steeped in antitrust jurisprudence. Federal court oversight is a very important part of the checks and balances system that I mentioned earlier. It is important for more antitrust cases to work their way through the federal courts because that is an important way to shape and clarify the law. Ideally this would happen by way of the Commission developing more Part 3 records and decisions that would then be reviewed by appellate courts. Evolving case law not only shapes our future enforcement decisions, but also provides important guidance for businesses.

THE SOURCE: Do you think that there should be more deference by the courts to the Commission on a preliminary injunction hearing?

HARBOUR: The short answer is yes, in many cases, but obviously there's more to it than that, particularly with judges who are less familiar with antitrust. I think we can too easily get hung up on the incipiency standard of Section 7. A judge, of course, does not want to block a transaction absent compelling evidence of competitive harm. But at the PI stage, under Section 7, the enforcement agencies are not required to prove that harm *will* occur, only that the transaction *may* substantially lessen competition. This is especially true for Commission cases, where our primary goal is to preserve the status quo ante while the case is in Part 3. We need to do a better job of explaining the "will" versus "may" distinction to the judges.

THE SOURCE: Your dissenting statement in *Arch Coal* suggested that you believe the Commission should be more ready to pursue administrative actions when a preliminary injunction is not granted by the courts. What remedies do you think will be appropriate in that context?

HARBOUR: I think there are two related questions that need to be addressed. First, is it appropriate to pursue administrative action when a court has denied a preliminary injunction? Second, if the case goes into Part 3, what remedies might the Commission seek?

As my *Arch* statement indicated, I think the answer to the first question is: yes, under some very limited circumstances, it may make sense for the Commission to pursue a Part 3 case after denial of a PI. Some might argue that this gives the Commission a proverbial second bite at the apple. I disagree. A PI proceeding is quite different from a Part 3 adjudication. It sometimes may be in

the best interest of consumers for the Commission to pursue a Part 3 case, to bring its unique expertise to bear. In *Arch*, I firmly believe that the courts did not fully understand what the law required us to establish in order to demonstrate a likelihood of coordinated effects. This was evidenced by the fact that the district court characterized our coordinated effects theory as novel. This error was later corrected by the appeals court. It also appears that the district court certainly, and the appeals court possibly, held us to a higher standard of proof than was appropriate in the PI context. For example, the district court judge faulted the Commission for failing to *prove* that coordination already had occurred. This is not the proper approach for an incipency analysis. In a full-blown Part 3 proceeding, the Commission could have done a great deal to further the development of the law of coordinated effects. We are expert antitrust fact-finders and adjudicators. The Part 3 process is designed to create an extensive factual record, far more substantial than the record in the PI proceedings. And even with respect to the facts that the district court did consider, we might have weighed them differently in light of a more complete record. We would have had an opportunity to clarify the law relating to coordinated effects, in an area where there is not much guidance.

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As to remedy, this is an extremely case-specific issue. In any given case, the Commission has a full panoply of remedies available to us. This includes Part 3 cases, where we can seek virtually any remedy other than money. But because we never had the opportunity to conduct a full trial on the merits, I'm unable to speculate on what remedy might have been appropriate in *Arch*.

Arch Coal and

THE SOURCE: Your dissenting statement in *Arch Coal* also was critical of the limited weight that the court gave to customer testimony concerning competitive effects, while at the same time relying on the customer testimony for assistance with market definition. What impact, if any, has this, as well as the *Oracle* decision for the Department of Justice, had on the Commission's reliance on customer testimony in making its enforcement decisions?

Oracle/PeopleSoft

chose to disregard it or

to use it inconsistently.

HARBOUR: I will provide my personal views here, but I believe that my views are entirely consistent with views that have been expressed by the Chairman and other Commissioners. These views are set forth in several speeches by Chairman Majoras,¹⁴ in the Commission opinion in *Chicago Bridge & Iron*¹⁵ and in the *Arch*¹⁶ majority statement, which was equally critical of the court's treatment of customer testimony. Customer testimony is still useful in making enforcement decisions, even though the two trial court judges in *Arch Coal* and *Oracle/PeopleSoft* chose to disregard it or to use it inconsistently. Customers are an invaluable source of information regarding a variety of merger issues, including competitive effects. Customers have the most to lose if competition is harmed. They have little incentive to provide misleading information as opposed, for example, to competitors. Customer testimony does, however, have its evidentiary limits. As someone charged with making enforcement decisions, I must assess how effectively I believe the testimony can be presented at trial. But at the end of the day, I must make the same assessment with respect to a whole range of different types of evidence—and in that respect, customer testimony is no different.

¹⁴ See, e.g., Deborah Platt Majoras, Recent Actions at the Federal Trade Commission, Remarks Before the Dallas Bar Association's Antitrust and Trade Regulation Section (Jan. 18, 2005), available at <http://www.ftc.gov/speeches/majoras/050126recentactions.pdf>.

¹⁵ Available at <http://www.ftc.gov/os/adjpro/d9300/050106opinionpublicrecordversion9300.pdf>.

¹⁶ Available at <http://www.ftc.gov/os/adjpro/d9316/050613commstatement.pdf>.

THE SOURCE: Let's return for a second to your comment about the *Genzyme* case and innovation markets. In your dissenting statement in the *Genzyme* case,¹⁷ you stated that mergers to monopoly in innovation markets should be presumptively anticompetitive, which would be rebuttable with evidence of efficiencies. Can you explain what you meant by that in more detail?

HARBOUR: The *Genzyme/Novazyme* case was one of the first major cases that crossed my desk after I arrived at the Commission. It involved a merger to monopoly between the only two companies pursuing a cure for a very rare genetic disorder. The case raised fundamental questions regarding the analysis of innovation markets and the concept of innovation competition. The deal already had been consummated, which added another interesting twist. Because the investigation already was in its final stages when I joined the Commission, I decided not to participate in the vote, so my statement was not a dissent.

Even though I wasn't participating, I thought it would be useful to explain my thinking about these critical issues. I concluded that a balanced approach to innovation markets is warranted. When all competition in an innovation market has been eliminated, I believe there should be a presumption of anticompetitive effects. There is strong reason to believe that competition is vital to continued innovation. I believe that the analytical framework of the Guidelines generally is appropriate for innovation markets. The Guidelines do condemn mergers to monopoly, and the merging parties do not get a free pass just because it's an innovation market.

But even in the merger to monopoly context, the presumption of anticompetitive effects should be rebuttable when analyzing an innovation market. The Guidelines cannot be applied mechanically in any market, and this is particularly true in innovation markets, where the traditional economic assumptions that underlie the Guidelines may or may not apply. What I'm trying to say is, currently empirical evidence and economic analysis don't conclusively demonstrate a causal link between increased concentration and decreased competition. Therefore, in my view, I believe the presumption may be rebutted if (and I'm about to quote from the efficiencies section of the Guidelines) "the merging parties can prove cognizable merger specific efficiencies of such a character and magnitude that the merger is not likely to be anticompetitive."¹⁸ I have not yet been presented with another pure innovation market case, but I hope that I get the chance to consider these issues again during the remainder of my term.

THE SOURCE: Let's turn to merger process for a second. At the Antitrust Modernization Commission hearings, a number of practitioners have noted certain areas for improvement in the HSR process, including, for example, more certainty in the interagency clearance process, more transparency and accountability in the HSR process, and a more efficient and focused second request process, to name three areas. Do you see the need for improvement in the HSR process and do you see the Commission addressing that already in certain respects?

HARBOUR: Let me step back and take the three areas you named, one at a time, and I'll comment on those.

As for the need for certainty in interagency clearance, call me a skeptic, but I do not believe that any tweaks to the clearance agreement will ever solve all of the clearance issues. By way of

¹⁷ See *supra* note 1.

¹⁸ Guidelines § 4.

background, I believe that the Commission and the DOJ Antitrust Division have complementary strengths and areas of expertise. Consumers are better off when both agencies are vigilant in protecting competition, and this is exactly what Congress intended. Very interesting cases tend to arise in so called convergence markets. These cases usually involve new or rapidly changing markets that emerge from the intersection of different technologies: for example, telephony, coaxial cable, or the Internet. In these areas, both agencies legitimately may have prior expertise, but it is not always easy to predict which agency's expertise will be more relevant as the technology evolves. So, not surprisingly, these are the types of cases where clearance is most likely to be disputed. It is important to realize, though, that disputes arise with respect to a very small percentage of cases. And from an analytical perspective a clearance dispute really forces both agencies to think carefully, at an extremely early stage of the investigation, about potential theories of competitive harm. One might argue that once clearance has been resolved, the staff is in a better position to conduct a focused and efficient investigation.

As for the need for

certainty in interagency

clearance, call me a

skeptic, but I do not

believe that any

tweaks to the clearance

agreement will ever

solve all of the

clearance issues.

I think you also mentioned the need for transparency in the system, and I'll comment on that for a moment. I think that the Commission has been sufficiently transparent over the last decade or so, due to some of the following things: the transparency of the 1992 Merger Guidelines that were revised in 1997 to provide more information relating to the analysis of efficiencies; speeches by various agency managers; statements by Commissioners; the release of merger challenge data by the Commission and DOJ back in December 2003, and then the release of additional merger challenge data by the Commission in February and November 2004; more frequent issuance of closing statements that explain our analytical approach, even in cases we ultimately choose not to bring; and the recent announcement of the commentary on the Merger Guidelines. So I do think that the Commission has been quite transparent.

In relation to the second request process, I am aware that certain segments of the antitrust bar feel very strongly that the second request process should be revised to reduce the burden on private parties and cut down on the length of merger investigations. I am also aware that parties are very troubled by the cost and burden of second request compliance. It is worth noting that the Commission itself also has an interest in improving the efficiency of the second request process. In this electronic era, even a medium sized merger investigation for example, can generate many thousands and thousands of pages of e-mails, PowerPoints, and other documents for staff to review. The increased availability of electronic data often allows our economists to conduct sophisticated econometric analyses, which can be quite useful, but also take more time to design and verify. Given our limited resources and the pressures of the HSR timetable, properly focused investigations are more likely to serve the public interest.

Having said all of that, however, there is only so far we can go in reducing the real or perceived burden on merging parties. The Commission has an obligation to conduct a thorough review of each potentially problematic transaction. We need to collect sufficient information to reach an informed decision. The Commission cannot rely on staff recommendations if staff feels that access to important information has been compromised. I imagine that the Chairman's merger process review initiative is addressing precisely these types of concerns, and I expect that the Chairman's initiative will result in tangible process improvements.¹⁹ However, the Commission still must be able to perform its merger oversight function to the best of our ability.

¹⁹ See News Release, FTC, FTC Chairman Announces Merger Review Process Reforms (Feb. 16, 2006), available at http://www.ftc.gov/opa/2006/02/merger_process.htm.

THE SOURCE: Let's turn for a few moments to non-merger enforcement. In one of your earlier comments, you mentioned that vertical restraints and the development of a better understanding of the anticompetitive and competitive effects was in fact a long-term goal of yours. Do you think that the FTC should give greater attention to vertical restraints enforcement?

HARBOUR: I addressed this during my confirmation process and I will say it again—yes. The Commission should be doing more to investigate and, when warranted, prosecute vertical restraints. When I was in state government, a good part of my antitrust work involved prosecuting violations of the law relating to vertical restraints. My experience in this area taught me that some vertical restraints clearly can cause consumer harm. The harm to consumers from vertical restraints is just as clear as with horizontal restraints, upon which the federal agencies have focused almost exclusively. The Commission is not doing enough in this area. This inactivity is not justified by any lack of potentially unlawful vertical conduct in the marketplace. Nor is it sufficient to say that private or state enforcement is adequate to protect consumers. Yes, the states traditionally have taken a leading role in the vertical area, but consumers deserve an active Commission as well, because this is an important area of antitrust enforcement.

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incentives within

distribution channels.

THE SOURCE: Do you think that there are any particular industries that are in need of review? Do you see vertical restraints as a particular concern in any specific industries?

HARBOUR: I am not really able to answer meaningfully because it would divulge confidential information, but I will say this: For many years I've been a faculty member of the annual ALI-ABA Product Distribution and Marketing program. I used to provide the state perspective on vertical restraints and, now that I'm a Commissioner, I provide the federal perspective, such as it is. And every year since I became a Commissioner, I have ended my ALI-ABA presentation with a statement to the following effect: on the federal side of next year's ledger, I hope to see cutting-edge initiatives that clarify the law and impose appropriate remedies. So beyond that, I really cannot say much more regarding any non-public cases or initiatives that may be underway at the Commission. But I will say this: As one Commissioner, I have a limited ability to influence the Commission to bring more vertical cases, but if it were up to me to bring the next generation of vertical cases, I would be looking for situations where there are conflicting interests and conflicting incentives within distribution channels. For example, any area where there has been substantial investment in bricks and mortar distribution outlets, and where there are emerging Internet sale options, would be an area that I would focus on.

THE SOURCE: You abstained from voting to approve the release of a Bureau of Economics report on petroleum industry mergers in August 2004²⁰ because you wanted to see a more comprehensive study of reasons for skyrocketing gas prices. This also is a hot-button issue for Congress, as seen in the confirmation proceedings for Chairman Majoras in 2004. What is being done at the Commission on this issue? What is the timing for release of additional reports?

HARBOUR: Those are complicated questions. Let me start with the first question, the easiest one.

²⁰ See News Release, FTC, FTC Issues Staff Report on "The Petroleum Industry: Mergers, Structural Change, and Antitrust Enforcement" (Aug. 13, 2004), available at <http://www.ftc.gov/opa/2004/08/oilmergersrpt.htm>.

I abstained from voting on the Petroleum Mergers Report because I took issue with the timing of its release. At the time, the Commission also was in the process of drafting another report, the Price Factors Report.²¹ I wanted both reports to be issued simultaneously because I wanted the Commission to be responsive to the issues that consumers cared most about. I was listening carefully to the concerns being expressed most loudly at that time—and I thought the information in the Price Factors Report would be viewed as more relevant and informative.

The Price Factors Report has since been issued. It analyzes the full panoply of market forces that can lead to fluctuations in the prices we pay at the pump. As the report explains, it mostly comes down to the most basic economic principles of supply and demand. Gasoline is made from crude oil. U.S. refiners compete with refiners all around the world to obtain crude. Therefore, the world price of crude has a major impact on the cost to produce gasoline. Most of the world's crude, of course, is controlled by OPEC. OPEC production levels vary over time, which means that world prices do, too. On the demand side, both national and international demand for crude oil and refined petroleum products is on the rise. Our domestic consumption goes up each year. And then there's the fact that rapidly industrializing nations, such as China and India, are consuming more and more crude oil. Assuming a relatively constant supply, increased demand can be expected to lead to higher prices over time. And then there are other factors at work, as the report explains. Various federal, state, and local regulations influence the price of gasoline, such as clean fuel and boutique fuel requirements. And supply disruptions and restrictions—such as the ones we saw in the wake of the hurricanes last year—also can dramatically influence price.

As you said, it's a hot-button issue, so the Commission has been quite vigilant in this area. We look closely at all merger activity in the petroleum industry. We have called for divestitures in many transactions where we thought anticompetitive price increases were likely. We have also taken enforcement actions against nonmerger conduct that threatened to harm consumers, such as in the *Unocal*²² matter.

We are now engaged in a substantial investigation of the petroleum industry as a whole. The Energy Policy Act of 2005 requires the Commission to conduct an investigation and, I quote, "to determine if the price of gasoline is being artificially manipulated by reducing refinery capacity or by any other form of market manipulation or price gouging practices." Our 2006 Congressional appropriations statute also requires us to investigate possible price gouging in the wake of Hurricane Katrina. So, the Commission has issued CIDs to many companies, and we are also collecting and analyzing data from other sources, and the Commission expects to issue a report of its findings sometime this spring. Of course, we also have all of the data generated through our gas price monitoring project, which has been underway since May 2002.²³ We track daily retail gasoline and diesel prices in 360 cities, as well as wholesale prices in 20 major urban areas. Our economists have developed an econometric model to help ferret out potential pricing anomalies that cannot be explained by market-driven causes, like a broken pipeline or a refinery fire. And we also get occasional tips from other federal and state agencies. If there appears to be no

²¹ See News Release, FTC, FTC Releases Report on "Gasoline Price Changes: The Dynamic of Supply, Demand, and Competition" (July 5, 2005), available at <http://www.ftc.gov/opa/2005/07/gaspricefactor.htm>.

²² See News Release, FTC, Dual Consent Orders Resolve Competitive Concerns About Chevron's \$18 Billion Purchase of Unocal, FTC's 2003 Complaint Against Unocal (June 10, 2005), available at <http://www.ftc.gov/opa/2005/06/chevronunocal.htm>.

²³ See News Release, FTC, FTC Chairman Opens Public Conference Citing New Model to Identify and Track Gasoline Price Spikes, Upcoming Reports (May 8, 2002), available at <http://www.ftc.gov/opa/2002/05/gcr.htm>.

market-based explanation for a pricing anomaly, it may be cause for either the Commission or an appropriate state attorney general to open an investigation.

THE SOURCE: Do you think price-gouging legislation is necessary or desirable?

HARBOUR: I have been doing some thinking about that issue lately. At the federal level, my answer is probably no, but that requires some explanation. We have to recognize that the price-gouging debate barely scratches the surface of energy policy in this country. The United States clearly has some energy problems; we face major challenges in sustaining a viable, long-term balance between supply and demand. There are environmental problems, engineering problems, lifestyle issues—it is all-encompassing. But most of these problems are not antitrust problems. So the first thing we have to accept is that, even assuming vigorous enforcement of the antitrust laws, antitrust cannot fix all of these problems.

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But having said that, I can understand why so many people ask whether price-gouging statutes can fix some small part of the problem. I tend to believe that federal price-gouging legislation is not necessary. My views are informed in large part by my experience in the New York AG's office. I realize that many states have price-gouging statutes and routinely enforce them. However, these statutes tend to be based on a broad public interest standard, which covers far more territory than the antitrust laws. For example, some of the state price-gouging laws may be directed against perceived market opportunism, rather than legitimate market failures. The unfortunate truth is, sometimes the market needs higher prices to bring supply and demand back into balance. I realize this is not a popular view, and sometimes it is hard for me to accept it. But it is Economics 101.

I read a recent economics article that suggested a market-based argument that could be made in favor of price-gouging statutes, under limited circumstances.²⁴ The article suggested that localized market failures might occur in areas where a natural or man-made disaster causes physical damage to the infrastructure. That is an excellent example of a situation where the states would be uniquely well-suited to identify and respond appropriately to localized harm. But even under these circumstances, it would be hard to convince me that a national solution is needed.

But going back to my original mantra—I am here to protect the interests of consumers. The Commission has been vigilant in the petroleum industry, and I, personally, am doing my best to remain vigilant. If there are principled antitrust or consumer protection approaches out there that the Commission is not pursuing, or that we should be pursuing more vigorously, I would love to hear about them.

THE SOURCE: You previously mentioned the announced joint FTC/DOJ single-firm conduct hearings. Are there particular areas or issues that are of particular interest to you?

HARBOUR: Yes, fleshing out certain issues with respect to Section 2 is another area of interest. Many issues relating to Section 2 are unsettled and thus controversial. One example is the development of competing tests to determine whether conduct is exclusionary. On the one hand, you have people who believe that exclusionary conduct should be assessed in accordance with the so-called profit sacrifice or no-business-justification test. One example would be Greg Werden at

²⁴ Geoffrey Christopher Rapp, *Gouging: Terrorist Attacks, Hurricanes, and the Legal and Economic Aspects of Post-Disaster Price Regulation*, 94 KENTUCKY L.J. (forthcoming), available at <http://ssrn.com/abstract=800745>.

the DOJ, the proponent of the “no economic sense” test. Others are more comfortable with the sort of balancing test that was used by the D.C. Circuit in *Microsoft*. These are hot issues even beyond our own borders. For example, the EU currently is involved in a robust debate over how it should analyze abuse of dominance. The EU approach in fact may diverge from the U.S. approach in fundamental ways. In order to be fully successful, I believe that our upcoming Section 2 hearings must account for this diversity of viewpoints. It is very important that the agenda and the list of speakers be formulated in a balanced manner to ensure that all points of view are adequately presented. I am confident that the forthcoming Federal Register notice of these hearings will trigger a process that ultimately brings all of these differences to light. If anyone has suggestions for speakers or topics or would like to submit a written comment, I would encourage them to get involved in this important debate.

THE SOURCE: When are those hearings scheduled for?

HARBOUR: There is not a specific date yet. The next event will be a Federal Register notice soliciting comment.

THE SOURCE: Let’s turn for a second to antitrust remedies. We understand from your dissenting statement in the *KFCC* matter that you take an aggressive stand on antitrust remedies for violators.²⁵ Have there been any further opportunities to seek disgorgement of profits in consumer protection or other cases?

HARBOUR: *KFCC* actually involved a consumer protection issue. The FTC alleged that the company deceptively advertised its fried chicken as being compatible with low carbohydrate weight loss programs, among other things. The Commission does seek disgorgement of profits in a number of consumer protection cases, particularly when consumer redress might not be an appropriate measure of consumer harm, and where the alleged harm does not include a rule violation, which would then allow DOJ to seek a civil penalty. In certain national advertising cases against well known advertisers, it may be particularly hard to calculate either consumer redress or disgorgement. The Commission did not require a monetary component in 2005 when it settled the complaint against Tropicana. The agency alleged that Tropicana misled consumers with claims that drinking two and three glasses a day of its healthy heart orange juice would produce dramatic effects on blood pressure and cholesterol.

I have been encouraging staff to actively look to see what matters might benefit from a consumer education remedy. In August 2005, the Commission announced that Consumerinfo.com settled charges with us that it deceptively marketed free credit reports. The settlement required, among other things, the company to pay redress to deceived consumers. It also required the defendants to give up \$950,000 in ill-gotten gains. In this case monies may be used to provide consumer education. Staff knows that I am extremely interested in returning money, whenever possible, to consumers who have been harmed. And if returning money is not possible, then I am in favor of using targeted consumer education so that these consumers won’t be duped again in the future.

THE SOURCE: Your public statements have suggested that you see investigation of consummated

²⁵ See *supra* note 2.

mergers as an area for enforcement priority. What do you believe are appropriate remedies in these types of cases?

HARBOUR: Due to an ongoing Part 3 matter, I do not want to say much about the appropriate legal standard or remedies in consummated merger cases. I will note that in my view two separate questions must be considered. One is what sorts of remedies are allowable under the law. This is very different from the next question, what remedies the Commission should seek on a case-by-case basis as an exercise of prosecutorial discretion. Theoretically, the Commission can pick from the same toolbox of remedies in a consummated merger case as in any other merger case, including divestitures if need be—as the Commission did in *Chicago Bridge & Iron*, and as I might have been willing to do in *Genzyme* if, after a full review, the factual record ultimately had demonstrated that the harm from a merger to monopoly outweighed any potential efficiencies. But in each case, the Commission must conduct an exhaustive factual inquiry, really looking closely at the market and how it has evolved, before deciding how far to go in attempting to unwind a consummated transaction.

THE SOURCE: You've already spoken extensively frankly on your views on consumer protection, but I wanted to give you an opportunity to add more about interests or priorities that you have in the consumer protection area.

HARBOUR: In the area of childhood obesity, I would like staff to continue to focus on examining any marketing method that may harm children. Staff worked with the U.S. Department of Health and Human Services to generate a report relating to last year's obesity workshop. Some marketers noted that they have begun to take self-regulatory measures, adopting voluntary advertising restrictions, such as not advertising food products to children under the age of six, or not advertising less-healthy food choices in schools. I think effective self-regulation is absolutely essential in this area.

In the area of tobacco advertising and testing, I would like to explore whether consumers really understand that smoking low tar or light cigarettes does not eliminate the risks of smoking. An important part of the Commission's work is consumer education, and I am concerned about whether we are doing all that we can to warn consumers about the dangers of tobacco products. In this area, the state of the science has evolved and needs to be clarified. I'm hopeful that the Commission will work with the Department of Health and Human Services and other public health officials to give consumers the information that they need about the dangers of cigarette smoking.

THE SOURCE: You gave a speech in London last October on harmony and conflict between the U.S. and EU competition laws. What are your views on the extent of convergence and on the state of cooperation between the EU and the United States today?

HARBOUR: As I mentioned in my speech last October, as a former state enforcer and as a sitting Commissioner, I believe that there is far more harmony than there is conflict between the United States and the European Union competition enforcers, although there are differences that still remain. Some enforcers may pursue a type of competitive harm that other enforcers have found, through their experience, is seldom supported by empirical evidence. For example, the EC Merger Regulation requires the EC to consider the economic and financial power of merging parties. This

has been referred to by some as the “deep pocket theory.” The U.S. agencies find this factor unpersuasive and no longer give it much, if any, weight. European courts also have endorsed leveraging and portfolio power. These theories are also viewed more skeptically by some enforcers in the U.S. Another area of remaining divergence between the EC and the U.S., as I mentioned, involves the analysis of conduct by dominant firms. And as I suggested earlier, I hope this might be aired in the context of our upcoming Section 2 hearings.

THE SOURCE: Commissioner Harbour, thank you for your time today.

HARBOUR: It was my pleasure. ●

Volvo v. Reeder: Narrow Holding, Broad Implications

Elaine Foreman and Robert Skitol

The Supreme Court's dislike of the Robinson-Patman Act¹ is evident in its opinion in *Volvo Trucks North America, Inc. v. Reeder-Simco GMC, Inc.*² This is the fifth time since 1979 that the Court has undertaken to construe and editorialize about this statute, each time producing interpretations that make it more difficult for Robinson-Patman plaintiffs to prevail in one or more kinds of circumstances (three by expanding affirmative defenses, two (including *Volvo*) by heightening requirements for a prima facie case).³ In this instance, the holding is narrow in its application to "competitive bidding" and "special order" situations, as opposed to far more common situations of dealers reselling standardized goods from their own inventories. But much of the Court's dicta, viewed in conjunction with the dissenting Justices' spin on the result, provides fodder for future RP defendants in a variety of other cases to argue about broad implications.

The Facts and Decisions Below

Volvo concerns the market for heavy-duty trucks that manufacturers like Volvo sell to fleet owners and other end-users through networks of franchised dealers. Customers do not purchase from dealers' inventories; rather, they provide their own customized truck specifications and then invite selected dealers to bid based on those specifications. A dealer invited to bid will then apply to its manufacturer/franchisor for a "concession" or special discount off the wholesale price to enable the dealer to make a competitive offer to the customer in question. Only if the dealer wins the business does the dealer purchase the specified trucks from the manufacturer at the discounted price for sale to the customer in question.

Reeder was a franchised Volvo dealer that believed Volvo had targeted it (along with some other dealers) for elimination. Among the ways Reeder believed Volvo sought to achieve that end was by giving other dealers greater price concessions than Reeder received. Its main evidence of this "discrimination" and resulting competitive injury in support of its RP claim involved situations where other Volvo dealers received higher discounts for their bids against non-Volvo dealers than Reeder received for its bids against non-Volvo dealers. Reeder did cite a few instances where it and another Volvo dealer were bidding directly against each other for the same customer but, in those cases, Volvo offered the same concession to both dealers.

Reeder framed its claim under Section 2(a) of the RP Act. This section makes it unlawful for a seller to "discriminate in price between different purchasers" of a given product where the "effect

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Elaine Foreman is Senior Counsel at Hewlett-Packard Company.
Robert Skitol is a partner in the Washington, D.C. office of Drinker Biddle & Reath LLP.

¹ 15 U.S.C. § 13(a) et seq.

² 126 S. Ct. 860 (2006).

³ The other four were *Great Atl. & Pac. Tea Co. v. FTC*, 440 U.S. 69 (1979); *Falls City Indus., Inc. v. Vanco Beverage, Inc.*, 460 U.S. 428 (1983); *Texaco Inc. v. Hasbrouck*, 496 U.S. 543 (1990); *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993).

of such discrimination may be substantially to lessen competition” or to “injure, destroy or prevent competition with any person who either grants or knowingly receives the benefit of such discrimination, or with customers of either of them.”⁴ On the evidence of disfavored treatment summarized above, Reeder won a jury verdict and an ensuing treble-damage judgment for over \$3.9 million. The damages included both lost profits on bids Reeder lost to non-Volvo dealers and lost profits on bids Reeder won but at lower margins than it could have derived if it had received the higher concessions that other Volvo dealers received on other (unrelated) bids.

The Eighth Circuit Court of Appeals affirmed that result, rejecting two main Volvo arguments.⁵ First, Volvo argued that there was no discrimination “between different purchasers”; Reeder was not a purchaser on bids it lost, and the allegedly favored dealers were not purchasers on bids Reeder won. The court of appeals held that the two-purchasers requirement was satisfied by the overall history of Reeder’s and other dealers’ purchasing Volvo trucks on bids they won even though involving different customers at different times. Second, Volvo argued that the record could not support a finding that discrimination resulted in the requisite competitive injury because there was no instance in which discrimination occurred in head-to-head competition between Reeder and another Volvo dealer. The court of appeals held there was sufficient evidence of competitive injury because Reeder and other Volvo dealers sold Volvo trucks at the same functional level in the same interstate retail market.

The Supreme Court’s Majority Opinion

The Supreme Court reversed, but decided only Volvo’s second argument. Justice Ginsberg’s opinion for a seven-Justice majority articulated the basic question before the Court as “whether a manufacturer offering its dealers different wholesale prices may be held liable for price discrimination” under the RP Act “absent a showing that the manufacturer discriminated between dealers contemporaneously competing to resell to the same retail customer.”⁶ The essence of the holding was that the Act “does not reach the case Reeder presents” because there was no such same-customer feature: “The Act centrally addresses price discrimination in cases involving competition between different purchasers for resale of the purchased product. Competition of that character ordinarily is not involved when a product subject to special order is sold through a customer-specific competitive bidding process.”⁷

The Court began its analysis by reference to the Act’s legislative history and, in particular, Congressional concern with “the perceived harm to competition occasioned by powerful buyers,” responding “to the advent of large chain stores . . . with the clout to obtain lower prices for goods than smaller buyers could demand.”⁸ Mindful of that focus, the Court emphasized that the Act does not “ban all price differences charged to different purchasers”; it proscribes only discrimination “to the extent that it threatens to injure competition.”⁹ And, most critically, a “hallmark of the requisite competitive injury . . . is the diversion of sales or profits from a disfavored purchas-

⁴ 15 U.S.C. § 13(a).

⁵ *Reeder-Simco GMC, Inc. v. Volvo GM Heavy Truck Corp.*, 374 F.3d 701 (8th Cir. 2004).

⁶ *Volvo*, 126 S. Ct. at 866.

⁷ *Id.*

⁸ *Id.* at 869.

⁹ *Id.* at 870 (quoting *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 220 (1993)).

er to a favored purchaser.”¹⁰ The Court acknowledged the longstanding *Morton Salt* doctrine under which there can be an inference of competitive injury “from evidence that a favored competitor received a significant price reduction over a substantial period of time.”¹¹ That doctrine, however, would not help Reeder: “Absent actual competition with a favored Volvo dealer, . . . Reeder cannot establish the competitive injury required under the Act.”¹²

More specifically, Reeder’s comparisons of concessions it received on its bidding opportunities versus concessions other Volvo dealers received in their bidding for other customers did not suffice to establish the requisite competitive injury because none of them involved Reeder’s competing “with beneficiaries of the alleged discrimination *for the same customer*.”¹³ Nor, the Court noted, “did Reeder even attempt to show that the compared dealers were consistently favored vis-à-vis Reeder.”¹⁴ The Court acknowledged that Reeder may have competed with other Volvo dealers for the opportunity to bid on potential sales in a broad geographic area. At that initial stage, however, competition is not affected by differential pricing. “Once a retail customer has chosen the particular dealers from which it will solicit bids, ‘the relevant market becomes limited to the needs and demands of a particular end user, with only a handful of dealers competing for the ultimate sale.’ . . . That Volvo dealers may bid for sales in the same geographic area does not import that they in fact competed for the same customer-tailored sales.”¹⁵ In short, the competition between Reeder and non-Volvo dealers was irrelevant for Robinson-Patman purposes.

As noted above, Volvo’s first and most sweeping argument for reversal was that the Act cannot reach competitive bidding/special order sales at all, even when they involve head-to-head rivalry for the same customer; in these situations, only one dealer will end up being a purchaser so the two-purchasers requirement is not met. The Court said it “need not decide that question”; assuming the Act applies to head-to-head transactions, “Reeder did not establish that it was *disfavored* vis-à-vis other Volvo dealers in the rare instances in which they competed for the same sale—let alone that the alleged discrimination was substantial.”¹⁶ Underlining the lack of substantiality, the Court pointed out that Reeder’s evidence showed loss of only one sale to another Volvo dealer involving 12 trucks that would have generated \$30,000 in gross profits.

In the final pages of the opinion, the Court reminds us that “[i]nterbrand competition . . . is the ‘primary concern of antitrust law’” and adds the comment that the RP Act “signals no large departure” from that focus; courts should thus resist interpretations “geared more to the protection of existing *competitors* than to the stimulation of *competition*.”¹⁷ The Court then observes that, in this case, “there is no evidence that any favored purchaser possesses market power, the allegedly favored purchasers are dealers with little resemblance to large independent department stores or chain operations, and the supplier’s selective price discounting fosters competition among suppliers of different brands.”¹⁸ And so, the Court concludes, by “declining to extend” RP liability to

¹⁰ *Id.* (citations omitted).

¹¹ *Id.* (citations omitted).

¹² *Id.*

¹³ *Id.* at 871.

¹⁴ *Id.*

¹⁵ *Id.* at 871–72 (quoting *Reeder-Simco GMC, Inc. v. Volvo GM Heavy Truck Corp.*, 374 F.3d 701, 719 (8th Cir. 2004)).

¹⁶ *Id.* at 872.

¹⁷ *Id.* (citations omitted).

¹⁸ *Id.* at 873 (citations omitted).

such situations, “we continue to construe the Act ‘consistently with broader policies of the antitrust laws.’”¹⁹

The Dissenting Opinion

In a combination that proves the RP Act creates strange bedfellows, Justice Stevens dissented in an opinion joined by Justice Thomas. It charges the majority with abandoning longstanding and mainstream RP jurisprudence. Until today, the dissent asserts, the Act has protected dealers in many competitive bidding situations, treating as competitors those “who sell ‘in a single, interstate retail market.’”²⁰ “[B]y adopting a novel, transaction-specific concept of competition, the Court eliminates that statutory protection in all but those rare situations in which a prospective purchaser is negotiating with two Volvo dealers at the same time.”²¹ More fundamentally, the dissent suggests that the Court has departed from, and thus undercuts continued reliance upon, (a) the *Morton Salt* inference of competitive injury from sales “to one retailer at a higher price than to its competitors”;²² and (b) the whole incipency doctrine under which the statute does not require actual harm to competition, only “a reasonable possibility . . . that [discrimination] ‘may’ have such an effect.”²³

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Unlike the majority, Justice Stevens sees this case as within the original intent of the RP Act “to protect small retailers from the vigorous competition afforded by chainstores and other large volume purchasers.”²⁴ He notes Judge Bork’s critique of the Act as resting upon a “wholly mistaken economic theory” and suggests that that view influenced (though not in a “conscious” way) the majority’s “unprecedented” decision.²⁵ He concludes by accusing the majority of “refusing to adhere to the text of the Act,” a cardinal sin for true believers in judicial restraint, textualism, originalism, etc.²⁶

Bottom Lines

Volvo does not foreclose altogether application of the RP Act to competitive bidding and special-order situations. The Solicitor General’s amicus brief on behalf of the Department of Justice and Federal Trade Commission had joined *Volvo* in seeking that result based on RP’s two-purchaser requirement. Instead, the opinion leaves open to RP claims two fact patterns involving competitive bidding/special-order situations: where a seller discriminates in its concessions or other competitive assistance between dealers that are contemporaneously competing to resell to the same retail customer; and where a seller consistently favors some dealers over others in the implementation of a competitive assistance program, an overall pattern of discriminatory treatment.

¹⁹ *Id.* (quoting *Brooke Group, Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 220 (1993)).

²⁰ *Id.* at 873, 875 (quoting *Falls City Indus., Inc. v. Vanco Beverage, Inc.*, 460 U.S. 428, 436 (1983)).

²¹ *Id.* at 873.

²² *Id.* at 875 (quoting *FTC v. Morton Salt Co.*, 334 U.S. 37 (1948)).

²³ *Id.* (quoting *Corn Prods. Co. v. FTC*, 324 U.S. 726, 742 (1945)).

²⁴ *Id.* at 876.

²⁵ *Id.* (quoting ROBERT H. BORK, *THE ANTITRUST PARADOX* 382 (1978)).

²⁶ *Id.* That accusation may be considered particularly unfair in light of eight words preceding the Judge Bork quote that Justice Stevens features. The full Bork statement was that the RP Act is “the misshapen progeny of intolerable draftsmanship coupled to wholly mistaken economic theory.” ROBERT H. BORK, *THE ANTITRUST PARADOX* 382 (1978). See also Robert L. Wald, Book Review, *The Price Discrimination Law: A Review of Experience*, 55 Nw. U. L. REV. 653 (1960), describing RP law as “bogged in a dense undergrowth of confusion, ambiguity, controversy and babel.”

In either circumstance, however, *Volvo* appears to require some evidence of actual “diversion of sales or profits from a disfavored purchaser to a favored purchaser” as a result of the discrimination to satisfy the competitive injury element of a Section 2(a) violation. Thus, after *Volvo*, an RP plaintiff pursuing a claim based on these kinds of bidding situations cannot expect to rely on the *Morton Salt* inference of injury merely by showing price differences between “competing” dealers over a substantial period of time.

The Court’s sharp distinction between competitive bidding/special order situations and “the chain-store paradigm,” under which competing dealers resell goods from inventory, suggests the opinion offers no comfort for discriminatory pricing in the latter garden-variety circumstances under which most RP cases have arisen over the course of the past 70 years and will continue to arise in many industries over the years ahead. On the other hand, and as suggested above, parts of the opinion as well as the dissent’s interpretation of it provide considerable ammunition for defendants’ summary judgment motions and requested jury instructions in RP cases of all kinds. Defendants, for example, may now credibly argue from *Volvo* that the competitive injury requirement in 2(a) cases of all (or many) kinds requires proof of meaningful and direct customer-specific competition between disfavored and favored dealers as well as “substantial” diversion of sales or profits from one to the other.

Some defendants might even argue that *Volvo* suggests a competitive injury finding cannot be made if (a) the favored dealer lacks market power or (b) “the supplier’s selective price discounting fosters competition among suppliers of different brands.”²⁷ The Court in *Volvo* highlighted the relevance of these considerations within the context of admonitions that “interbrand competition” is antitrust’s primary concern, the RP Act is “no large departure from” that focus, and courts must resist interpretations of the RP Act that may result in “protection of . . . competitors” instead of “stimulation of competition.”²⁸

Counseling Implications

Apart from arguments made for litigation, what can RP counselors take away from *Volvo* that may bear on advice to clients about competitive bidding/special order market contexts? We offer the following general observation along with three qualifications to it. For most sellers, little has changed from a counseling perspective. Sellers can and should retain discretion to offer different kinds or amounts of competitive bidding assistance to different requesting dealers at different times or under different competitive circumstances. The qualifications are as follows:

(a) Offer the same assistance to two or more dealers who will be competing for the same customer opportunity.

Surely few if any RP Act advisors have routinely counseled their clients that it is permissible to offer different assistance to competing dealers in competitive bidding contexts. But the risks in offering different assistance may not often have been thoughtfully assessed. Advisors will now add competitive bidding situations to the list of areas where a seller should “ordinarily” treat similarly situated dealers in a like manner. In practice, sellers will be advised that they should consider a

²⁷ *Volvo*, 126 S. Ct. at 873.

²⁸ *Id.* at 872 (emphasis in original). Since competitive injury is not an element of a Section 2(d) or Section 2(e) violation, *see* 15 U.S.C. §§ 13(d), (e), these arguments would not apply—and *Volvo* in general would be of little or no help—in situations involving discrimination in the provision of payments, services, or facilities within the scope of these parts of the RP Act. Of course, any claim for damages under these parts of the Act would still require a showing of “antitrust injury” which may, in turn, require connecting discrimination to diverted business.

wide band of potentially competitive circumstances in setting up their assistance programs. This may be overwhelming for some sellers and could thus ironically lead to the very conduct that led to Reeder's suit against Volvo: a determination to reduce the number of authorized dealers. Many sellers believe that the RP Act unduly burdens their sales and pricing strategies. If there is no way around the burden (because the Court did not take the opportunity to limit the Act in the way Volvo and amici urged), sellers may decide that it is time to jettison their less productive dealers.

(b) Avoid implementing the policy in a manner that could appear to be "consistently" treating some dealers less favorably than other dealers.

As with the previous point, this is likely something that most sellers already do—as counselors we generally urge consistency across different groups of resellers and hope our clients follow that advice. Again, the Court leaves us with a conundrum: business people are always looking to treat their "best" dealers in a way commensurate with their performance, commitment to the brand, etc. How do we now allow them to do so in light of the fact that the Court has, in effect, admonished against consistently favoring some dealers over others? The answer comes down to a company's own tolerance for risk with respect to the RP Act. Less risk-averse sellers may conclude that they need to worry about better treatment of some dealers than of others only if there is a substantial amount of actual competition among them. The more conservative approach will be to avoid any favoritism at all costs. Where your clients fit in the risk spectrum will decide your advice.

(c) Let all dealers know about the policy and the manner in which it will be followed (some reasonable degree of transparency about it).

This has long been a hallmark of RP Act counseling. In short, it is always prudent to ensure the policy is communicated to and understood by all affected dealers. More specifically, sellers should want their policies about when differing types of assistance are available to be sufficiently visible that the "complainers" will know where to go when concerned that they are being treated unjustly. After all, the goals of counseling are first and foremost to avoid lawsuits altogether and to win if one nonetheless ensues. Being able to demonstrate that the seller had a fair, reasonable, and transparent written explanation for when it offers different types or amounts of assistance will go a long way to meeting these goals. Again, encouraging clients to have an "objective basis" for treating dealers differently ought not to be much of a change for most advisors. ●

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Contrasting Canadian and U.S. Plea Practices in Antitrust Cases

Graham Reynolds

In the criminal justice systems of the United States and Canada, only a minority of cases proceed to trial. In the Province of Ontario, Canada, a 1998 study concluded that 91 percent of all criminal cases were resolved without trial.¹ Similar statistics apply in the United States.² The antitrust area is no different. The overwhelming majority of non-immunized antitrust defendants in both the United States and Canada resolve their cases by means of a guilty plea.

In Canada, there has been a decided lack of contested cases under the criminal conspiracy provisions.³ Even with available jurisdictional defenses, most offshore corporate and individual defendants choose to resolve their Canadian criminal antitrust liability through attorning to Canada's jurisdiction and entering a plea of guilty, rather than contesting the indictment. From a systemic perspective, one might say that the administration of justice is well served by this trend, which reduces the pressing workload of disputes in the courts and frees up judicial resources.

Moreover, pre-trial resolution of a criminal case is often in a defendant's best interests, limiting criminal and civil exposure through charge or fact bargaining, which can result in reduction of the number of counts or time periods for the offense and an accelerated and predictable disposition. Legal expenses can also be quantified and reduced. Before proceeding with plea discussions, the prosecution must be satisfied that it has a prosecutable case⁴ and the defense must be satisfied that the government's case is of sufficient strength to warrant the opening of those discussions.⁵ The defendant⁶ must of course be prepared to admit guilt to the standard required by law,⁷ and the conduct of attorneys in pleading clients guilty must conform to the various ethical rules and guidelines maintained by law governing bodies.

■ Graham Reynolds, Q.C.

is a Partner in the Competition & Antitrust Law Group, Osler, Hoskin & Harcourt LLP, Toronto. Prior to joining Osler, Mr. Reynolds acted as Senior General Counsel for the Competition Law Division of Canada's Department of Justice.

¹ STATISTICAL MONITORING REPORT OF ONTARIO COURT, PROVINCIAL DIVISION (Dec. 12, 1997); Ontario Ministry of the Attorney General, THE INVESTMENT STRATEGY REPORT, REPORT OF THE CRIMINAL JUSTICE REVIEW COMMITTEE ch. 6 Part IV (Feb. 1999).

² Close to 90 percent of all federal criminal cases involve guilty pleas. See Jonathan Oberman, Clinical Professor of Law, Benjamin N. Cardozo School of Law, Yeshiva University, Interview with Frontline (Jan. 14, 2004), available at <http://www.pbs.org/wgbh/pages/frontline/shows/plea/interviews/oberman.html>.

³ Competition Act Subsection 45(1) R.S.C. 1985, c. C-34.

⁴ For example, it is the policy of the Department of Justice that federal prosecutors must charge and pursue "the most serious, readily provable offense or offenses that are supported by the facts of the case, except as authorized by an Assistant Attorney General, United States Attorney, or designated supervising attorney." See John Ashcroft, Attorney General, Memorandum Regarding Policy on Charging Criminal Defendants (Sept. 22, 2003), available at http://www.usdoj.gov/opa/pr/2003/September/03_ag_516.htm.

⁵ In Canada, alternatively referred to as "plea" or "resolution" discussions.

⁶ Commonly referred to as the "accused" in Canadian criminal law.

⁷ The Antitrust Division will not enter plea agreements with defendants who will not admit their guilt in open court during plea and sentencing proceedings. 1 U.S. DEP'T OF JUSTICE, ANTITRUST DIV'N, ANTITRUST GRAND JURY PRACTICE MANUAL, ch. 9 n.5 (1st. ed. Nov. 1991) [hereinafter Plea Agreement Guidelines], available at <http://www.usdoj.gov/atr/public/guidelines/207144.htm#IXB>. Similarly, Ontario Law Society Rules of Professional Conduct 4.01(9)(c) and (d) bar plea agreements where the defendant will not voluntarily admit the factual and mental elements of the offense charged.

The practice of “plea bargaining,” as it is colloquially called in both the United States and Canada, has met with judicial approval.⁸ In Canada, the practice has been described as an “integral element of the Canadian criminal process”⁹ and as an important discretionary feature available to prosecutors.¹⁰

While the practice of plea bargaining in antitrust cases is common to both the United States and Canada, there are important distinctions in the substantive antitrust and criminal laws, criminal procedures, and plea practices employed by prosecutors on each side of the border. These differences not only have an impact on the way in which a defendant’s criminal liability is resolved, but have important strategic implications for civil liability and other issues. Comparing and contrasting those differences can be of assistance to attorneys advising clients who may have trans-border antitrust exposure.

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Federal Rule of Criminal Procedure 11 and the Antitrust Division’s Plea Agreement Guidelines¹¹

Given the greater volume of U.S. cases and regulatory resources in the antitrust area, it is not surprising that the Antitrust Division has published specific guidelines on the use of plea agreements in antitrust cases.¹² By contrast, Canada (with limited exceptions)¹³ has no legislation or federal rules regarding the substantive content and procedure for pleas of guilty. In the United States, Federal Rule of Criminal Procedure 11 authorizes four general types of pleas as well as, inter alia, setting out plea procedures. The plea types are:

- (1) A plea of not guilty and traditional proceedings at trial;
- (2) A plea of guilty with or without a plea agreement;
- (3) A conditional plea (requiring the consent of the court and the government); and
- (4) A plea of nolo contendere with the approval of the court.

Federal prosecutors most frequently will employ a written agreement to memorialize the terms of the proposed proceedings and set out the respective rights and obligations of the parties. Such a plea agreement may comprise an agreement as to the particular charges, sentences to be imposed, or both. Rule 11 authorizes “charge bargains” (under Federal Rule of Criminal Procedure 11(c)(1)(A))—generally referred to as “A” agreements, and two types of sentencing arrangements, non-binding (Fed. R. Crim. P. 11(c)(1)(B)), generally known as “B” agreements, and binding sentence agreements (Fed. R. Crim. P. 11(c)(1)(C)), known as “C” agreements.

In an “A” agreement, the government attorney moves for dismissal of other charges in circumstances where the defendant has been indicted on several counts or in more than one indictment and the prosecution determines that a guilty plea will be accepted on some of the charges or in substitution of certain charges.

⁸ In the United States, for example, the practice was determined to be constitutional in the Supreme Court’s decision in *Blackledge v. Allison*, 431 U.S. 63, 76 (1977); in Canada, the practice has been endorsed by an Attorney General Advisory Committee in 1993.

⁹ *R. v. Burlingham*, [1995] 2 S.C.R. 206 ¶ 23 (Iacobucci, J.).

¹⁰ *See, e.g., R. v. T. (V)*, [1992] 1 S.C.R. 749.

¹¹ This discussion does not constitute legal advice on Division plea procedures but rather is a summary based upon the published guidelines and after informal discussions with Division attorneys.

¹² *See* Plea Agreement Guidelines, *supra* note 7.

¹³ *See* provisions of Canada’s Criminal Code relating to available pleas, *infra* note 37.

The “B” agreement is a frequently used form of plea agreement in which the government’s attorney will agree to recommend a particular punishment; the defense is free to oppose this recommendation and argue for a lesser sentence. However, a defendant subject to a “B” agreement has no right to withdraw the guilty plea if the court rejects all or part of the government’s recommendation.¹⁴ Thus, the “B” defendant must accept the sentence imposed by the court irrespective of the government’s recommendation.

The overwhelming majority of the Antitrust Division’s cases involving foreign corporations and individuals have been resolved on the basis of a “C” agreement.¹⁵ The “C” agreement is a mutual recommendation by the prosecutor and defendant to the court on the appropriate sentence and the application or non-application of certain factors or provisions of the Federal Sentencing Guidelines. Such an agreement binds the court after presentation and acceptance, although the Plea Agreement Guidelines note that a great many courts will not accept them because of the removal of the sentencing court’s discretion. The Plea Agreement Guidelines suggest, therefore, that the parties enter into joint sentencing recommendation “B” type agreements or include a provision in the “C” agreement that automatically converts the agreement into an agreed-upon “B” should the court reject the party’s “C” agreement.¹⁶ Significantly, the court that rejects a “C” agreement must do so on the record and must also advise a defendant that the court is not bound by the agreement and give the defendant a right to withdraw the guilty plea.¹⁷

Normally, cooperation clauses are included in U.S. plea agreements. For corporations, such cooperation will typically involve production of officers and employees for oral interviews, as well as comprehensive disclosure of all relevant documentary and associated evidence. After receiving an initial proffer of the facts and circumstances outlining the implication and extent of the antitrust activity, prosecutors will commence the interview process with the assistance of “use immunity” letters. These letters protect defendants from the Division’s use of statements made during the interview against defendants in later criminal proceedings. However, the letter will typically reserve the right to use leads against a defendant if no plea agreement is reached and to make indirect use of information developed during the interview, as well as using it against other persons. Clauses reserving the right to impeach a defendant, to rebut evidence offered on a defendant’s behalf, and to use a defendant’s interview statements against him or her in a prosecution for false statements or declarations, obstruction of justice, or perjury are standard.

In the event of breach of the standard “B” or “C” agreement, the Division is released from its obligations under the plea agreement and may thereafter use any document, statement, information, testimony, or evidence provided by a defendant and any leads therefrom in any further prosecution.¹⁸

Finally, as noted in the Plea Agreement Guidelines, the Sentencing Guidelines have played a “central role” in sentencing generally and plea bargaining in particular. Continued applicability of

¹⁴ Note, however, that Fed. R. Crim. P. 11(d)(2)(B) permits a defendant to withdraw the plea if the defendant can show “a fair and just reason for requesting the withdrawal.”

¹⁵ Gary R. Spratling, Deputy Assistant Attorney General, Antitrust Division, *Negotiating the Waters of International Carter Prosecutions*, Remarks to the ABA Criminal Justice Section’s National Institute on White Collar Crime 21–22 (Mar. 4, 1999).

¹⁶ Plea Agreement Guidelines, *supra* note 7, at A.2.c.

¹⁷ Fed. R. Crim. P. 11(e)(4).

¹⁸ *See, e.g.*, United States v. Samsung Elecs. Co., Case No. CR-05-0643PJH, Plea Agreement ¶¶ 16(d) & (e) (Nov. 30, 2005), available at <http://www.usdoj.gov/atr/cases/f213400/213483.htm>.

the Sentencing Guidelines seemed in doubt after the Supreme Court's decisions in *Blakely v. Washington*¹⁹ and *United States v. Booker*.²⁰ These cases held that a sentencing judge's determination of a fact not found by a jury or admitted by a defendant and thereby leading to an enhanced sentence under the Sentencing Guidelines violated the Sixth Amendment, thus rendering those guidelines advisory in nature. However, post-*Booker* cases would suggest that the Sentencing Guidelines will continue to be applied.²¹

The Antitrust Plea Process in Canada

In Canada, federal prosecutors acting on behalf of the Attorney General of Canada execute and appear on all plea proceedings in antitrust cases. As in the United States, Canadian prosecutors will employ written plea agreements setting out respective rights and obligations of the parties in advance of proceedings before a court. In general terms, Canadian plea agreements are similar to the Division's "C" agreements in that they constitute a mutual recommendation by the prosecutor and defendant on an appropriate sentence upon a plea of guilty to a specified offense or offenses and require cooperation from a defendant. However, Canadian law and practice in the plea process differs from the United States in several significant respects. Some of the noteworthy differences follow.

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Substantive Law—No Per Se Offense. Section 45(1) of Canada's Competition Act is not a per se provision akin to Section 1 of the Sherman Act, but rather employs a "modified rule of reason" approach.²² Canadian law also has an offense of implementing foreign cartel directives whether or not any director or officer of the corporation in Canada participates in, or has any knowledge of, the underlying foreign cartel.²³ These differences, particularly in the substantive conspiracy offense, affect the substantive burden on the prosecution and will be reflected in the content of admissions as to facts, which are typically filed in the Canadian plea process and are more expansive than in the U.S. process.

Procedural Law—No Limitation Period. Canada has no statutory period of limitation for antitrust offenses. Thus, "waiver of limitation" terms as a bargaining component of a plea arrangement are irrelevant under Canadian law. It also means that a defendant with antitrust exposure in Canada may be facing prosecution for antitrust conduct that would potentially be statute-barred in the United States.

Procedural Law—No Grand Juries. Canada abolished its grand jury process in the mid-1970s. Apart from a civil inquiry mechanism under Canada's Income Tax Act²⁴ and provisions for compulsion of testimony of corporate witnesses under the Competition Act,²⁵ there is no counterpart in Canadian law to this key screening component of the U.S. justice system. Accordingly, prosecutors in Canada do not have a mechanism for screening an indictment and potential witnesses

¹⁹ 124 S. Ct. 2531 (2004).

²⁰ 125 S. Ct. 738 (2005).

²¹ See, e.g., *United States v. Crosby*, 397 F.3d 103, 113 (2d Cir. 2005) (Sentencing Guidelines reflected Congress's intent and were not to be lightly disregarded); *United States v. Mykytiuk*, 415 F.3d 606 (7th Cir. 2005) (court observed that sentences properly calculated under the Sentencing Guidelines are entitled to a rebuttable presumption of reasonableness).

²² See *R. v. Nova Scotia Pharmaceutical Society*, [1992] 2 S.C.R. 606.

²³ Competition Act, s. 46.

²⁴ S. 231.4, R.S.C. 1985, c. 1 (5th Supp.).

²⁵ S. 11, Competition Act, R.S.C. 1985, c. C-34, as amended.

prior to public charges. Given also the traditional Canadian separation of the Attorney General's office from the investigative function²⁶ (as in the U.K.), Canadian prosecutors generally must rely on witness statements and interviews conducted by agency personnel in assessing their case strength and determining whether there is a reasonable prospect of conviction.

Jurisdiction May Be an Issue. In criminal prosecutions, Canada has not adopted an "effects" test to assert subject matter jurisdiction over extraterritorial antitrust conduct. Rather, subject matter jurisdiction is based on whether a significant portion of activities constituting the offense actually occurred in Canada.²⁷ Thus, difficulties loom for prosecutors in antitrust scenarios where defendants do not meet, communicate, or commit other overt acts (such as the exchange of pricing information) in Canada. Whether Canada's Supreme Court would see fit to extend subject matter criminal jurisdiction on the basis of anticompetitive effects alone remains unclear.

There also are difficulties in establishing personal jurisdiction in Canada. While the Criminal Code contains provisions authorizing service of summonses throughout Canada,²⁸ this does not enable extraterritorial application. At least one court has determined that reliance on provincial statute law authorizing mail service of an extraterritorial corporation was insufficient to establish personal jurisdiction.²⁹ It has sometimes been thought that Canada might resort to provisions of its Mutual Legal Assistance in Criminal Matters Act³⁰ and relevant treaties authorizing the service of initiating documents, but these provisions have not yet been tested in the courts and would undoubtedly meet with vigorous opposition by defendants.

Tests for Prosecution Differ. The respective tests or guidelines for prosecution for Canadian and U.S. prosecutors are somewhat different. The *U.S. Attorney Manual* provides that the U.S. prosecutor is to indict upon the most serious, readily provable offense or offenses consistent with the defendant's conduct.³¹ In Canada, however, a prosecutor must employ a two-phased test involving, initially, whether there is a "reasonable prospect of conviction"³² and secondly, whether there is a "public interest" in either the initiation or continuation of the prosecution.³³ In practice, the two tests may prove to be equivalent but they do offer a slightly different emphasis as between the two jurisdictions.

No Corporate Jury Trials. Corporations charged with antitrust violations in Canada cannot be tried by a jury.³⁴ This removes the potential for bias in the trial process and enables a corporation to more effectively assert "legal" rather than "factual" defences at trial. There is no danger of a "runaway jury" in Canada.

²⁶ See *R. v. Regan*, [2002] 1 S.C.R. 297 ¶ 71 (LeBel, J.) (Supreme Court affirmed that the "separation of police and Crown roles is a well-established principle of our criminal justice system").

²⁷ *R. v. Libman*, [1985], 21 D.L.R. (4th) 174 (S.C.C.).

²⁸ S. 703.1 Criminal Code, R.S.C. 1985, c. C-46.

²⁹ See *R. v. R.J. Reynolds Tobacco Co. (Delaware)*, [2004] O.J. No. 548 (Ont. S.C.) (currently under appeal by the government.).

³⁰ R.S., 1985, c. 30 (4th Supp.).

³¹ U.S. ATTORNEY MANUAL Title 9-27.400 ("Plea Agreements Generally").

³² FEDERAL PROSECUTION SERVICE DESKBOOK (CANADA) Part V, § 15 ("The Decision to Prosecute").

³³ *Id.*

³⁴ Competition Act, s. 67(4), s. 73(2).

No Deferred or Non-Prosecution Agreements. Unlike the circumstances outlined in the recent *KPMG* case,³⁵ Canadian prosecutors do not enter into deferred or non-prosecution arrangements which are conditional upon a defendant's payment of penalties and fulfillment of certain conditions. However, competition cases in Canada have sometimes been resolved by means of a prohibition order under the Competition Act, which does not require the assertion of a criminal charge.³⁶

No Conditional Pleas. Canadian law and practice follows general common law principles and, apart from reference to the "standard" pleas of guilty or not guilty and the "special pleas" of *autrefois acquit*, *autrefois convict*, and *pardon*,³⁷ a conditional plea or a nolo contendere is unknown to the law of Canada. However, the net transborder antitrust practice is the same as the Division's policy not to use conditional pleas in the disposition of antitrust cases.³⁸

With the exception of certain mandatory sentence provisions, Canadian courts are not bound by any sentencing guidelines or rules and are free to accept or reject recommendations made by the parties who appear before them.

Judges Not Bound. With the exception of certain mandatory sentence provisions,³⁹ Canadian courts are not bound by any sentencing guidelines or rules and are free to accept or reject recommendations made by the parties who appear before them. In sentencing matters, Canadian trial courts take guidance from their respective provincial appellate courts and under (relatively rare) sentencing cases decided by the Supreme Court of Canada. While a trial court is not bound to accept the position expressed by parties jointly as to sentence,⁴⁰ appellate courts have strongly cautioned lower courts to give "serious consideration" to a joint sentencing submission and not to depart from such submissions unless they are contrary to the public interest and would bring the administration of justice into disrepute. This is aimed at maintaining proper balance between respect for the plea bargain and the sentencing court's role in the administration of justice.⁴¹ Thus, a degree of certainty, but not absolute certainty, characterizes the Canadian plea process.

No Revocation of Immunity (and Subsequent Indictment) to Date in Canada. In various public statements,⁴² officials from Canada's Competition Bureau have confirmed that no antitrust immunity has ever been revoked, nor have officials ever sought revocation of immunity in Canada. However, officials have observed that they have considered revocation in two cases where there was dissatisfaction with a party's fulfillment of cooperation undertakings. To date, there is no Canadian counterpart to the *Stolt-Nielsen* case, which at this writing is currently pending before the U.S. Third Circuit Court of Appeals.⁴³

³⁵ Press Release, U.S. Dep't of Justice, *KPMG to Pay \$456 Million for Criminal Violations in Relation to Largest-Ever Tax Shelter Fraud Case*, (Aug. 29, 2005), available at http://www.usdoj.gov/opa/pr/2005/August/05_ag_433.html.

³⁶ See, e.g., *R. v. John Deere Limited* (Federal Court docket T-1836-04, Oct. 19, 2004), in which allegations of resale price maintenance were resolved by imposition of a prohibition order under Section 34 of the Competition Act under which John Deere made no criminal admissions, but was required to comply with certain conditions which included making voluntary refund payments to consumers.

³⁷ Criminal Code, R.S.C. 1985, c. C-46, as amended, ss. 606-1, 607-1.

³⁸ Plea Agreement Guidelines, *supra* note 7, at E.4.; Fed. R. Crim. P. 11(a)(2).

³⁹ There are over 30 non-antitrust offenses in Canada's Criminal Code that carry mandatory minimum sentences, e.g., discharging a firearm with intent (s. 244 Criminal Code); minimum four year sentence.

⁴⁰ See, e.g., *R. v. McGoldrick*, [2000], O.J. No. 321 (Ont. C.A.); *R. v. Fervez* [1984], O.J. No. 769 (Ont. C.A.).

⁴¹ *R. v. G.W.C.*, [2000] 150 C.C.C. (3d) 513 at 519-20 (Alta C.A.).

⁴² See, e.g., Denyse MacKenzie, Senior Deputy Commissioner of Competition, Comments at breakout panel on the immunity process, Canadian Bar Association Competition Law Conference, Gatineau, Quebec (Nov. 3, 2005).

⁴³ *Stolt-Nielsen v. United States*, 352 F. Supp. 2d 553, 569 (E.D. Pa. 2005).

The Bureau has recently issued FAQs that clarify, to some degree, the circumstances under which immunity may be withdrawn.⁴⁴ However, further clarification will undoubtedly be requested in this area, and particularly where an immunized party may face indictment where it allegedly fails to cooperate on terms similar to those in the typical Canadian plea agreement.

Plea Agreements Not Public. Unlike U.S. plea agreements, which are filed with the court in advance of proceedings,⁴⁵ Canadian antitrust plea agreements are generally not made public or filed with the court. Thus, there is no direct judicial scrutiny of the contents of a plea agreement, nor is the agreement supervised by a court. The only occasion where a plea agreement is likely to be disclosed to a third party in Canada would be in cases where an employee or officer of the pleading corporation is a prosecution witness against another cartel participant who is a defendant in a trial. Where that occurs, the agreement would form part of the pre-trial criminal disclosure package provided to the defense⁴⁶ in order, inter alia, that the defense may explore the basis for immunity and attempt to impeach the credibility of prosecution witnesses.

Admissions as to Facts More Explicit. Antitrust defendants in Canada are customarily required to stipulate to an agreed statement of facts or statement of admissions that will be filed with the court as a component of the plea. The document will set out, in some detail, the nature of the agreement, the parties involved, the time period involved, the product(s), the overt acts (e.g., meetings, contacts) underlying the agreement, and detail of market effects such as volumes of commerce in Canada (the latter springing from the requirement under Canada's conspiracy offense of demonstrating that the agreement or arrangement limited competition *unduly* in the product). The admissions document constitutes the foundation for the plea of guilty and also will normally serve as a template for civil plaintiffs in follow-on civil litigation.⁴⁷ It therefore often serves as a flashpoint in plea agreement negotiations and must be carefully scrutinized to consider its potential impact on civil liabilities.

Pre-Trial Processes Differ. Although the plea agreement entered into by the parties is not filed in Canadian court proceedings, a procedure exists whereby the parties may "preview" the proposed admissions of fact and joint sentencing recommendation in a closed-door judicial process prior to any public proceedings. This is through the device of a "pre-hearing conference"⁴⁸ in the superior courts. Such a conference is mandatory in the case of jury trials in Canada and is frequently practiced in any large case to be tried by a judge alone. The legislation provides that the hearing "be held prior to the proceedings to consider the matters that, to promote a fair and expeditious hearing, would be better decided before the start of the proceedings, and other similar matters, and to make arrangements for decisions on those matters."⁴⁹

While this provision is directed towards settling pre-trial logistical and similar issues on cases to be tried, it also provides a forum in which the parties can "screen" the proposed settlement arrangement before a court. While the judge presiding at such a hearing does not normally provide

⁴⁴ See Competition Bureau Revises Responses to Frequently Asked Questions on Immunity Program (Oct. 17, 2005), available at <http://www.competitionbureau.gc.ca/internet/index.cfm?itemID=1981&lg=e>.

⁴⁵ Fed. R. Crim. P. 11(e)(2).

⁴⁶ See *R. v. Hamilton* [1994], 94 C.C.C. (3d) (12 Sask. C.A.).

⁴⁷ Section 36(1) of the Competition Act provides for a private right of action for victims of anticompetitive conduct; Section 36(2) provides that the "record of proceedings in any court in which [the defendant] was convicted" serves as proof of anticompetitive conduct.

⁴⁸ Criminal Code, ss. 625.1; Rule 27.03(1), Rules of the Ontario Court of Justice in Criminal Proceedings.

⁴⁹ Criminal Code, ss. 625.1(1).

formal approval or disapproval of the proposed arrangement, it is common for the court to provide feedback on the position advanced by the parties, on whether it accords with appellate guidelines on sentencing, and whether the arrangement, in general, is an appropriate one from the perspective of the administration of justice.⁵⁰ On receipt of positive feedback, the parties may elect, on consent, to proceed with the plea before that court, provided the court agrees and appropriate logistical arrangements may be made. In certain cases, this may occur on the same date as the pre-hearing conference, thus enabling a form of expedited plea and sentencing procedure akin to the United States.

Canadian courts are particularly attuned to issues of “judge-shopping” in guilty plea practices, and the parties will be required to disclose to the particular presiding judge whether they have attempted a pre-hearing conference before another judge and what the result of that prior proceeding has been. In such instances, judicial comity would likely prevail; justices of the same division are unlikely to repudiate their colleagues’ views on a particular plea arrangement. The approach to such a pre-hearing conference will entail an assessment of the experience and approach of the bench in antitrust matters and the degree to which joint plea and sentencing recommendations have, in past, been adopted.

Right to Withdraw Plea Diminished. Attempts by defendants to withdraw a plea of guilty in Canadian criminal proceedings are extremely rare. Although the sentencing court is not considered *functus officio* until after the imposition of sentence,⁵¹ a trial judge will generally only permit withdrawal of (or a motion to strike) the plea only on a showing that the plea of guilty was not made voluntarily, was obtained through factors such as intimidation, duress, or undue influence, was induced by improper conduct on the part of the prosecutor, or was otherwise entered into without the defendant’s knowledge of the consequences.⁵² The most frequent remedy for an aggrieved defendant seeking to reverse a non-conforming trial court sentence is to proceed to appeal the sentence imposed on the basis of error in principle by the trial court and the grounds mentioned above.⁵³

Non-Conforming Sentences Remedied Only by Appeal. Appellate review of non-conforming sentences has generally followed a pattern of deference to the trial court, and intervention will occur only where the trial court has erred in principle, failed to consider a relevant factor, or over-emphasized a relevant factor, and the sentence is demonstrably unfit.⁵⁴ However, while courts of appeal generally endorse the broad discretionary powers of trial courts to accept or reject recommendations made to them, they have cautioned trial courts against general departures from

⁵⁰ See, e.g., *R. v. Gregoire* [2005], O.J. No. 3397 (Ont. Sup. Ct.), in which the procedure was summarized as follows: The Crown would present a summary of its case to the pre-trial judge. The defense would set out its arguments with respect to the Crown’s case. The judge would express an opinion on the basis of the facts as disclosed. Was it or was it not appropriate to accept a plea of guilty if it were tendered? If the judge believed that it would be inappropriate to accept a plea on the facts as set out then that would be the end of the pre-trial hearing. Assuming that a plea would be accepted the Crown would then make its submissions as to sentence and the defense would respond. The pre-trial judge would express an opinion as to the disposition he would make in these circumstances. If counsel indicated a willingness to accept that disposition then defense counsel would discuss the matter with the accused. The accused would either attend before the judge and enter a plea or he would decline to do so. If he declined to do so then the matter was put over to another judge for a plea or trial.

⁵¹ *R. v. P.E.L.* [1976] 30 C.C.C. (2d) 70 (Ont. C.A.).

⁵² See *R. v. Moser* [2002], 163 C.C.C. (3d) 286 (Ont. C.A.).

⁵³ Compare Fed. R. Crim. P. 11(e)(4), which requires the court rejecting a proposed “C” agreement to inform the parties, permit the defendant to withdraw the plea, and inform the defendant that persisting with the plea of guilty thereafter may result in a disposition less favorable than proposed in the agreement.

⁵⁴ *R. v. W. (L.F.)* [2001] 1 S.C.R. 132.

joint recommendations on sentencing made as a component of a plea agreement or plea bargain process.⁵⁵ This provides some level of comfort for litigants contemplating a plea.

No Explicit Safeguards Against Actions by Other Investigative Agencies. In the United States, terms under which the prosecution may agree to advise other administrative agencies on the manner and extent of co-operation by a defendant may be inserted into plea agreements. Such clauses are rare in Canadian antitrust case resolutions, owing in part to the division of powers and responsibilities for investigation and prosecution of criminal and quasi-criminal offences in Canada. For example, in Canada, most of the general criminal laws (murder, robbery, sexual assault, etc.) are investigated and prosecuted under the aegis of provincial police and Attorneys General who, under Canada's constitution, are sovereign entities (akin to U.S. state attorneys general) that have no reporting relationship with the federal authorities involved in antitrust investigations and prosecutions. Thus, while the facts underlying a given antitrust complaint may give rise to multiple potential violations under the federal Competition Act, as well as certain Criminal Code offenses, immunity from further provincial prosecution cannot be guaranteed by federal authorities. In practice however, it would not be unusual for a federal prosecutor to make a favorable recommendation against prosecution of the defendant if prosecution were contemplated by a provincial prosecutor for fraud or regulatory violations upon the same facts as a Competition Act violation. But such terms do not normally find their way into federal antitrust plea agreements.

No Provisions for Immigration Relief. Unlike the Antitrust Division, which has explicit cooperation agreements with other U.S. agencies,⁵⁶ there is no such agreement among Canada's Competition Bureau, the Attorney General, and Immigration Canada as to the status of potential fugitives in antitrust criminal proceedings. Generally speaking, a criminal conviction in another jurisdiction is sufficient to bar entry into Canada, and antitrust violations are similarly categorized under Canadian law. However, immigration relief cannot be offered by the Competition Bureau or Attorney General, and such terms are foreign to Canadian plea agreements.

No Stipulation as to Use and Derivative Use Immunity. While most U.S. antitrust plea agreements contain an extinction clause which nullifies use and derivative-use protection for evidence obtained in the negotiation process in the event of breach by the defendant, Canadian agreements have not historically incorporated such terms. Whether the prosecution would subsequently be able to mount a case against an individual defendant following a failed plea negotiation process thus remains questionable in Canada. However, both U.S. and Canadian antitrust practices retain extinction clauses for use and derivative-use evidence in the event of perjury, false statements, obstruction of justice, or similar violations on the part of negotiating defendants.

No Stipulation as to Where Sentence Is to Be Served. Unlike in the United States,⁵⁷ Canadian plea agreements for individuals may not specify the institution where the defendant will be incarcerated. Once more, this reflects the separation of authority within Canada's justice system. Deter-

⁵⁵ See, e.g., *R. v. Cerasuolo* [2001], 151 C.C.C. (3d) 445 (Ont. C.A.).

⁵⁶ For a discussion of the need for immigration relief from the Division's policy of placing indicted fugitives on a "Red Notice" INTERPOL list and immigration policy of prohibiting foreign executives convicted of antitrust crimes from obtaining a visa to enter the United States, see R. Hewitt Pate, Assistant Attorney General, Antitrust Division, U.S. Department of Justice, *Securing the Benefits of Global Competition*, Remarks to Tokyo American Centre, Tokyo, Japan (Sept. 10, 2004); see also Memorandum of Understanding Between the Antitrust Division U.S. DOJ and the Immigration and Naturalization Service, U.S. DOJ (Mar. 15, 1996).

⁵⁷ See Plea Agreement Guidelines, *supra* note 7, at E.2. (Wording for Straight "B" Agreement with Individual (as to specification of federal prison camp)).

minations of the particular place of custody are made solely by correctional authorities, although non-binding recommendations may be made by the parties, and endorsed by the court, in some circumstances.

Corporate Probation Orders May Be Imposed. Section 34 of the Competition Act provides that a court may, as a component of sentencing after a plea of guilty, impose a prohibition order that would prohibit the commission of any act or conduct similar to that on which the corporation has entered its plea of guilty, and impose other terms such as the implementation of a compliance policy. Although prohibition orders have not always been sought by the Competition Bureau, a recent decision from Canada's federal court suggests that the device of a prohibition order is alive and well at Canadian law and should be employed frequently.⁵⁸

No Civil Jury Trials. Most jurisdictions in Canada have eliminated the prospect of civil juries in civil cases. This, together with loser-pay cost regimes and a single scale of damages for antitrust actions, creates a somewhat diminished civil liability exposure for criminal defendants. While Section 36 of the Competition Act provides a derivative action remedy for persons suffering damage as a result of criminal antitrust activity, these provisions have been relatively infrequently used.⁵⁹ The primary focus for Canadian antitrust defendants is their civil exposure in the United States, either by way of a governing U.S. class-action proceeding or through "copycat" Canadian actions modeled after U.S. proceedings. Canadian class action plaintiffs may also benefit from production and discovery derived from U.S. litigation, which is not subject to domestic limitations and may even be utilized in pre-certification class action proceedings,⁶⁰ a process unavailable at Canadian law.

Conclusion

There are many important substantive and procedural distinctions between U.S. and Canadian antitrust plea practices. As will be seen from the foregoing, Canadian plea practices in antitrust matters do not have the same high degree of transparency as the Division's practices. This does not mean that the resolution of Canadian antitrust cases is any less possible or predictable, but rather that different considerations, including distinctions in the substantive and procedural law, aspects of judicial discretion, and the separation of the attorney general's functions from investigators, will impact upon the process. Plea agreements for non-immunized antitrust defendants are the prevailing manner in which both Canadian and U.S. cases have been, and will continue to be, resolved in the future. ●

⁵⁸ See *Prohibition Order, R. v. Bioproducts Incorporated*, and accompanying remarks of Gibson J., Federal Court (Trial Division) (Aug. 18, 2003).

⁵⁹ See Christopher P. Naudie, *Private Antitrust Enforcement in Canada: So What Exactly Have We Achieved?*, Paper Delivered to Canadian Bar Association Annual Competition Law Conference (Nov. 4, 2005).

⁶⁰ See *In re Linerboard Antitrust Litig.* 333 F. Supp. 2d 333 (E.D. Pa. 2004).

Second Circuit Puts Antitrust Conspiracy's Skeletal Pleading Rules on a Diet

Mark D. Alexander

Defending an antitrust action past the pleading stage into civil discovery can make the most hardened corporate litigant blanch. This is because the scope of what is “relevant to the claim or defense of any party” in antitrust claims can quickly encompass virtually all documents and other information related to the functioning of the markets in which the defendant competes—an expansive universe in which discovery compliance costs in the six figures or even greater are common. As a result, antitrust defendants have regularly argued over the years, with mixed success, that courts should grant motions to dismiss under Rule 12(b)(6) of the Federal Rules of Civil Procedure to weed out insubstantial antitrust claims before they can exact heavy discovery burdens.¹

The Second Circuit's recent decision in *Twombly v. Bell Atlantic Corp.*² is likely to disappoint advocates of such early-stage pruning because it delimits a narrow role for attacks on the pleadings in antitrust conspiracy cases. In addition, *Twombly's* reasoning is potentially broad enough to apply in other antitrust contexts, such as allegations regarding market definition or competitive effects in which courts have previously been more amenable to pleading-stage resolution. Acknowledging concerns regarding the potentially burdensome aspects for defendants of minimal pleading requirements in the antitrust context, the *Twombly* court invited litigants to seek a Congressional remedy or a change to the Federal Rules of Civil Procedure to combat the perceived risk of vexatious antitrust discovery.

The *Twombly* Decision

Twombly concerned the applicable pleading standard for the “contract, combination or conspiracy” element in claims arising under Section 1 of the Sherman Act. The *Twombly* plaintiffs alleged that incumbent local telephone companies unlawfully conspired with one another to avoid competing outside their respective “home” territories. In support of this claim, the plaintiffs alleged that the incumbent carriers had failed to take advantage of opportunities for out-of-region entry afforded by the 1996 Telecommunications Act, particularly in areas adjacent to their home regions where the plaintiffs claimed the carriers would enjoy “substantial competitive advantages,” and they also alleged various public statements and industry meetings in furtherance of the alleged conspiracy.³ The plaintiffs further alleged that the incumbent carriers agreed to foil the market-opening provisions of the 1996 Act by impeding the efforts of competitive carriers to interconnect

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Mark D. Alexander is a Partner, Axinn, Veltrop & Harkrider LLP. The author's firm represents BellSouth in some matters but was not involved in the Twombly case discussed in this article.

¹ *Compare* Hack v. President and Fellows of Yale College, 237 F.3d 81 (2d Cir. 2000) (dismissal of claim premised on implausible market share definitions) *with* Discon, Inc. v. NYNEX Corp., 93 F.3d (2d. Cir. 1996) (reversing dismissal of inartfully drafted complaint stating two-firm group boycott claim), *vacated on other grounds*, 525 U.S. 128 (1998).

² 425 F.3d 99 (2d Cir. 2005), *petition for cert. filed* (No. 05-1126) (Mar. 6, 2006).

³ *Id.* at 103.

with incumbent networks claiming that if any defendant allowed equitable interconnection agreements, it would allegedly make it more difficult for the other defendants to continue to exclude competitors.⁴

The district court held that the plaintiffs failed to state a claim because they did not sufficiently allege one or more “plus factors” going beyond parallel conduct that would tend to show that the defendants had not reached the same decisions independently.⁵ The district court noted that the factual allegations of the *Twombly* complaint focused primarily on the defendants’ parallel competitive decisions to refrain from out-of-region competition and to disadvantage competitive carriers.⁶

The district court’s requirement that “plus factors” must be alleged to state an antitrust conspiracy claim hardly came out of thin air. As the Second Circuit recognized, courts have long rejected antitrust conspiracy claims at the summary judgment stage when predicated merely upon evidence that competitors in an industry closely monitor and follow one another’s decisions on price, output, or other aspects of competition.⁷ Indeed, most courts have required evidence of one or more “plus factors” that, in the words of the *Twombly* district court, “tend[] to exclude independent self-interested conduct as an explanation for defendants’ parallel behavior.”⁸

The “plus factors” requirement developed because, notwithstanding the difficulty of directly proving antitrust conspiracies, conscious parallelism, standing alone, is simply rational marketplace behavior in many circumstances, and thus can be as consistent with lawful independent action as with unlawful conspiracy.⁹ While plaintiffs may face difficulties identifying “plus factors” (much less directly proving a conspiracy) in advance of an opportunity for discovery, the lower court in *Twombly* followed other district court decisions in concluding that the rationale for requiring evidence beyond parallel conduct at the summary judgment stage also warranted a requirement of allegations tending to negate the possibility of independent action.¹⁰

The Second Circuit rejected the district court’s approach:

We have consistently rejected the argument—put forward by successive generations of lawyers representing clients defending against civil antitrust claims—that antitrust complaints merit a more rigorous pleading standard, whether because of their typical complexity and sometimes amorphous nature, or because of the related extraordinary burdens that litigation beyond the pleading stage may place on defendants and the courts.¹¹

⁴ *Id.* at 104.

⁵ “Plus factors” can include shared conspiratorial incentives, frequent communications among alleged co-conspirators, or evidence of conduct that would be against a conspiring firm’s economic self-interest in the absence of a conspiracy. *Id.* at 114 (citing *Apex Oil Co. v. DiMauro*, 822 F.2d 246, 254 (2d Cir. 1987)).

⁶ The plaintiffs argued on appeal that their allegations stated a claim whether or not “plus factors” were required at the pleading stage. *Twombly*, 425 F.3d at 106. While basing its holding on the absence of a “plus factors” pleading requirement, the Second Circuit also noted in dicta that it agreed that plaintiffs adequately pled “plus factors” in any event. *Id.* at 118 n.15.

⁷ See generally *Apex Oil*, 822 F.2d at 253–54 (discussing “plus factors” requirement). Judge Posner has questioned the long-established proposition that parallel conduct alone is insufficient to establish an antitrust conspiracy case, arguing that the statutory language of Section 1 can be read to encompass the offer of a “unilateral contract” by an oligopoly price leader in the expectation that competitors will follow its lead. See *In re High Fructose Corn Syrup Antitrust Litig.*, 295 F.3d 651, 653 (7th Cir. 2002) (Posner, J.).

⁸ *Twombly v. Bell Atlantic Corp.*, 313 F. Supp. 2d 174 (S.D.N.Y. 2003).

⁹ See generally *Interstate Circuit, Inc. v. United States*, 306 U.S. 208, 222 (1939).

¹⁰ *Twombly*, 313 F. Supp. 2d at 179–80 (citing *Kramer v. Pollock-Krasner Found.*, 890 F. Supp. 250, 255 (S.D.N.Y. 1995); *Levitch v. CBS Inc.*, 495 F. Supp. 649, 675 (S.D.N.Y. 1980)).

¹¹ *Twombly*, 425 F.3d at 108 n.6.

Twombly's Implications for Pleading Antitrust Conspiracy

Twombly's reaffirmance that the Federal Rules of Civil Procedure require only skeletal notice pleading to survive into discovery follows a line of cases dating back to *Conley v. Gibson*.¹² The Supreme Court's more recent non-antitrust decisions in *Swierkiewicz v. Sorema, N.A.*,¹³ and *Leatherman v. Tarrant County Narcotics Intelligence and Coordination Unit*,¹⁴ make clear that special pleading requirements are limited to specific types of allegations, such as "fraud or mistake" under Federal Rule 9(b), and that allegations regarding all other matters need only meet the "short and plain statement" standards of Rule 8(a). In line with these authorities, Judge Posner has questioned "why lawyers insist on writing prolix complaints that can only get them into trouble."¹⁵

Nevertheless, while Rule 8(a)(2) of the Federal Rules of Civil Procedure requires only "a short and plain statement of the claim," that short and plain statement must allege facts "showing that the pleader is entitled to relief." Because a plaintiff could not rest its case on evidence of parallel conduct without "plus factors," it is not clear how allegations omitting such "plus factors" make the requisite showing that the pleader is entitled to relief.

Twombly reasoned that "plus factors" are not a necessary element of an antitrust conspiracy claim, but merely a common evidentiary tool to establish a conspiracy.¹⁶ A plaintiff can also uncover direct evidence of a conspiracy through "smoking guns" and the like that would obviate any need for plus factor evidence. Accordingly, *Twombly* held that a district court cannot require a plaintiff to include allegations of "plus factors" to avoid dismissal at the pleading stage.¹⁷

While rejecting the idea that any heightened pleading standards are required in an antitrust action, *Twombly* simultaneously professed adherence to decisions holding that an antitrust complaint must allege a "plausible" antitrust grievance to survive a motion to dismiss. The plausibility rule has developed in response to the concern that allegations merely tracking the minimalist language of the Sherman Act will invariably cover presumptively lawful activity as well as potentially unlawful conduct.¹⁸ The First Circuit explained the issue in affirming a dismissal of an antitrust conspiracy claim in *DM Research, Inc. v. College of American Pathologists*:

[T]erms like "conspiracy," or even "agreement," are borderline: they might well be sufficient in conjunction with a more specific allegation—for example, identifying a written agreement or even a basis for inferring a tacit agreement . . . but a court is not required to accept such terms as a sufficient basis for a complaint. . . . Occasionally, an implausible conclusory assertion may turn out to be true. . . . But the discovery process is not available where, at the complaint stage, a plaintiff has nothing more than unlikely speculations. While this may mean that a civil plaintiff must do more detective work in advance, the reason is to protect society from the costs of highly unpromising litigation.¹⁹

Twombly itself illustrates the fine line between rejecting heightened antitrust pleading standards and allowing dismissal of antitrust complaints that make "implausible" allegations. The Second Circuit held in *Twombly* that as long as conspiracy allegations based upon parallel conduct go

¹² 355 U.S. 41 (1955).

¹³ 534 U.S. 506 (2002).

¹⁴ 507 U.S. 163 (1993).

¹⁵ *Hammes v. AAMCO Transmissions, Inc.*, 33 F.3d 774, 778 (7th Cir. 1994).

¹⁶ *Twombly*, 425 F.3d at 114.

¹⁷ *Id.*

¹⁸ *Id.* at 109–12.

¹⁹ 170 F.3d 53, 56 (1999) (citation omitted).

The [Second Circuit] stripped the “plausibility” requirement of any limiting force because conspiracy and coincidence will both be plausible inferences to draw from parallel competitive conduct.

beyond “unlikely speculations” and “bare bones” conspiracy allegations, they will be sufficiently plausible to survive dismissal: “[T]o 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.”²⁰ In so doing, however, the court stripped the “plausibility” requirement of any limiting force because conspiracy and coincidence will both be plausible inferences to draw from parallel competitive conduct.²¹ Because parallel conduct will often be the status quo in concentrated industries, the Second Circuit’s plausibility requirement is likely to prove completely toothless in weeding out frivolous conspiracy claims prior to discovery. Indeed, the Second Circuit observed that it was “not unsympathetic to the[] concerns,” raised by the defendants, which argued that the upshot of the decision may be that “any claim asserting parallel conduct will survive a motion to dismiss.”²² *Twombly* nevertheless found such concerns insufficient to outweigh the policy that pleading requirements should be limited to providing defendants with basic notice of the allegations against them.²³

More than 20 years ago, the Supreme Court expressed concern about such a result in *Associated General Contractors of California, Inc. v. California State Council of Carpenters*,²⁴ observing in dicta that allowing a claim comprised of bare-bones allegations of coercion resulting from a group boycott to advance to discovery would be “perhaps stretching the rule of *Conley v. Gibson*, too far. Certainly, in a case of this magnitude, a district court must retain the power to insist on some specificity in pleading before allowing a potentially massive factual controversy to proceed.”²⁵ The more recent holdings in *Leatherman* and *Swierkiewicz*, however, suggest that today’s Supreme Court may be more sanguine about the prospect of “unpromising” complaints clearing minimal hurdles to discovery unless heightened pleading standards are specifically mandated by rule or statute.

A More Restrictive Approach for Market-Definition Dismissals Ahead?

The wafer-thin plausibility requirement in *Twombly* for antitrust conspiracy allegations stands in contrast to a line of cases concerning the minimum market definition allegations required to defeat a motion to dismiss. This raises the question of whether *Twombly*’s reasoning might be extended to market definition and other contexts, as well.

In cases in which an antitrust claim turns on allegations that a business practice results in an unreasonable restraint on commerce, courts from several federal circuits have held that, even in light of the liberal federal pleading rules, Rule 12(b)(6) dismissals are appropriate where a complaint alleges a product or geographic market found to be implausible on its face. For example, in *Queen City Pizza, Inc. v. Domino’s Pizza, Inc.*,²⁶ a Third Circuit panel that included then-Judge Alito considered allegations that Domino’s had contractually restricted competition in the “market” for supplies to its own Domino’s Pizza franchises. The Third Circuit held that because it is the plain-

²⁰ *Twombly*, 425 F.3d at 114.

²¹ See generally *Williamson Oil Co. v. Phillip Morris USA*, 346 F.3d 1287, 1299 (11th Cir. 2003).

²² *Twombly*, 425 F.3d at 116 (quoting defendants’ brief [emphasis added]).

²³ *Id.* at 114–16.

²⁴ 459 U.S. 519 (1983).

²⁵ *Id.* at 528 n.17.

²⁶ 124 F.3d 430 (3d Cir. 1997).

tiff's burden to define the relevant market, dismissal is appropriate where the pleadings either fail to allege a market with reference to the indicia used by courts to define markets, such as reasonable interchangeability and cross-elasticity of demand, or fail to account for all interchangeable substitute products.²⁷ Other courts have reached similar conclusions when confronted with alleged product or geographic market consisting of a single product.²⁸

The pleading hurdles in the market definition area should not be overstated. As the Second Circuit explained in *Todd v. Exxon Corp.*, avoiding Rule 12(b)(6) dismissal requires merely that the alleged market “bear a ‘rational relation to the methodology courts prescribe to define a market for antitrust purposes—analysis of the interchangeability of use or the cross-elasticity of demand.’”²⁹ *Todd* characterized the cases in which 12(b)(6) dismissals on market definition grounds have been granted as tending to involve either attempts to define a market to a single brand or similar entity, or “failure even to attempt a plausible explanation as to why a market should be limited in a particular way.”³⁰

The teachings of *Twombly* are not perfectly harmonious with market definition cases like *Todd*. *Todd*'s suggestion that a “failure even to attempt a plausible explanation” of an element an antitrust claim renders a complaint dismissible is inconsistent with more recent cases like *Leatherman* and *Twombly* that do not require plaintiffs to explain the substance of their claims. *Twombly* and the market definition cases both involve the sufficiency of pleadings concerning typical, but not necessarily mandatory, elements of an antitrust claim—market share allegations in *Todd* and “plus factors” in *Twombly*.³¹ In *Twombly*, the possibility of an alternative route to a viable antitrust conspiracy claim (direct evidence of the conspiracy) proved sufficient to defeat the motion to dismiss. Allegations of “plus factors” were not necessary in *Twombly* because it was possible to prove conspiracy directly as well as by reference to “plus factors.” Recognition that direct evidence of a statutory violation may provide an alternative route to the normal elements of a prima facie case follows directly from the Supreme Court's decision in *Swierkiewicz*.

Anticompetitive effects can similarly be established through more than one approach: either through market share evidence or through direct evidence of an adverse effect on competition, such as increased prices or a reduction in output.³² While legions of cases specifically require market definition allegations, the tension between *Twombly* and the market share cases may become increasingly strained as traditional approaches to market definition evolve. Growing judicial acceptance of sophisticated econometric analysis allowing direct (or at least quasi-direct) evi-

²⁷ *Id.* at 436.

²⁸ *See, e.g.*, *Tanaka v. Univ. of Southern Cal.*, 252 F.3d 1059 (9th Cir. 2001) (affirming dismissal where complaint alleged anticompetitive effect in relevant product market defined as single university); *Hack v. President and Fellows of Yale College*, 237 F.3d 81 (2d Cir. 2000) (same); *TV Communications Network, Inc. v. Turner Network Television, Inc.*, 964 F.2d 1022 (10th Cir. 1992) (affirming dismissal of complaint predicated on attempted monopolization of product market limited to a single cable television channel).

²⁹ 275 F.3d 191, 200 (2d Cir. 2001) (quoting *Giana Enters. v. Miss World (Jersey) Ltd.*, 551 F.2d 1348 (S.D.N.Y. 1982)).

³⁰ *Id.*

³¹ Market power allegations are generally unnecessary in per se cases. *See, e.g.*, *FTC v. Superior Court Trial Lawyers Ass'n*, 493 U.S. 411, 432–36 (1990). Rule of reason cases typically require an assessment of the competitive impact of restraint in a “product market as a whole.” *Continental T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36 (1977). But evidence of actual adverse effect on competition can suffice even in the absence of a detailed analysis of the relevant market. *FTC v. Indiana Fed'n of Dentists*, 476 U.S. 447, 458–61 (1986).

³² *See Todd*, 275 F.3d at 206–07.

dence of market impact is undermining the traditional market definition-based approach.³³ This trend could, in turn, be used by plaintiffs to attempt to erode the basis for 12(b)(6) market definition dismissals. This outcome is certainly not a foregone conclusion—the facts behind antitrust conspiracies are typically hidden in a way that the facts necessary to define a market are not, arguably justifying different treatment—but it will be interesting to see the extent to which litigants seek to extend *Twombly* to other contexts.

Legislative and Other Alternatives

Whether *Twombly* represents a restrictive view of dismissal motions only in parallel conduct cases or a broader reaffirmance of traditional liberal-pleading rules in the antitrust realm, it is an unwelcome decision for corporate litigants concerned about minimal hurdles standing between plaintiffs and burdensome discovery obligations. The *Twombly* court acknowledged the legitimacy of such concerns:

We are mindful that a balance is being struck here, that on one side of that balance is the sometimes colossal expense of undergoing discovery, that such costs themselves likely lead defendants to pay plaintiffs to settle what would ultimately be shown to be meritless claims, that the success of such meritless claims encourages others to be brought, and that the overall result may well be a burden on the courts and a deleterious effect on the manner in which and efficiency with which business is conducted. If that balance is to be re-calibrated, however, it is Congress and the Supreme Court that must do so.³⁴

Twombly noted that potential litigants could seek a legislative remedy to the problem, using the Private Securities Litigation Reform Act of 1995³⁵ and Securities Litigation Uniform Standards Act³⁶ as examples. While there appear to be no current efforts underway to consider such pleading reforms (the Antitrust Modernization Commission apparently did not consider pleading standards), that approach may have considerable appeal to corporate litigants. Alternatively, *Twombly* invited the Supreme Court to step in by revising the Rules of Civil Procedure. Parties must rely meanwhile on usual case management techniques³⁷ to keep discovery within reasonable bounds and try to obtain early disposition on summary judgment grounds where elements of a plaintiff's case cannot be proven. Litigation reform is, of course, never simple or easy, but the *Twombly* court's invitation—along with the burdensome implications of its decision—may together supply the necessary impetus for corporate litigants to mount an organized effort to seek legislative relief. ●

Judicial acceptance of sophisticated economic analysis allowing direct (or at least quasi-direct) evidence of market impact . . . could be used by plaintiffs to attempt to erode the basis for 12(b)(6) market definition dismissals.

³³ Cf. *United States v. Oracle Corp.*, 331 F. Supp. 2d 1098, 1122 (N.D. Cal. 2004) (“Merger simulation models may allow more precise estimations of likely competitive effects and eliminate the need to, or lessen the impact of, the arbitrariness inherent in defining the relevant market”); but cf. *Republic Tobacco Co. v. N. Atl. Trading Co., Inc.*, 381 F.3d 717, 737 (7th Cir. 2004) (even where direct evidence of competitive effects can be established in lieu of formal market definition evaluation, plaintiff must establish at least “the rough contours of a relevant market”).

³⁴ *Twombly*, 425 F.3d at 117.

³⁵ 15 U.S.C. §§ 77z-1-2, 78j-1, 78u-4-5.

³⁶ Pub. L. No. 105-353, 112 Stat. 3227 (amending scattered sections of Title 15, U.S.C., including 15 U.S.C. §§ 77p, 77v, and 78bb).

³⁷ District courts could also seek to deter antitrust claims erected on flimsy foundations through the use of case management orders similar to those used in RICO cases in many districts, although a requirement that parties file some form of detailed antitrust case statement at the outset of litigation itself would be in some tension with liberal pleading rules. See generally Christopher M. Fairman, *The Myth of Notice Pleading*, 45 ARIZ. L. REV. 987, 1052–53 & n.406 (2003).

A Safety Zone for the Ex Ante Communication of Licensing Terms at Standard-Setting Organizations

John J. Kelly and Daniel I. Prywes

Many industry standard-setting organizations (SSOs) encourage or require participants in the standards development process to disclose patents or patent applications that relate to a proposed standard. This is done so that the SSO may make an informed choice among different options when selecting the technology to be used in a standard.¹

If one option is likely to require use of a patented technology subject to high royalty rates, and others are not, then the SSO should take this factor into account in its selection decision to arrive at the best standard. As a matter of economic efficiency, the “best” standard is the one that strikes the optimal balance between cost and technical superiority.

John J. Kelly is the President of the JEDEC Solid-State Technology Association, which serves as the semiconductor and solid-state engineering standardization body of the Electronic Industries Alliance. **Daniel I. Prywes** is a partner in the Washington, D.C. office of Bryan Cave LLP, and has represented participants in standard-setting organizations, as well as JEDEC. The views stated in this article are the personal views of the authors. They do not necessarily reflect the views of the organizations they are associated with or of the members or other employees of those organizations.

Fear of Antitrust Liability or Claims

Standard-setting activity, however, can be inhibited by SSO concerns about potential antitrust liability and the cost of defending antitrust claims.² SSO members fear, with justification, that any communications with patent holders during the standards development process regarding the latter’s royalty demands can expose the SSO and its participants to antitrust claims. Patent holders may allege that such communications are part of a “joint buying cartel” among SSO members collusively to suppress the cost of purchasing technology to sub-competitive levels. A “subcompetitive” royalty rate is one below the rate that would result if there were open and fair competition among technologies for inclusion in a standard.³

Because of these concerns, most SSOs do no more than require patent holders to declare during the standards development process that the patent holder will license its technology on “RAND” terms (reasonable and non-discriminatory terms), with or without a royalty, if the patent holder’s technology should be incorporated into the standard. Any further discussions about roy-

¹ There has been considerable litigation over the scope and extent of an SSO member’s obligation to disclose the existence of patents or patent applications that may relate to a proposed standard. The Federal Trade Commission has considered issues of this type in *Rambus*, FTC Docket No. 9302 and in *Union Oil Co. of Calif.*, FTC Docket No. 9305. Other significant cases on this topic include *Rambus v. Infineon Techs. AG*, 318 F.3d 1081 (Fed. Cir. 2003); *Dell Computer Corp.*, 121 F.T.C. 616 (1996); *Wang Laboratories, Inc. v. Mitsubishi Elecs. America, Inc.*, 103 F.3d 1571 (Fed. Cir. 1997); *Stambler v. Diebold, Inc.*, 11 U.S.P.Q.2d (BNA) 1709 (E.D.N.Y. 1988), *aff’d*, 878 F.2d 1445 (Fed. Cir. 1988); *Potter Instrument Co. v. Storage Technology Corp.*, 207 U.S.P.Q. (BNA) 763 (E.D. Va. 1980), *aff’d*, 641 F.2d 190 (4th Cir. 1981). See Daniel Prywes, *Patent Ambushes and Licensing in Computer Standard-Setting Groups*, ANTITRUST REP., Mar. 2001, at 17.

² This phenomenon is not unique to SSOs. The federal antitrust agencies have recognized generally that “a perception that antitrust laws are skeptical about agreements among competitors may deter the development of procompetitive collaborations.” U.S. Dep’t of Justice & Federal Trade Comm’n, *Antitrust Guidelines for Collaborations Among Competitors* (2000), 4 Trade Reg. Rep. (CCH) ¶ 13,161, at 20,852, available at <http://www.ftc.gov/os/2000/04/ftcdojguidelines.pdf> [Antitrust Guidelines].

³ The general concern with competitor collaborations under the antitrust laws is that they “may harm competition and consumers by increasing the ability or incentive profitably to raise price above or reduce output, quality, service, or innovation below what likely would prevail in the absence of the relevant agreement.” *Id.* at 20,854.

alty rates before the final adoption of a standard—namely, ex ante discussions—are often prohibited. In essence, SSOs are free to go shopping for the most suitable technology, but not to ask how much it will cost. As discussed below, this can lead to unexpectedly high royalty demands later on, once the standard has become widely adopted and the industry is “locked in” to its use.

A number of commentators have noted that a patent holder’s ex ante commitment to license under RAND principles may not provide enough information to the SSO’s participants to enable an informed decision that balances cost and technical features to reach the optimal standard. There are at least three problems:

1. There may be a wide range of royalty rates that could be deemed “reasonable.”⁴
2. It may not always be easy to determine when different royalties charged to different firms are discriminatory. The different firms may be situated differently (e.g., using the standard for different applications), and some (but not all) may have pre-existing license arrangements with the patent holder.
3. Most importantly, unless the SSO participants know the actual royalty rate to be demanded by the patent holder, at least within a range, it is impossible to make even a reliable estimate of the future cost of selecting a particular patent-laden technology over other technical options. As a result, the SSO’s selection decision will lack critical information and the optimal solution may not be selected.

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The Patent “Hold-Up” Problem

Because most SSOs have not permitted, or engaged in, ex ante licensing discussions with patent holders, the SSO industries are subject to a potential patent “hold-up” problem. Before a standard is adopted, a particular patent may be only one of several solutions to meet a technical challenge, and the value of the patent may be modest. There may be options to “work around” the patent, to use non-patented technology, or to use another patented technology on royalty-free or lower royalty terms.

However, once the SSO adopts a standard using a patented technology and the market for the standardized, patented technology grows, it can often be difficult for the industry to switch to a different standard if the patent holder demands high royalties. As investment grows in the production of a standardized item, and the standard is incorporated widely by industry into devices and systems, the industry may become “locked in” to the patent-laden standard. At this point after—or ex post—the standard selection decision, the patent holder can hold up the industry by demanding a higher royalty than it could have achieved had it disclosed its royalty demands ex ante during the standard development process. Manufacturers then have no choice but to pay the royalty demands (at least until the industry can efficiently migrate to an alternative) or to litigate the validity, applicability, or enforceability of the patent.⁵ The cost of using the standard, and the resulting cost to consumers, will be increased above the true value of the patent at the time the selection was made.

⁴ See Daniel G. Swanson & William J. Baumol, *Reasonable and Nondiscriminatory (RAND) Royalties, Standards Selection, and Control of Market Power*, 73 ANTITRUST L.J. 1, 5 (2005).

⁵ For example, in *Rambus*, FTC Docket No. 9302, the FTC alleged that Rambus failed to disclose patent applications to a JEDEC standard-setting committee and that Rambus was later able to extract supracompetitive royalties after the patents were issued and the industry had widely incorporated the Rambus technology into computer memory systems. See <http://www.ftc.gov/os/adjpro/d9302/index.htm>.

Rule of Reason Standard for Ex Ante Communications About Royalties

There is increasing recognition that the patent hold-up problem can result in economically inefficient standards. As a result, there has recently been a tide of commentary that ex ante communications about royalty rates should not be per se prohibited under the antitrust laws.⁶ Instead, it has been suggested that such communications should be permitted, subject to antitrust scrutiny under the looser rule of reason standard. Generally speaking, a practice is permitted under the rule of reason standard if its efficiency-enhancing characteristics outweigh any anticompetitive characteristics (including a reduction in incentives to innovate).⁷

In September 2005, FTC Chairman Deborah Majoras delivered a speech in which she commented favorably on SSO rules or practices that would allow ex ante communications about royalty rates (including negotiations) during the standards development process.⁸ Chairman Majoras first explained that there are legitimate reasons for SSOs to take steps to prevent the patent hold-up problem:

The ability of a patent holder to charge a high royalty rate may . . . result from the reduction in competition that may occur after a standard is chosen and lock in has occurred. The antitrust laws are concerned with situations in which a patent holder obtains such market power as a result of anti-competitive conduct.⁹

Chairman Majoras went on to note that SSOs have nonetheless been reluctant to allow any ex ante communications about royalty terms because of “concerns that agreed rates are exercises in collective price-fixing and therefore run afoul of the antitrust laws’ per se ban on price fixing.”¹⁰ She explained that these concerns are too restrictive and “may have unduly prevented announcements of pricing intentions or royalty discussions that may, in fact, provide procompetitive benefits.”¹¹

Chairman Majoras wrote that “a patent holder’s voluntary and unilateral disclosure of its maximum royalty rate . . . is highly unlikely to require antitrust scrutiny,” because the unilateral announcement of a price is not a collective act (subject to challenge under Section 1 of the Sherman Act), and on its own is not an exclusionary practice (that could be challenged under Section 2 of the Sherman Act).¹²

More generally, Chairman Majoras indicated that “joint ex ante royalty discussions that are reasonably necessary to avoid hold up do not warrant per se condemnation.”¹³ Instead, she stated

⁶ A comprehensive presentation of this position is made in Robert A. Skitol, *Buying Power and Antitrust: Concerted Buying Power: Its Potential for Addressing the Patent Holdup Problem in Standard Setting*, 72 ANTITRUST L.J. 727 (2005).

⁷ As articulated by the federal antitrust agencies, under a “rule of reason” analysis, “[t]he central question is whether the relevant agreement likely harms competition by increasing the ability or incentive profitably to raise price above or reduce output, quality, service, or innovation below what likely would prevail in the absence of the relevant agreement.” Antitrust Guidelines, *supra* note 2, at 20,856.

⁸ Deborah Platt Majoras, Chairman, FTC, Recognizing the Procompetitive Potential of Royalty Discussions in Standard Setting, Remarks Prepared for Standardization and the Law: Developing the Golden Mean for Global Trade, Stanford University (Sept. 23, 2005), available at <http://www.ftc.gov/speeches/majoras/050923stanford.pdf>.

⁹ *Id.* at 4 (emphasis added).

¹⁰ *Id.* at 6.

¹¹ *Id.* at 6.

¹² *Id.* at 7.

¹³ *Id.*

that “[w]e would apply the rule of reason to joint ex ante royalty discussions because, quite simply, they can be a sensible way of preventing hold up, which can itself be anticompetitive.”¹⁴

Similar comments were made in a June 3, 2005, speech by R. Hewitt Pate, who was then the Assistant Attorney General for the DOJ’s Antitrust Division. He observed that many SSOs’ fears of antitrust liability arising from any discussion of actual royalty rates with potential licensors may be excessive, because “[i]t would be a strange result if antitrust policy is being used to prevent price competition.”¹⁵ He too observed that there is a “possibility” that “ex ante license fee negotiations” could be “anticompetitive,” but “it seems only reasonable to balance that concern against the inefficiencies of ex post negotiations and licensing hold up.”¹⁶

These statements should offer some comfort to SSOs that want to allow ex ante discussions with patent holders. However, as noted next, the continuing uncertainty about antitrust litigation and liability—even under a rule of reason analysis—will continue to exert a chilling effect on the practice of ex ante royalty communications.

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The Rule of Reason Still Exposes SSOs and Their Participants to Antitrust Risk

As noted above, the rule of reason standard of antitrust review does not insulate a practice from legal challenge. In the case of ex ante royalty discussions, the question remains whether, in a particular case, the SSO and its participants have engaged in those communications in a manner that enhances competition by avoiding the patent hold-up problem, or whether the communications were conducted in a manner having anticompetitive consequences.

It is not difficult to imagine circumstances in which ex ante royalty discussions could be credibly challenged as running afoul of the rule of reason test. Most obviously, the discussions would be condemned as illegal if SSO participants who are “manufacturing rivals cross over the line from discussing the price of technology they will ‘buy,’ . . . and start discussing—and fixing—the price of the products they sell.”¹⁷

Even if SSOs avoid such perilous conduct, they still will have reason for concern. SSOs and their participants may face claims that the ex ante royalty discussions have used the SSO participants’ joint buying power (as an “oligopsony”) inappropriately. This could occur in any case where a disappointed patent holder can show that the SSO participants sought lower royalty rates than could be justified by a good-faith technical/cost evaluation of the patent holder’s technology relative to other candidates for the standard. In such an instance, antitrust enforcement agencies and potential antitrust plaintiffs would likely consider the outcome to be anticompetitive because it threatens to reduce economic incentives for innovation by firms developing patented technology.

Consequently, the rule of reason analysis would subject SSOs and their participants to challenge in the many cases where there can be reasonable disagreement about the choice among several different technological approaches for use in a standard. The decision to select one approach over another is a matter of judgment and may be subjective to at least some degree. SSOs do not typically use expert economists to model the different costs of various technical

¹⁴ *Id.*

¹⁵ R. Hewitt Pate, Competition and Intellectual Property in the U.S.: Licensing Freedom and the Limits of Antitrust 5, Remarks to 2005 EU Competition Workshop (June 3, 2005), available at <http://www.usdoj.gov/atr/public/speeches/209359.htm>.

¹⁶ *Id.*

¹⁷ Majoras, *supra* note 8, at 10.

approaches. SSOs ordinarily depend on the judgment and technical expertise of engineers or other participants in making these determinations.

If an SSO and its participants get the selection process “wrong” under the antitrust laws, and lose an antitrust case in litigation, the cost can be enormous. In civil suits, the SSO and its participants in the standards development process may face awards of treble damages, be required to pay the plaintiff’s attorneys’ fees, and face injunctions that impede future standard-setting activity. SSOs and their members can also face criminal charges under the antitrust laws, particularly if they are poorly advised and do not give wide berth to the sometimes hazy line between pro-competitive, ex ante royalty communications aimed at preventing a patent hold-up, and the illegal exercise of joint buying power to drive down the price of technology to unreasonably low levels.

The mere possibility of an antitrust challenge, even under the rule of reason standard, inhibits many SSOs from allowing most forms of ex ante royalty communications. Antitrust litigation can be exceedingly expensive, and the Supreme Court has held that SSOs themselves are subject to liability for anticompetitive activity conducted under their auspices.¹⁸

These concerns are demonstrated by the recent *Soundview* litigation.¹⁹ In that case, an antitrust counterclaim was filed by Soundview Technologies, Inc., against two SSOs (the Consumer Electronics Association and the Electronics Industries Alliance) and several of their member companies. Soundview claimed that it had a patent for technology needed to implement the Congressionally and FCC mandated television V-Chip (used to allow parents to block the display of violent or sexually explicit programming). Soundview alleged that members of the SSOs “had agreed upon a uniform price for a license under the Soundview patent: 5 cents per television set,” which allegedly constituted an illegal “joint boycott and concerted refusal to deal.”²⁰ Soundview characterized the alleged “5 cent” agreement as one among a group of buyers with market power who were seeking to depress the price of one of the key inputs into their product. Even though the end result was to reduce costs that would ultimately be borne by consumers, Soundview alleged that the agreement had anticompetitive effects because it negatively impacted the price Soundview could charge for its intellectual property and thus reduced the incentive to innovate.

When the SSOs at the outset of the case filed a motion to dismiss Soundview’s antitrust claim, the trial court declined to do so. The court did not find that the alleged agreement was per se illegal. Instead, it found that there were too many factual issues to conclude that the claims were legally insufficient. The court allowed discovery and further proceedings to determine whether the SSOs and their members were “acting as rational economic decision-makers or participants in an illegal price-fixing conspiracy.”²¹ As a result, the litigation continued for several years through the discovery process and a *Markman* hearing on patent infringement. Ultimately, the court ruled that the television manufacturers had not infringed Soundview’s patent in the first instance,²² which mooted the antitrust claims.²³ At the end of this extensive and expensive litigation, there was still

¹⁸ See *American Soc’y of Mech. Eng’rs, Inc. v. Hydrolevel Corp.* 456 U.S. 556, 577 (1982).

¹⁹ *Sony Elecs., Inc. v. Soundview Techs., Inc.*, 157 F. Supp. 2d 180 (D. Conn. 2001).

²⁰ *Id.* at 182, 187.

²¹ *Id.* at 188.

²² *Sony Elecs., Inc. v. Soundview Techs., Inc.*, 225 F. Supp. 2d 164 (D. Conn. 2002).

²³ *Sony Elecs., Inc. v. Soundview Techs., Inc.*, 281 F. Supp. 2d 399 (D. Conn. 2003).

no court ruling as to whether the alleged royalty agreement among the SSO members was pro-competitive and legitimate, or illegal.

The cumulative litigation expense in the *Soundview* case to the SSOs and their members is estimated to exceed ten million dollars, even though no liability was imposed on the SSOs or their members. The *Soundview* case demonstrates that any SSO considering ex ante royalty discussions must consider the costs of defending an antitrust challenge—even if unsuccessful—when evaluating whether, and to what extent, to allow ex ante communications concerning royalty terms.

Given these concerns, SSOs will remain cautious with respect to the extent and scope of any ex ante royalty communications that they permit. The chilling effect of potential antitrust challenges will be strong enough to dissuade many SSOs from allowing ex ante communications that are sufficient in scope to prevent patent hold-ups. While Chairman Majoras has suggested that antitrust challenges in the more benign rule of reason climate will be few, and reserved for extreme cases, the future is uncertain because private plaintiffs (such as disappointed holders of patents not selected for a standard) also have the statutory right to sue to enforce the antitrust laws.

To truly solve the patent hold-up problem in standard setting, SSOs need a clearer delineation of the boundary between legitimate and illegitimate ex ante royalty communications. The federal antitrust agencies can do their part by outlining these boundaries in various ways, such as through Business Review letters issued by the Antitrust Division, or by developing more specific guidelines pertinent to standard-setting activity. SSOs and their respective industries would greatly benefit from the development of “safety zone” guidelines which, if followed by SSOs, would ensure that antitrust action will not be taken by the federal antitrust agencies absent extraordinary circumstances. Although not binding in litigation brought by private plaintiffs, such forms of guidance can be influential with courts.

New legislation should also be considered to create truly binding guidelines that protect SSOs and their members from private antitrust suits, as well as government enforcement actions, that challenge ex ante royalty communications. Congress has proven itself attentive to the problems associated with SSO activities that touch on intellectual property, but its actions to date go only so far.

In 2004, Congress enacted the Standards Development Organization Advancement Act²⁴ (SDOAA) to reduce to an extent the possibility that true standards-development activity by an SSO (as contrasted to collusion in fixing prices for downstream products) can be challenged as a per se violation of the antitrust laws.²⁵ Under the SDOAA, SSOs that engage in a defined range of “standards development activity” will be subject to antitrust challenge only under the rule of reason standard.²⁶ The Act, however, does nothing to change the standard of antitrust liability for individual firms participating in an SSO’s standards development process.²⁷ Those individual firms remain at risk of claims alleging that their ex ante royalty communications are illegal per se. Since

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²⁴ Standards Development Organization Advancement Act of 2004, Pub. L. No. 108-237, Title I, 118 Stat. 661 (2004).

²⁵ 15 U.S.C. § 4302(2). The legislative history of the SDOAA includes comments by supporters that that Act “seeks to encourage disclosure by intellectual property rights owners of . . . proposed licensing terms.” 150 Cong. Rec. H3657 (June 2, 2004) (Supplemental Legislative History agreed to by Rep. Sensenbrenner and Rep. Conyers).

²⁶ 15 U.S.C. §§ 4301(a)(7) and (c), and 4302.

²⁷ Nothing in the Act “shall be construed to alter or modify the antitrust treatment under existing law of . . . parties participating in standards development activity of standards development organizations within the scope of this title, including the existing standard under which the conduct of the parties is reviewed, regardless of the standard under which the conduct of the standards development organizations in which they participate are reviewed” SDOAA § 108, 118 Stat. at 665.

SSOs are ultimately composed of participating firms, the SSOs cannot function in those areas which the SSO participating firms find too risky. Nor does the Act protect an SSO from the following broad categories of per se allegations:

1. Exchanging information among competitors relating to cost, sales, profitability, prices, marketing, or distribution of any product, process, or service that is not reasonably required for the purpose of developing or promulgating a voluntary consensus standard, or using such standard in conformity assessment activities.
2. Entering into any agreement or engaging in any other conduct that would allocate a market with a competitor.
3. Entering into any agreement or conspiracy that would set or restrain prices of any good or service.²⁸

Safety-Zone Guidelines

The federal antitrust agencies have specified safety zones (or safe harbors) for a wide range of industries and circumstances. These have been determined to be useful to “provide participants in a competitor collaboration with a degree of certainty in those situations in which anticompetitive effects are so unlikely that the [a]gencies presume the arrangements to be lawful without inquiring into particular circumstances.”²⁹ Activity outside the safety zone may be procompetitive or competitively neutral, but may require a more detailed analysis.

Specific safety zones can be tailored for the specific circumstances of standard setting. Various commentators have offered suggestions for procedures with low antitrust risk that might be used to govern ex ante royalty communications.³⁰ The goal is to develop a safety zone in which the ex ante royalty communications are almost surely (1) going to promote the SSO’s informed selection of the best cost/technical tradeoff between different technical options, but (2) not force a patent holder to license its patent below the rate that would apply if there were an open and fair competition between different technical options.

Of course, one size may not fit all. A generalized safety zone may need to be adjusted to address different factual scenarios, as well as different industries.³¹ For the moment, however, we suggest procedures that are likely to have wide applicability. Of course, any form of ex ante royalty communication or negotiation that goes beyond the proposed safety zone is not intrinsically improper or illegal; it may simply require an individualized analysis under all the circumstances. Additionally, the safety-zone provisions should not be so onerous as to discourage participation by firms having large patent portfolios or large market shares.

One major issue in determining the scope of ex ante communications is whether SSOs can request or require potential licensors to make disclosure of their royalty demands, or whether the SSOs may safely go further by permitting or requiring additional communications about royalty

²⁸ 15 U.S.C. § 4301(c).

²⁹ Antitrust Guidelines, *supra* note 2, at 20,864.

³⁰ See, e.g., Daniel Swanson, Evaluating Market Power in Technology Markets When Standards Are Selected in Which Private Parties Own Intellectual Property Rights 12–13 (Apr. 18, 2002) (submitted to Joint Hearings of the DOJ and FTC regarding Competition and Intellectual Property Law and Policy in the Knowledge-Based Economy), available at <http://www.ftc.gov/opp/intellect/detailsandparticipants.htm>; Skitol, *supra* note 6, at 742.

³¹ Once the basic model is set for a safety zone for ex ante communications relating to royalty rates, the model could hopefully be refined to allow for communications about other licensing terms such as grantbacks.

rates. The mere disclosure of royalty demands, with nothing more, will reduce some of the uncertainty in the standards selection process. However, it may be too limited to allow the SSO (and ultimately consumers) fully to achieve the optimal price/technology tradeoff among competing technologies for inclusion in the standard. Therefore, in our proposal below, we suggest that a safety zone should be allowed for ex ante communications that go beyond the mere disclosure of a potential licensor's royalty demands. The safety-zone proposal could be adopted by the antitrust agencies as a guideline or could serve as the basis for possible legislation by Congress.

There could be endless debate among engineers and economists whether any particular royalty reached through ex ante communications is optimal or consistent with a competitive outcome. Therefore, to be useful, any safety zone guidelines need to stress the *process* of standard setting, the *scope* of the ex ante communications, and the *structure* of the choice facing the SSO in selecting a standard among competing technical options. Our safety-zone proposal therefore emphasizes these issues. The proposal can be summarized with ten principles:

To be useful, any safety zone guidelines need to stress the process of standard-setting, the scope of the ex ante communications, and the structure of the choice facing the SSO in selecting a standard among competing technical options.

Principle 1. The SSO and its members may ask participating patent holders to state the maximum royalties (if any) that they will demand if their patented technology (or any rights under patent applications) is adopted as part of an SSO standard. The SSO and its participants may ask patent holders to indicate if their proposed royalty rates are higher than the royalty rates obtained for any pre-existing licensing arrangements. The SSO may require that the patent holder agree to license on other reasonable and non-discriminatory (RAND) terms. An SSO can do these things even if there is only one technical option under consideration, because the SSO always has the option not to propose a standard at all.

Comment: These features will enable the SSO and its members to obtain meaningful information about the royalty rates to be charged by patent holders so that the SSO can make an informed evaluation in selecting a standard. In essence, this principle allows SSOs to seek the “disclosure” of royalty demands. The RAND non-discrimination requirement will serve to ensure that the standards development process is not misused as a means of favoring some industry firms over others. Absent some communication about the specific royalty rates sought by owners of patent rights, it would be difficult to make an informed evaluation of the cost and technical features of different candidates for a standard.

Principle 2. Notwithstanding the foregoing, the SSO may not require participants to engage in ex ante discussions beyond committing to license on RAND terms. The participants' decision to respond to inquiries about their licensing plans should be entirely voluntary. However, if an SSO requests that a participant engage in such discussions, and the participant refrains from doing so, the SSO may take the resulting uncertainty about future royalty rates into account in its selection of a standard but may not exclude the participant's technology from consideration if the participant gives a RAND commitment.

Comment: By making ex ante discussions voluntary, a patent holder supporting its patented technology for inclusion in a standard may not claim that it was forced by the SSO to enter negotiations. On the other hand, the SSO is entitled to consider the resulting uncertainty over the scope of the participant's licensing demands when selecting a technology for the standard. Otherwise, the SSO could be subjected to the patent hold-up problem.

Principle 3. During the development process, the SSO and its members may consult with each other and evaluate the estimated cost and technical advantages of different options, subject to three conditions:

- (a) The patent holders must be given access to the findings and the right to participate in such consultations.

(b) The SSO members' communications about cost should be limited to those cost elements that are relevant to the selection among competing technologies being considered for inclusion in a standard.³²

(c) Neither the SSO nor its members shall jointly agree on or demand a specific, maximum royalty rate to be paid to any patent holder.

Comment: This provision contemplates that some negotiation-type communications with the patent holder are permissible, provided that they are conducted in an open fashion and do not lead to specific licensing demands set collectively by the SSO members. If the disclosure of a royalty demand occurs, it may be difficult to prevent at least some signaling between the patent holder and the SSO members about an appropriate rate, and it is better to get those discussions into the open. Sunlight is a great deterrent to collusive activity. There is also no reason to condemn direct exchanges on the question of royalties, since that is a useful factor in the standards selection process. Discussions about cost should not veer off into the discussion of costs that will be incurred no matter which technology is selected. The interests of patent holders will be protected under the remaining elements of the safety zone, particularly principles (4), (5), (6), and (9) below.

Principle 4. The SSO, its members, or a patent holder, if they elect, shall have the right to commission a strictly independent expert to prepare an expeditious study of the relative incremental cost and technical advantages of different technical approaches. Any such expert report must be shared with the SSO members and the patent holder.

Comment: This procedure provides a means for bringing independent advice into the standards development process.

Principle 5. If more than one patent holder is offering its technology for inclusion in a standard, the SSO shall conduct an "auction" in which each such patent holder is provided the opportunity to publicly state its royalty demands, and to change those demands after learning of the other patent holders' royalty demands. The auction shall be conducted only at an open meeting of the SSO.

Comment: This requirement aims to ensure that competition actually occurs in the standards development process.

Principle 6. After a standard is selected, each patent holder which had offered its technology shall have the right to register a protest with the SSO on grounds that the SSO or its members pressured it or any other participating patent holder to offer a royalty rate which was below the rate that such patent holder could have obtained in an open and fair competition among different technical approaches. If no such protest is made, the SSO may proceed safely to adopt the standard and gain the benefit of the safety zone. If such an objection is made, the SSO shall have the choice of (1) canceling its proposed standard, (2) proceeding anyway (outside the protective scope of the safety zone), or (3) referring the issue to a strictly independent arbitrator for expedited consideration of whether the technology selected for inclusion in the standard is being offered at a subcompetitive rate, and if so whether there is any reasonable basis to believe that is due to illegal collusive activity. To make the arbitration option effective, SSO rules should incor-

³² For example, assume that there is a device that can be used to perform a certain function, and that it has several components that will be used no matter which of several competing technologies is selected in a new standard as an enhancement to the device. While engaging in ex ante communications and analysis, the SSO participants should avoid discussion of the costs of those components that will be used no matter which technology is selected. Rather, they should focus on the relative cost advantages of those elements of the component that could change depending on which technology is selected.

porate such an arbitration requirement, or a commitment to arbitration should be required when a protest is filed.

Comment: The courts have stressed that SSOs should conduct their activities with procedures that protect against anticompetitive conduct. This provision seeks to ensure that any objections to the way in which ex ante communications are conducted are flushed out early, and corrected if appropriate.

Principle 7. The safety zone protection will apply only to SSO adoption of standards of products or technologies that are not already in widespread use (such as de facto standards) in the industry. The safety zone would also extend to products or technologies that are government mandated but not already in widespread use.

Comment: This requirement should avoid the misuse of the SSO process as a means to collectively negotiate royalty rates on a product or technology that is already in widespread use. In such cases, there is a danger the SSO process may be used as joint buyers' cartel with no procompetitive benefits in the development of new technological standards.

Principle 8. The safety zone will apply only if none of the patent holders vying for inclusion of their technology into a standard dominates the selection process for the specific standard in question.

Comment: This rule would prevent the situation where one SSO member could bias the selection process to favor its own technology (or those of strategically allied firms) and thereby reach an outcome that does not strike the optimal balance between cost and technical quality.

To ensure that a balanced approach is taken, the safety zone might include principles that "require openness, balance, transparency, consensus, and due process" in the standards development process, as outlined in the SDOAA.³³ Such principles would provide:

- (a) notice to all parties known to be affected by the particular standards development activity;
- (b) the opportunity to participate in standards development or modification;
- (c) balancing interests so that standards development activities are not dominated by any single group of interested persons;
- (d) readily available access to essential information regarding proposed and final standards;
- (e) the requirement that substantial agreement be reached on all material points after the consideration of all views and objections; and
- (f) the right to express a position, to have it considered, and to appeal an adverse decision.³⁴

Principle 9. The SSO and its participants should not discuss or enter into any agreement that precludes any firm from entering into an individual license to use a patent holder's technology for any purpose.

Comment: This provision should eliminate the possibility of imposing a joint group boycott on the patent holder.³⁵

³³ The DOJ has indicated in various Business Review letters that "it is less inclined to challenge a proposed standard where a wide array of constituencies was involved in setting the standard." AMERICAN BAR ASSOCIATION, HANDBOOK ON THE ANTITRUST ASPECTS OF STANDARDS SETTING 51 (2004).

³⁴ SDOAA § 102(5).

³⁵ Antitrust concerns are reduced where SSO members remain free after the adoption of a standard to purchase license technology that was not included in a standard. Antitrust Guidelines § 3.34(a), *supra* note 2, at 20,861.

Principle 10. Neither the SSO nor its members shall discuss the specific prices to be charged on downstream products, or agree to boycott the use of the patent holders' technology for uses other than that embodied in an industry standard.

Comment: Any such discussions likely would be unlawful under the per se standard.

Conclusion

The time has arrived to bring greater certainty into the area of ex ante royalty communications. Unless appropriate safety zones are developed and approved, the antitrust laws may perversely become an impediment to efficiency and consumer welfare. The federal antitrust agencies, and Congress, should seriously consider adopting such safety zones in the near future. ●

Minimum-Service Requirements in Real Estate Brokerage: A Reply to Darryl W. Anderson

Maureen K. Ohlhausen

In my prior article, I described the advocacy efforts by the Federal Trade Commission and the Department of Justice in opposing minimum-service requirements for real estate brokers.¹ These requirements force consumers to choose between purchasing a larger bundle of real estate brokerage services than they would otherwise desire, or forgoing the help of a real estate agent altogether.² Anderson responded that, rather than limiting consumer choice and restricting competition, minimum-service requirements are procompetitive because “they solve the asymmetric information problem that is otherwise exacerbated by [limited-service brokers (LSBs)].”³ He posits that without such restrictions, a consumer who hires an LSB is vulnerable to harm from “lock-in.” Once a consumer has entered into an exclusive agency agreement with an LSB, she effectively is locked-into that broker to purchase all additional brokerage services that she may subsequently decide she needs. He states that, “the exclusive services agreement makes the LSB a monopoly brokerage provider to the particular customer, and she is subject to monopoly pricing if she seeks to purchase additional brokerage services after she had already entered into the limited-service agreement and signed the exclusive agency agreement.”⁴

By Anderson’s reasoning, minimum-service requirements will foster *ex ante* negotiation over the price that an LSB will charge for each of the services the law requires him to provide. In this way, *ex post* exploitation of locked-in consumers is impossible “because the price for these services is included in the initial contract,” and “a customer can shop around when he or she has the maximum amount of options to minimize the costs of the additional services if they later become required.”⁵ He also argues that LSBs’ prices will not rise in response to the requirement to provide these additional services because “an LSB can charge the same flat fee for a listing-only service and if the customer only uses the listing service, the transaction will occur just as it did before the minimum services were implemented.” Under Anderson’s interpretation of the minimum-service requirements, a customer will incur additional fees only “if he or she later elects to make use of the LSB.”⁶

Although Anderson’s critique seems plausible on its face, it does not withstand scrutiny. First, and perhaps most importantly, he misstates the requirements of the minimum-service laws.

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Maureen K. Ohlhausen

is Director, Office of
Policy Planning, Federal
Trade Commission.

These views are her own
and do not necessarily
represent the views of
the FTC or any
Commissioner.

¹ See Maureen K. Ohlhausen, *Competition Issues in Real Estate Brokerage*, ANTITRUST SOURCE, Nov. 2005, at 6–7, at <http://www.abanet.org/antitrust/source/11-05/Nov05-FullSource11=29.pdf>.

² *Id.* at 6.

³ Darryl W. Anderson, *Minimum-Service Requirements in Real Estate Brokerage: A Response to Maureen K. Ohlhausen*, ANTITRUST SOURCE, Jan. 2006, at 3, at <http://www.abanet.org/antitrust/at-source/06/01/Jan06-Anderson1=26f.pdf>.

⁴ *Id.* at 3–4.

⁵ *Id.* at 4–5.

⁶ *Id.* at 5.

Minimum-service laws mandate that brokers provide the enumerated services, not merely require that LSBs make those services available for purchase separately, if needed later. By forcing LSBs to provide a more extensive array of services than some consumers wish to purchase, these laws frustrate consumer choice and restrict competition among LSBs and full-service brokers. Moreover, there is no evidence that minimum-service restrictions are necessary to protect consumers.

Minimum-Service Laws Force Consumers to Purchase Services That They May Not Want or Need

The key problem with Anderson's analysis is that the minimum-service bills do not leave consumers or brokers the options that he thinks they do. They do not, as Anderson appears to believe, simply force real estate brokers to state upfront the price that they will charge consumers to perform each of these minimum services but let the consumer ultimately decide whether to purchase these services.⁷ Rather, these restrictions force brokers to provide, and thus consumers to purchase, the entire menu of state-determined real estate services. For example, the proposal put forward by the Texas Real Estate Commission stated that a broker "shall . . . assist the principal in developing, communicating, and presenting offers [and] counteroffers," and "answer the principal's questions relating to offers [and] counteroffers."⁸ The Alabama and Missouri legislation had nearly identical mandatory language.⁹

Thus, an LSB could not comply with these laws by disclosing his per-service fees upfront and charging a consumer only for what he or she ultimately purchases.¹⁰ Rather, these laws dictate that an LSB must provide these services to consumers, and economics dictate that he must set his price to cover the likelihood that consumers will use these required services. This is why the FTC and DOJ have argued that minimum-service laws are anticompetitive: consumers in these states are no longer able to purchase less than the required bundle of minimum services and LSBs are less of a competitive constraint on the price that full-service brokers charge because LSBs are forced to raise their prices in response to a requirement to provide more services.

There Is No Evidence That Consumers Are Harmed by Limited-Service Brokerage

Competition generally promotes consumer welfare. Regulation is appropriate, however, when market failures threaten harm to consumers. As the Supreme Court has observed, "ultimately competition will produce not only lower prices, but also better goods and services."¹¹ When a reg-

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⁷ See *id.* at 4–5.

⁸ Broker's Responsibility, 30 Tex. Reg. 1400, 1401 (proposed Mar. 11, 2005).

⁹ See Mo. H.B. 174 (the broker "shall provide, at a minimum, the following services: [a]ccepting delivery of and presenting to the client or customer offers and counteroffers . . . [a]ssisting the client or customer in developing, communicating, negotiating, and presenting offers [and] counteroffers . . . [and] answering the client's or customer's questions relating to the offers [and] counteroffers") (emphasis added); Ala. H.B. 156 (a listing broker "shall, at a minimum, accept the delivery of and present to the consumer all offers, counteroffers and addenda to assist the consumer in negotiating offers, counteroffers, and addenda, and answer the consumer's questions relating to the transaction") (emphasis added).

¹⁰ Indeed, it is unclear how minimum-service provisions will force an LSB "to disclose in advance what her or she will charge for each of the required minimum services." Anderson, *supra* note 3, at 4. Minimum-service laws do not require disclosure of discrete pricing of each of the required services, but merely require that a broker provide them as a bundle. As discussed *infra*, disclosure requirements without minimum-service requirements are a far less restrictive way at arriving at this result.

¹¹ Nat'l Soc'y of Prof'l Eng'rs v. United States, 435 U.S. 679, 695 (1978) (citation omitted).

ulation unnecessarily restricts competition, it harms consumers. Thus, a regulation can be justified only if its consumer benefits outweigh its potential harms.

Minimum-service requirements do not pass this test. In our factual inquiries with states considering minimum-service regulation, we have yet to uncover evidence suggesting that consumers have been harmed from limited-service brokerage.¹² Absent evidence that consumers are harmed from limited-service brokerage, it is hard to justify depriving consumers of the opportunity to save thousands of dollars in a real estate transaction.

One reason that we do not see the type of harm that Anderson hypothesizes is that many of the assumptions supporting the purported ability of LSBs to exploit locked-in consumers are not likely to hold in the case of limited-service brokerage. In theory, when a consumer purchases a service whose full price is known only after he has picked a seller and then faces the costs of switching sellers, a seller can “hold-up” the consumer for the amount of the switching costs. A necessary condition for sellers to be able to exploit locked-in consumers is that consumers are unable to discern the full price of the product before they agree to purchase the service. If consumers know the price of the aftermarket services, they are much less likely to be subject to hold-up. For example, consumers typically anticipate that they will be locked-into the concession price for candy and popcorn in the movie theater and take that into account when determining whether to purchase a ticket in the first place. If consumers cannot calculate the full price of a service *ex ante*, sellers can have strong reputational incentives not to exploit locked-in consumers. Once a consumer discovers that she has been taken advantage of, she is unlikely to return or to recommend the seller to friends and family. Even in cases where sellers are willing and able to exploit locked-in consumers, competition among sellers to profit from locked-in consumers will drive the up-front price down, reducing the impact of the supracompetitive price consumers pay for services after being locked-in.¹³

The actual state of the market for limited-service brokerage contradicts the assumptions upon which Anderson relies. Contrary to Anderson’s premise, it appears that the majority of LSBs are willing and able to provide the full range of real estate brokerage services and typically list the prices for various levels of service on their Web sites.¹⁴ Thus, consumers entering into MLS-only listing agreements with LSBs are likely to know the price they will be charged for purchasing additional services later. Further, it is unlikely that in a business so driven by referrals and repeat business, LSBs would risk building a reputation for exploiting their clients.¹⁵ If there is concern that consumers may not understand the steps involved in selling a home or what an LSB is going to do for them, there are better ways to address this issue than outlawing a business model for which there is substantial consumers demand. As the FTC and DOJ have advocated in each of their letters on minimum-service laws, requiring LSBs to disclose to consumers exactly what services they will provide is a far less restrictive way to address this problem than forcing consumers to purchase a bundle of services that they may not want or need.¹⁶

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¹² For example, after reviewing complaints filed with the Texas Real Estate Commission for the most recent three years, we found no complaints involving limited-service brokerage.

¹³ See Carl Shapiro, *Aftermarkets and Consumer Welfare: Making Sense of Kodak*, 63 ANTITRUST L.J. 483, 493–94 (1995).

¹⁴ See, e.g., <http://www.texasdiscountrealty.com/flatfeepplus.htm>; http://www.mycastle.com/selling/selling_plans.aspx (listing prices and services available).

¹⁵ See 2004 NATIONAL ASSOCIATION OF REALTORS PROFILE OF HOME BUYERS AND SELLERS 59 (2004) (69 percent of home sellers employed a real estate agent that either they had used before or that a friend, neighbor, or relative had referred to them).

¹⁶ Recent legislation in Ohio, Virginia, and Wisconsin has followed this disclosure and consent model.

Conclusion

Anderson's conclusions rest on assumptions that do not square with reality. Minimum-service laws require LSBs to provide certain services to consumers, not merely to stand ready to provide those services if requested. Further, there is no evidence that Anderson's theory of consumer harm is anything more than hypothetical. Restricting competition in response to hypothetical consumer harm, however, is an almost-certain recipe for actual consumer harm. ●

Book Review

Evaluating the Pro- and Anticompetitive Effects of Intellectual Property Protection

François Lévêque & Howard Shelanski, editors

Antitrust, Patents and Copyright: EU and US Perspectives

Edward Elgar Publishing, Inc. • 2005

Reviewed by Thomas F. Cotter

To the casual observer, it might appear that antitrust and intellectual property (IP) laws move in diametrically different directions, with antitrust condemning monopolistic behavior and IP law promoting it, through a system of government-granted patent and copyright “monopolies.” As I have just articulated it, however, this perception would be mistaken for several reasons. First, the tension between antitrust and IP dissipates somewhat once it is recognized that both antitrust and IP laws can be viewed as tools for promoting social welfare: in antitrust, by condemning monopolies in order to avoid short-run welfare losses (the economists’ “deadweight loss”); and in IP law, by conferring temporary monopolies so as to induce inventors and authors to invest in creating and disclosing inventions and works of authorship, and thus to bring about long-run welfare gains. From this perspective, antitrust and IP are simply different means to the same end, with antitrust taking a more process-oriented approach that concerns itself with promoting competitive markets rather than specific outcomes, and IP law taking a more result-oriented perspective that, ideally, induces just the right amount of innovation.¹

Second, IP law does not confer a general immunity from antitrust law. The U.S. Patent Act is explicit on this point,² and no serious advocate would try to convince a court, for example, that a naked agreement between two rivals to fix the prices of their competing patented or copyrighted products would amount to anything less than a per se antitrust offense. Nor is it difficult to find cases in which courts have condemned IP-related transactions and conduct as violative of Sherman Act Section 1 or 2. Viewed in this light, IP rights are just another form of property which, like real or personal property, can be used to facilitate anticompetitive ends; when IP owners exercise their rights to achieve such ends, antitrust law rightly intervenes. Third, as even the U.S. Supreme Court has come to recognize,³ IP rights do not invariably, or even typically, give rise to substantial market power, meaning the ability to raise prices and lower output for an extended period of time. This is true—even if the improbable chance that IP rights *will* enable inventors and

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Thomas F. Cotter is
Professor of Law,
Washington and Lee
University School
of Law.

¹ See David McGowan, *Regulating Competition in the Information Age: Computer Software as an Essential Facility Under the Sherman Act*, 18 HASTINGS COMM. & ENT. L.J. 771, 777 (1996).

² See 35 U.S.C. § 211 (stating that “[n]othing in this chapter shall be deemed to convey to any person immunity from civil or criminal liability, or to create any defenses to actions, under any antitrust law”).

³ Ill. Tool Works Inc. v. Independent Ink, Inc., 126 S. Ct. 1281 (2006).

authors to attain monopoly rents (what F.M. Scherer refers to as the “lottery effect”)⁴ is, in large part, what drives many potential inventors and authors. Fourth, it is a familiar principle that antitrust law does not condemn the mere possession of monopoly or market power, but rather condemns (1) concerted action that threatens to raise prices and lower output without plausible, cognizable countervailing benefits; and (2) unilateral action directed toward monopoly power’s “willful acquisition or maintenance” (terms that are, however, not always easy to define).

The antimonopoly “thrust” of the antitrust laws, therefore, while important, should not be overstated. Taken together, these four insights suggest that the tension between antitrust and IP is at least partly illusory; perhaps the circle can be squared, after all.

And yet on further reflection a certain tension between these two bodies of law appears both real and undeniable. IP rights sometimes *do* enable IP owners to exercise market power when no good substitutes exist for a product embodying an IP right. And on some occasions, either IP statutes or court decisions *do* appear to grant a degree of immunity from antitrust liability. The Patent Act, for example, explicitly permits a patent owner to license its patent using territorial restraints that might otherwise be highly suspicious under the antitrust laws.⁵ More generally, an overly aggressive antitrust policy threatens to undermine the incentive structure embedded in the IP laws by reducing the expected payoff from investing in the creation of new ideas and products. And sometimes the two bodies of law may appear to be seeking the very same short- or long-run goal but in potentially conflicting ways. In recent years, for example, antitrust enforcers have sometimes deployed antitrust as a tool for promoting so-called “innovation markets,” that is, markets for products which do not yet exist but which may exist in the future if competitive conditions align in some desired fashion. At the same time, IP law itself sometimes appears to take the position that the potential long-run gains from IP protection are outweighed by other potential short- or long-run costs, including costs resulting from an excessive reduction in competition: think, for example, of the patent and copyright misuse doctrines; or of some applications of fair use, merger, and *scènes à faire* in copyright; or of trademark law’s functionality doctrine. Negotiating the intersection between IP and antitrust therefore remains a difficult task—and one that appears to be more important now than ever, with the proliferation of IP rights giving rise to new areas for dispute and encouraging the rethinking of long-settled legal doctrines and economic models.

Antitrust, Patents and Copyright: EU and US Perspectives, edited by Professors François Lévêque of l’Ecole des Mines de Paris and Howard Shelanski of the University of California-Berkeley, includes nine stimulating papers, originally presented at a 2004 conference at l’Ecole des Mines, on the antitrust/IP intersection. The authors include some of the most highly respected lawyers and economists working in the field today. As Lévêque and Shelanski note in their introduction, the book does not purport to be a “comprehensive treatment” of the many issues relevant to antitrust and IP. Nevertheless, there are several recurring themes addressed by the individual authors, including the antitrust treatment of alleged refusals to deal, compulsory licensing, and tying/bundling. A few of the papers emphasize IP matters much more than antitrust. All of them, however, are important reading for scholars and practitioners in the field.

For purposes of this review, I will depart somewhat from the order in which the papers are presented in the book and instead group them into three categories: one dealing with general mat-

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⁴ See F.M. Scherer, *The Innovation Lottery*, in EXPANDING THE BOUNDARIES OF INTELLECTUAL PROPERTY: INNOVATION POLICY FOR THE KNOWLEDGE SOCIETY 3, 19–21 (Rochelle Cooper Dreyfuss et al. eds., 2001).

⁵ See 35 U.S.C. § 261.

ters of antitrust/IP policy; a second addressing matters relating mostly to IP; and a third dealing with specific antitrust/IP issues, including the aforementioned refusals to deal, compulsory licenses, and tying/bundling.

In what I refer to as the first group I include an essay by FTC Commissioner and former George Washington University Law School Professor William Kovacic, titled *Competition Policy and Intellectual Property: Redefining the Role of Competition Agencies*, and a paper by UCLA School of Law Professor Neil Netanel, titled *Copyright and 'Market Power' in the Marketplace of Ideas*. There is much to admire in both papers. Both Kovacic and Netanel stress the need for IP policy makers to be sensitive to the effects of IP rules on competition, albeit in quite different ways. Kovacic begins by noting that IP rights that are too broad or too long, or that are improvidently granted, can have the effect of retarding innovation and unduly impeding competition. A patent office that routinely grants patents on trivial improvements over the state of the art, for example, may well do more harm, in terms of gumming up the workings of the free market, than many more conventional, but insubstantial, antitrust violations. To this point, however, Kovacic appends an interesting warning: that unless IP policymakers begin to address these problems effectively, antitrust authorities may be tempted to enter the fray, with less than ideal consequences for all involved. As Kovacic sees it, the use of antitrust to correct for IP's shortcomings may be a decidedly second-best solution, to the extent that antitrust is not easily adaptable to the task of determining the correct balance of innovation and competition. More generally, both IP and antitrust enforcers would be wise to heed Kovacic's call for a more interdisciplinary, empirically grounded approach to the problems of innovation and competition policy—one that is, in his words, less "case-centric" and focuses more on addressing perceived problems at their root.

On the other hand, Netanel makes (what appears to me to be) the equally valid point that, at least with regard to copyright policy, an undue focus on the ideals of competition in the conventional economic sense may be unwarranted. For purposes of antitrust analysis, the use of economic tools to define markets in light of substitution and price criteria, and to focus exclusively upon whether challenged conduct is likely to result in actors being able to exercise power within such markets in ways that lead to demonstrable losses of social welfare, makes a good deal of sense. But copyright policy is a tool not only for promoting economic welfare in this relatively narrow sense but also, arguably, for promoting other social goods, including the encouragement of speech diversity and speaker autonomy. Thus, even when there are adequate market substitutes for my speech, I have an interest in speaking and others (may) have an interest in hearing what I have to say. Policy makers should be careful not to make unthinking analogies to market competition in ways that undermine these socially desirable, but noneconomic, considerations.

A second group of papers, including one by Richard Watt, a Professor of Economics at the Universidad Autonoma de Madrid, titled *Adverse Selection and the Legal Protection of Intellectual Property Rights*, and another by the University of Amsterdam's P. Bernt Hugenholtz titled *Abuse of Database Right: Sole-Source Information Banks Under the EU Database Directive*, deal more fully with IP than with antitrust issues. Watt, the author of a respected book on the economics of copyright,⁶ presents a theoretical model under which IP owners can contract for greater or lesser protection against the unauthorized use of their creations, in much the same way that persons seeking insurance can contract for greater or lesser protection against adverse events. He derives a counterintuitive result under which the authors and inventors of less socially valuable works have

⁶ RICHARD WATT, *COPYRIGHT AND ECONOMIC THEORY: FRIENDS OR FOES?* (2000).

an incentive to contract for greater protection (for which they pay a higher fee) than do the authors and inventors of more valuable works; the latter pay a lower (sometimes negative!) premium, in return for partial protection which nevertheless provides them with a positive expected payoff that is greater than if they contracted for the more extensive, but more costly, protection chosen by the authors and inventors of less valuable works. Although I find myself skeptical at present whether Watt's model will yield any practical policy recommendations that would have wide appeal in the near future, his work is an important contribution to the growing literature debating whether there should be different levels of protection for different types of creations—for example, whether patent law should provide inventors the option of paying for a more intensive examination up front, in return for more substantial benefits *ex post*⁷ (a proposal that appears to move in the opposite direction from Watt's conclusion, though the two models are not directly comparable).

The P. Bernt Hugenholtz paper, by contrast, focuses on developing legal doctrine within the EU relating to *sui generis* exclusive rights, mandated within the EU since the adoption of the Database Directive in 1996, in noncopyrightable databases. Hugenholtz provides a thoughtful commentary on recent EU case law which, he argues, correctly adopts a (narrow) interpretation of the right that should reduce some of the risk that database owners will create socially wasteful bottlenecks over information for the production of which adequate incentives already exist. With respect to the database right, at least, European courts arguably are heeding Kovacic's advice to construe a (new) form of IP right in such a way as to minimize the need for antitrust to (over)correct. When courts or other IP policy makers fail to act prudently, on the other hand, the temptation to grasp for second-best solutions may create further difficulties, as illustrated by some of the cases discussed in the third group of papers.

This third group includes essays on refusals to deal, essential facilities, and compulsory licensing, by Professors Herbert Hovenkamp, Mark Janis, and Mark Lemley (*Unilateral Refusals to License in the US*), authors of a two-volume treatise on antitrust and IP under U.S. law; and by John Temple Lang, a distinguished practitioner affiliated with the Cleary, Gottlieb firm's Brussels office, titled *The Application of the Essential Facility Doctrine to Intellectual Property Rights Under European Competition Law*. It also includes three papers dealing principally with tying, bundling, and other potentially exclusionary practices, by Daniel Rubinfeld and Robert Maness (*The Strategic Use of Patents: Implications for Antitrust*); by coeditor Lévêque (*Innovation, Leveraging, and Essential Facilities: Interoperability Licensing in the EU Microsoft Case*); and by the University of Chicago's Randal Picker (*Copyright and the DMCA: Market Locks and Technological Contracts*).

The Hovenkamp et al. paper presents the considered view that unilateral refusals to license IP should rarely be grounds for antitrust liability, both because unilateral refusals to deal concerning *any* kind of property should only rarely give rise to antitrust claims, and because of the further potential for requiring forced sharing of IP to undermine investment incentives. The authors nevertheless recognize that there may be uncommon cases in which this principle might give way—for example, when the IP owner attempts to use its IP to acquire rights outside the scope of the IP grant. To illustrate, the authors argue that in the *Microsoft* case⁸ the D.C. Circuit was probably right to reject Microsoft's assertion that its copyright in its OS software entitled it to prevent OEMs from altering some features from the standard Windows desktop configuration; as a matter of copyright law, Microsoft's copyright entitled it to no such thing. More generally, where a

⁷ See Mark A. Lemley et al., *What to Do About Bad Patents?*, REGULATION, Winter 2006-06, at 10–13.

⁸ *United States v. Microsoft Corp.*, 253 F.3d 34, 62–63 (D.C. Cir. 2001).

purported assertion of IP rights bears no reasonable relation to the scope of those rights—is, in effect, a pretext—courts should not hesitate to condemn the use as an antitrust violation if the facts so warrant. Of course, in a sense this rule begs the question of what the scope of one’s IP rights are, in the first place. The answer to that question is sometimes clear as a matter of statutory text or precedent but, when it is not, courts inevitably must fall back on policy—presumably including competition and innovation policy—to determine scope. There is, in other words, some potential for circularity here, though one must hope nevertheless that courts and other IP policy makers will attempt to define IP rights so as to reach sensible accommodations and thus defuse the potential for conflict.

Temple Lang’s paper, by contrast, highlights some of the problems that can arise when IP policy makers drop the ball. As Temple Lang demonstrates, European courts—partly in response to interpretations of European copyright laws that have permitted the assertion of copyright rights in what appear to be very minimally creative works—have been struggling to give consistent and meaningful content to the still-evolving essential facilities and “abuse of dominant position” doctrines, and to define the conditions under which compulsory licensing of IP is an appropriate remedy for an “abuse.” Although I am not as conversant as Temple Lang with the intricacies of European competition law, his reconciliation of the competing strands within the case law strikes me as plausible, and it should engender serious consideration by the competent authorities within the EU. Perhaps more importantly, however, the difficulties prompted by these cases provide a cautionary note: as Kovacic might have predicted, overly broad interpretations of copyright have given rise to countervailing pressures on the part of antitrust enforcers to rein in rights that perhaps should never have been recognized in the first place.

The remaining papers all show how IP rights can be used for predatory, innovation-inhibiting purposes but also how difficult it can often be to distinguish those instances from instances that are likely to be benign or even procompetitive. For example, as Rubinfeld and Maness discuss, an IP owner who bundles many patents, including some of questionable validity, within a portfolio and offers that portfolio on a take-it-or-leave-it basis may succeed in raising its rivals’ costs and thereby extend or maintain an anticompetitive advantage. Similarly, Lévêque discusses how Microsoft’s tying practices could have resulted in anticompetitive leveraging under a variety of post-Chicago theories, and he recognizes how in theory IP rights may stifle innovation. At the same time, however, he realizes that the result to be reached in real-world cases may depend crucially on which party bears the burden of proof regarding harm (or the lack thereof) to consumers or to innovation. Both Rubinfeld and Maness, on the one hand, and Lévêque, on the other, rightly look to patent reform as in many ways a superior solution to the potential anticompetitive consequences of IP rights.

Finally, Picker presents an interesting overview of, among other things, some recent U.S. case law interpreting the applicability of the Digital Millennium Copyright Act (DMCA). Picker explains how owners of copyrighted software in these cases unsuccessfully sought to use the DMCA to tie complementary fore- and aftermarket products in ways that may have facilitated efficient price discrimination. Reflecting more of a Chicago (as opposed to post-Chicago) bent, perhaps, Picker is largely sympathetic to such efforts at “technological tying,” but he recognizes that the text of the DMCA itself is not easy to reconcile with the copyright owners’ efforts in these cases. By contrast, Picker is largely in accord with the courts’ use of copyright doctrine to prevent copyright owners from asserting copyright in user interfaces, parts numbers, and the like, so as to deter entry by firms that intend to market competing, as opposed to complementary, products. Picker rightly criticizes the courts in some of these cases, however, despite their having reached the correct

If there is a common thread that pervades many of the preceding papers, it is that policy makers should devote more resources to setting IP's house in order, so as to avoid anticompetitive bottlenecks, rather than expecting antitrust to correct for IP's mistakes.

results, for having failed to make explicit that in such instances copyright necessarily has taken on an important role in competition policy.

If there is a common thread that pervades many of the preceding papers, it is that policy makers should devote more resources to setting IP's house in order, so as to avoid anticompetitive bottlenecks, rather than expecting antitrust to correct for IP's mistakes. To the extent that IP rights at present are too strong, too long, or too easily granted, it is clearly better for IP policy makers to make appropriate corrections ex ante—or, where necessary, for IP courts to interpret IP rules with some sense of the potential for these rules to have anticompetitive consequences—than for antitrust enforcers to apply the relatively awkward tools of competition policy ex post. To be sure, antitrust can be an important part of innovation policy. By comparison with IP, however, it can be slow, inflexible, and (what with treble damages, the possibility of indirect purchaser suits under state law or EC law, and the like) potentially susceptible to serious overdeterrence problems when applied outside the context of conventional price-fixing schemes.

Concerns about the potential for false positives have correctly led antitrust courts in the U.S. in recent years to move away from rigid, formalistic, per se rules, in favor of more nuanced approaches. Such concerns similarly should counsel in favor of caution in applying antitrust doctrine in response to overly broad IP rights. For this division of labor to succeed, however, IP law itself needs to avoid its own potential for excess. As many of the contributors to this splendid volume attest, there will be less need to worry about the potential anticompetitive effects of IP rights when IP policymakers act responsibly in the first instance. Or, as our friends in the EU might put it, sometimes a milliliter of prevention is worth a kilogram of cure. ●

Paper Trail: Working Papers and Recent Scholarship

Editor's Note: In this issue, we review testimony on the state of merger enforcement presented to the Antitrust Modernization Commission. Our conclusion: consensus, not controversy, prevailed. For details—and commentary on the discussion—read on.

Send suggestions for papers to review to Bill Page (page@law.ufl.edu) or John Woodbury (jwoodbury@crai.com).

—WILLIAM H. PAGE AND JOHN R. WOODBURY

AMC Hearings Summary

On November 17, 2005, and on January 19, 2006, the Antitrust Modernization Commission held hearings on the state of merger enforcement. In November, the AMC heard from a panel of distinguished antitrust experts—William Baer (former Director of the FTC's Bureau of Competition and now partner and Chair of the Antitrust Practice at Arnold & Porter), James Rill (former Assistant Attorney General for Antitrust and now a partner at Howry), David Scheffman (former Director of the FTC's Bureau of Economics and now a Director at LECG), and Robert Willig (former Deputy Assistant Attorney General in the Antitrust Division and now at Princeton). The January hearing offered a distinguished academic economist roundtable—Timothy Bresnahan and Peter Reiss from Stanford, Steven Kaplan from the University of Chicago, Daniel Rubinfeld from Berkeley, and Larry White from New York University. In this issue, the *Paper Trail* reviews the substance of these hearings, and what, if anything, it portends for the future of merger enforcement.

All but one of these witnesses provided papers to the AMC, which are available on the AMC site via the links listed below.¹ Those links also provide the transcripts of the hearings themselves. This *Paper Trail* will summarize many of the views offered to the AMC on a variety of topics, drawing both from the prepared statements and the discussion before the AMC.² Interested readers who want to run through the full gamut of the issues raised should follow the links.

Spoiler alert: At the outset, you should be forewarned that if you're looking for controversy, for some serious policy head-butting, for an adrenaline-raising debate—you will not find that here. The strongly-held consensus of these distinguished witnesses is that antitrust merger enforcement is pretty much just right. Some may find that conclusion disquieting.

Market Definition

AMC Commissioner Dennis Carlton framed many of the important questions while moderating the roundtable, and this review lifts liberally from his organization. One key focus of the hearings was

¹ For the November hearing, see http://www.amc.gov/commission_hearings/merger_enforcement.htm. For the January hearing, see http://www.amc.gov/commission_hearings/economists_roundtable.htm.

² It should be noted that this summary will not include the efficiencies presentations that were also made during the November AMC hearings. Thus, here, the focus is largely on issues related to anticompetitive risk. In addition, one of the roundtable participants, Steven Kaplan (University of Chicago) summarized a collection of finance and finance/industrial organization studies reviewing merger performance. This summary of the hearings cannot do justice to Kaplan's presentation, given the level of detail provided. Interested practitioners should review his statement on the AMC Web site.

market definition: can we do it and do we need it? Carlton observed in what must have been an intentionally provocative way that while he thought the DOJ and FTC Merger Guidelines (Guidelines) asked the right questions about market definition, the information required to answer those questions may be impractically large—the estimation of a complete demand system to determine which products are in the market and which are out, and the profit functions of the firms in the market, among other data, to gauge reaction to a SSNIP (a small but significant and non-transitory increase in price). In practice, he asserted, practitioners just end up asking customers what they would do if prices rose by a 5 percent SSNIP.

Rill noted that this is not the way it is done today—rather, the agencies and the parties rely on natural experiments, strategic planning documents, and meeting-competition documents (among other evidentiary sources) to factually anchor the market definition analysis. Rubinfeld noted that, in fact, there are sources of insight into the nature of demand that do not require such an elaborate empirical and analytic framework. He highlighted marketing documents, sales reports, and properly conducted surveys of consumers' price reactions as a means of providing a reasonable empirical basis for the market definition exercise. And as firms become more quantitative with the growth in computing power, internal documents will increasingly provide practitioners with a sounder factual basis for market definition. Scheffman noted that while it has come under some critical assault recently, the use of critical loss analysis can provide significant insights into antitrust market boundaries.

Is the Market Definition Exercise Obsolete?

In a world in which we have simulation tools to evaluate the effects of mergers in product-differentiated industries and where “natural” experiments can provide direct evidence of harm, has market definition become obsolete? With respect to simulations, Bresnahan opined that although we have become very good at analyzing unilateral effects matters, the market definition exercise is useful because it focuses the analysis on the identification of competitive constraints and because the courts do not seem receptive to more quantitative approaches. Both White and Rubinfeld agreed that in unilateral effects cases, market definition does not matter. However, Willig and Rubinfeld did argue that the market definition exercise was nonetheless useful because it assists in identifying those products that should be in the analysis. Willig notes that “the requirement of market definition creates the imperative for consideration of sources of competition beyond the parties' own products along with the need to generate some calibration of the strength of that additional competition.”

Rill was quite clear that he did not believe that simulations were ready for prime time. He cited a “lack of sufficient confidence in the methodology or reliability of the underlying data which calls for caution” in using simulations. He did suggest that simulations can be a useful supplement to test conclusions based on other evidence. Bresnahan, White, and Rubinfeld were distinctly more supportive of simulations. Rubinfeld noted that while simulations should not be the sole basis for an enforcement decision, it can provide key insights into the magnitude of any price increase, the effect of efficiencies and divestitures on mitigating any price increase, and the price effects of repositioning.

Scheffman, on the other hand, seemed a bit more pessimistic. In his view, the actual reality of competition is different from the assumed reality of the economists' models. We are “applying models that are modestly updated versions of economic models more than 100 years old.” Scheffman laments the failure of economists to develop new theories that fit the facts and better reflect the full complexity of competition. As one example, he notes that most of the simulation

models assume that a firm charges a single price—an assumption that in most cases is far removed from reality.

There did seem to be a general consensus that a convincing direct effects analysis would not require a market definition exercise (although it could be used to infer how the market should be defined). The most cited example of a persuasive direct-effects analysis was the econometric evidence in the *Staples* matter, strongly indicating the prices increased as the number of office superstores fell from 3 to 2 to 1. (Reiss did not seem to regard this as a complete analysis, and therefore was potentially misleading, because the approach simply left out any formal entry considerations.)

Market Definition and Monopolization

Carlton also wondered about the extent to which the Guidelines market definition paradigm could be used in non-merger monopolization cases. Carlton, Willig, and White seemed to agree that if the “bad act” that gave rise to the monopolization charge had not yet been implemented, then the paradigm would be appropriate. (But it’s not obvious to me that that works, if the purpose of the bad act were to protect existing market power.) Bresnahan raised the interesting possibility that to avoid the *Cellophane* fallacy in monopolization cases, ask a different hypothetical: If monopolization is the allegation, what would the market look like if there were two firms instead of one?

Customer Testimony

Against the backdrop of *Arch Coal* and *Oracle*, the question naturally arose of the extent to which the agencies (and parties) can rely on customer complaints as a guide to both market definition and competitive effects. Rill noted that these cases may force the agencies to be more probing when assessing customer reaction, but that informed customer testimony will continue to play an important role in merger enforcement. Baer seemed to agree, opining that the agencies and practitioners need to improve their ability to extract credible evidence from customers, but the agencies will also have to weigh other relevant evidence in their decision.

Scheffman noted these recent court decisions highlight the fact that customer complaints “are not the answer to a fact finder making a decision,” that those complaints were not a substitute for a careful market delineation and analysis of competitive effects. Nonetheless, he argues that credible customer testimony should be accorded substantial weight in the enforcement decision process. He noted that customer testimony on market definition and competitive effects is likely to be both more reliable and credible in industries where there are large sophisticated buyers.

Willig seemed to be the least concerned of the witnesses. He views the current development of customer testimony at the agencies as in fact up to the task. Agencies, he opined, know how to distinguish between what amounts to industry gossip and genuinely useful insights. Willig believes that the enforcement problems arise when the agency staff is looking forward to possible litigation. He seems to suggest that being in litigation mode might make staffers less judicious about eliciting credible customer testimony.

Does Concentration Matter?

Not surprisingly, the Commissioners wondered whether the agencies’ existing reliance on concentration was appropriate. White noted that it should continue to play an important role. Notwithstanding the withering criticism of the broad cross-sectional structure-performance studies of the 1960s and 1970s, White followed the “where there’s smoke, there’s fire” paradigm, pointing out that those studies consistently demonstrated that concentration had statistically important impacts on

profits and prices. But he also observed that more recent industry-specific studies, as well as studies of auction outcomes, provide substantial support for continued reliance on concentration as an important datum in the merger investigation, a view also shared by Bresnahan.

Willig and Rubinfeld seemed to agree that concentration remains a significant consideration, but is obviously not the end of the analysis. Rubinfeld further noted that, while current market shares in dynamic industries may not be a particularly useful indicator of future competitive significance, a merger in a dynamic industry should not get the enforcement equivalent of a “free pass.” “It is appropriate to ask whether the merger will cause the new entity to have durable, lasting market power that could lead to sustainable high prices.” The agencies might be particularly concerned if, e.g., the acquired firm were poised to challenge a dominant firm or whether the merger would make exclusionary practices more profitable and hence more likely. Rubinfeld also suggests that in the case of markets characterized by substantial network effects, the market players may well be competing for the market. The inference here is that even if a merger immediately benefits consumers by providing increased network effects, consumers may experience a substantial net loss, as a reduction in competition for the market slows the pace of innovation.

In his prepared remarks, Baer provided interesting statistics on investigation outcomes indicating the extent to which (rightly or wrongly) the FTC relies on concentration for its enforcement decisions relative to other factors. Based on 1996–2003 FTC data, only 57 percent of mergers receiving a Second Request and with HHIs between 2400–2999 and a delta between 200–299 were challenged. The FTC brought enforcement actions in 89 of 109 concentrated markets where it found entry to be “difficult.” The FTC did not challenge any of the 19 mergers in concentrated industries where entry was found to be “easy.” In the 51 matters where it received “strong” customer complaints, the FTC challenged 50 of those mergers. The FTC challenged 18 of 20 mergers for which the Commission had “hot docs” describing significant anticompetitive effects. Baer concluded that in merger investigations, “HHI numbers alone are not dispositive; enforcement decisions appropriately weigh other factors.”

Coordinated Effects

Carlton began by asking a question only an economist could love. For both unilateral effects and coordinated effects mergers, we can use game theoretic models to test the price-prediction concern. In both kinds of matters, we are interested in how firms interact and how that interaction is affected by the merger. If the analytic (i.e., game theoretic) approach to evaluating both effects is the same, is there really any distinction between unilateral and coordinated effects analysis?

White opined that the distinction between unilateral and coordinated effects remains useful because in the case of unilateral effects, the Guidelines are not necessary—they are far more important for coordinated effects, in describing the issues that one has to evaluate to determine the price effects of a merger. Rubinfeld appeared to agree with White, noting that in analytic terms, we think differently about coordinated effects and unilateral effects concerns. Bresnahan agreed with Carlton that the key distinction between the two concerns was evidentiary, not analytical. He noted that there is considerable data to implement the unilateral effects models, but little in the way of data to answer the key coordinated effects question—will cartel formation and/or mainte-

³ In fact, there has been conceptual and empirical work on identifying just such analyses. See the discussion in the July *Source, Paper Trail*, <http://www.abanet.org/antitrust/source/07-05/Jul05-PaperTrail7=28f.pdf>.

nance be easier with one less firm?³

Beyond the concentration and market definition discussions, there was surprisingly little discussion of the way in which the agencies actually conduct coordinated effects analyses. While some may view as unprincipled the “checklist” approach of the Guidelines to coordinated effects, Rill noted in his prepared remarks that the list is just the starting point and in practice is tailored to fit the market under scrutiny—the weighting of the list components will vary with the kind of market analyzed.

Entry

The focus of Reiss’s prepared statement was the treatment of entry in the Guidelines. Reiss observed that the concepts of sunk costs, uncommitted entrants (i.e., those firms that could begin production of a good without incurring any significant sunk costs), and committed entrants reflect modern game theoretic concepts. But the Guidelines provide little guidance how in practice these concepts should be quantitatively implemented and weighed in the merger analysis.

Reiss was optimistic about our ability to measure sunk costs using modern quantitative methods, although those techniques would seem to be very data intensive. He also highlighted recent research into the option value of entry as a sunk cost—once entry occurs, the entrant loses the ability to defer the entry decision until more information becomes available.⁴ The greater the uncertainty about the way the future unfolds, the higher the value to deferring entry to obtain additional information. This sunk cost—this opportunity cost of entry—could be very substantial in industries marked by substantial technological, demand, or cost uncertainty and, as with “ordinary” sunk costs, can delay or deter entry. While economists are developing dynamic models that account for the effect of sunk costs on the entry decision and that allow for sophisticated strategic behavior on the part of incumbents, Reiss believes that these models are currently too complicated to implement for merger analysis.

A key question for entry analysis is how to assign shares to uncommitted entrants, and Reiss notes that there is little in the Guidelines that assists the practitioner in making this assignment. A complete analysis of committed entry would require data on the output reduction due to a merger-induced price increase; the entrant’s fixed, sunk, and variable costs; an estimate of minimum viable scale; and each entrant’s supply response. The data demands of a complete analysis seem so substantial that it is unlikely that the agencies would undertake such an analysis. Instead, he concludes that the agencies and courts will “base their decisions only on documents and factual testimony. While this is not necessarily bad, there is no guarantee that this process will match” the Guidelines logic.

In response to questions from Carlton, Reiss seemed a bit more upbeat about entry. He noted that we can learn a lot about entry from the study of specific industries, citing in particular the studies of generic drug production when the branded drug loses its patent protection. But he also noted that we are a long way from being able to generalize about the empirical importance of entry factors (e.g., cost structures and distribution systems). However, Willig discouragingly noted that as he sees it, in the absence of a history of actual entry, entry arguments are much more discounted by the agencies than should be the case.

⁴ A more extended discussion of this concept can be found in a *Paper Trail* summary of the key paper by Robert Pindyck, <http://www.abanet.org/antitrust/source/07-05/Jul05-PaperTrail7=28f.pdf>.

In Sum, the State of the Guidelines and Merger Enforcement

Expressing a view that seemed to be shared by all of the witnesses, Willig opined that merger enforcement “has evolved into an intelligent design.” That is, Willig opined that the Guidelines have proven to be both adaptive and reflective of modern antitrust thinking. Similarly, Rill noted that the Guidelines as written are clear and flexible enough to accommodate new thinking. Baer noted that with the Guidelines has come greater predictability in the application of the Guidelines. Specifically, he reports that Second Requests during the Clinton Administration accounted for about 4.7 percent of all eligible transactions; during the first two years of the Bush Administration, the corresponding figure was 4 percent. By contrast, the number of Second Requests dropped by over 50 percent (from 10.3 to 3.9 percent) in 1981, when the Democrats lost the White House.

Only White suggested some rewriting of the Guidelines to provide more clarity with respect to the application of unilateral effects analysis. White also thought the use of more post-mortems of the close-calls would allow the agencies to determine whether the HHI thresholds in the Guidelines remained appropriate, as well as serving as a check on whether enforcement was too lax or too aggressive. Along these lines, Willig suggested that requiring some limited *ex post* data from the merging firms would facilitate these kinds of merger follow-ups. Rubinfeld believed that providing the agencies with limited authority to subpoena data for merger follow-ups would be worth the candle.

Willig, Scheffman, and Baer urged more transparency between the agencies and the public in the merger process, through, e.g., explanations of decisions such as that which was provided when the FTC declined to challenge the Cruise Line mergers. Willig also argued for greater openness within the agencies. He noted that in many cases, the agencies acquire data that the merging parties cannot acquire and that data can serve as the basis for an agency decision. Willig suggested that the agency lawyers should be able to find a way for disinterested third parties to review these data while maintaining the confidentiality of the data.

Rubinfeld and Reiss recommended that in complex economic matters, the use of an economist as a court-appointed Special Master could assist the court in distinguishing between the wheat and the chaff of the economic arguments. A number of panel members, however, were clearly uncomfortable with this recommendation, expressing concern that the Special Master would effectively become the judge.

Final Take

It is disappointing that there was virtually no discussion of vertical mergers and the Guidelines. The SBC/AT&T and Verizon/MCI mergers were cited by some witnesses for the Antitrust’s Division reliance on efficiencies in clearing these deals (a reliance that some might think odd because of a view that SBC and Verizon have a track record of over-claiming efficiencies). None of the witnesses even mentioned the vertical aspects of those deals (i.e., local exchange access is an input into the provision of long-distance service). Another key issue for modern merger enforcement is the application of the Guidelines to deals in industries characterized by significant network effects. Only Rubinfeld addressed these effects, and then only in passing.

Speaking of efficiencies (notwithstanding my note 2 disclaimer that I would not speak of efficiencies), here too, there was very little discussion of their role in merger analysis, which was particularly surprising for the open-ended roundtable. Willig opined that discounting efficiency claims was appropriate given their speculative nature, provoking Scheffman to respond that the process of gauging anticompetitive effects was no less speculative (which I don’t actually think is the case—we likely feel more empirically comfortable inferring from the general to the specific in com-

petitive effects analysis, given the theoretical and empirical foundations for that analysis).

But what some might find most troubling are Reiss's views on the state of entry analysis, given its importance in the Guidelines and in merger analysis in practice. One can hope that the agencies and academics will devote more time to identifying the important conceptual and empirical indicators of likely successful entry. ●

—JRW