

Interview with Sharis A. Pozen, Acting Assistant Attorney General, Antitrust Division, U.S. Department of Justice

Editor's Note: Sharis Arnold Pozen was appointed Acting Assistant Attorney General of the Antitrust Division on August 4, 2011, on the eve of Christine Varney's resignation from that post. Ms. Pozen will step down on April 30. This marks a transitional period for the Division as it awaits the confirmation of President Obama's nominee to lead the Division, William J. Baer. In the interim, Joseph Wayland, Deputy Assistant Attorney General, will be Ms. Pozen's successor.

In this interview with The Antitrust Source, Ms. Pozen discusses recent changes at the Division, coordination with the Federal Trade Commission, the 2010 Horizontal Merger Guidelines, budgetary concerns, high-tech markets, MFN provisions, remedies, and recent litigation, including the H&R Block and AT&T-Mobile cases.

Before joining the Antitrust Division as the Chief of Staff and Counsel in February 2009, Ms. Pozen was the Practice Group Director and a partner in Hogan & Hartson's (now Hogan Lovells) Antitrust, Competition and Consumer Protection Group, where she had worked since 1995. Before joining Hogan & Hartson, Ms. Pozen spent five years at the Federal Trade Commission as an Attorney Advisor, the Assistant to the Director of the Bureau of Competition, and a staff attorney.

Editor Hugh Hollman conducted this interview for The Antitrust Source on March 21, 2012.

ANTITRUST SOURCE: Let's start with a question about what your priorities have been since assuming the role of Acting AAG in August 2011.



SHARIS POZEN: As set out in Attorney General Holder's statement announcing my appointment as Acting Assistant Attorney General, there was an expectation that I would provide a seamless transition from former AAG Christine Varney. The core of that transition is continuing to robustly and vigorously enforce the antitrust laws. That is my number one priority for both the criminal and civil programs. Substantively, we have focused on what I call the "pocketbook" issues that affect consumers directly, including significant actions in the financial services, technology and telecommunications, health care, and agriculture industries. An additional priority has been our criminal program's auto parts matter. We have taken several actions in this industry, including significant fines and a number of plea agreements with both corporations and individuals.

ANTITRUST SOURCE: Would you tell us how responsibilities at the Division have been reshuffled since you joined the Division and what the Division hopes to accomplish with its new allocation of responsibilities?

POZEN: I arrived at the Division in February 2009, and Christine Varney was confirmed in April 2009. We started looking closely at the Division and determining what if anything could enhance the work here and help make it more efficient and effective. And, as I said at the 2011 ABA Fall Forum, we did make some changes. In particular, we focused on the Office of Operations, which is the heart of the Antitrust Division. We have four great leaders there: our Director of Civil Enforcement, Patty Brink, our Director of Criminal Enforcement, John Terzaken, our Director of Economics, Bob Majure, and our latest addition, Director of Litigation Mark Ryan. Adding a

Litigation Director covering both civil and criminal litigation was a significant change. Mark is a terrific resource for our litigators and will help ensure our litigation capabilities are “institutionalized” across the Division. The enhanced Office of Operations helps the Division work efficiently and effectively, which is increasingly important in an environment of shrinking budgets and resources.

Another significant addition is the Office of General Counsel that Bob Kramer leads. Bob is a Division veteran and previously served as the Director of Operations. He agreed to become the General Counsel and now heads a multifaceted General Counsel’s Office. The idea was to have one repository within the Division for issues that had wide-ranging impact, particularly those kinds of legal issues that affect both our criminal and civil program. He works across all parts of the Division and liaises with the Federal Trade Commission’s General Counsel’s Office. He also has two Assistant General Counsel, one for criminal issues and one for civil issues.

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The General Counsel’s Office also manages consent order compliance. Traditionally, that responsibility had been handled by the lawyers in the section that brought the enforcement matter. We moved the coordination of that effort to the General Counsel’s Office so that we could more systematically track compliance with all Division decrees. Bob has been serving as General Counsel for almost two years now.

Another change was hiring an experienced litigator as Deputy Assistant Attorney General for litigation. Our first was Bill Cavanaugh, and now Joe Wayland is our DAAG for litigation. Both are members of the American College of Trial Lawyers. It’s unusual, not just in the Antitrust Division but in the Department of Justice in general, to have a DAAG who actually litigates and is the lead attorney on a trial team. Joe was our lead attorney on *H&R Block* and on *AT&T*.¹ To have that caliber of trial lawyer working with our staff, many of whom are experienced litigators themselves, is important to our successes.

ANTITRUST SOURCE: We’d like to turn now to the 2010 Horizontal Merger Guidelines. You commented in a speech at last year’s ABA Antitrust Fall Forum that the Guidelines are a “building block to create ever more clarity and certainty for businesses.” Now that the final Guidelines have been around for more than a year, how do you think they have been received?

POZEN: Let me start with some background. We first set out to determine whether the Guidelines, which hadn’t been updated for seventeen years, needed to be revised. We went through a process soliciting views from a wide variety of sources, and it was unanimous we should update them. We worked collaboratively and effectively with the FTC to do that. The revised Guidelines describe what we were already doing at each agency—assessing competitive effects by looking closely at the facts of each transaction and using a number of different economic tools to evaluate those likely effects. We also adjusted the description of HHI thresholds based on our actual practice.

The revised Guidelines have been very well received. One marker is the *H&R Block* decision. Judge Howell wrote an eighty-plus page decision citing extensively to the revised Horizontal Merger Guidelines. In terms of private practitioners, those in the circle of antitrust lawyers who appear regularly before the agencies already know how we conduct our analyses and the range of economic tools we use to analyze competitive effects. But my sense is that the increased transparency in the revised Guidelines has assisted businesses and lawyers who aren’t before us reg-

¹ United States v. H&R Block, Inc., Civ. Action No. 11-00948 (BAH), 2011 U.S. Dist. LEXIS 130219 (D.D.C. Nov. 10, 2011); Complaint, United States v. AT&T Inc., Case: 1:11-cv-01560 (D.D.C. Aug. 31, 2011), available at <http://www.justice.gov/atr/cases/f274600/274613.htm>.

ularly. The revised Guidelines are also important on the international front. They are a ready and accessible guide for emerging authorities as to how merger analysis is conducted in the United States. Although there were some concerns expressed regarding unilateral effects and product market definition when we first issued the revised Guidelines, they've been put to rest by our applications of the Guidelines and, more importantly, by court treatment and acceptance of them.

ANTITRUST SOURCE: One of the main features of the 2010 Guidelines is the statement that merger analysis "need not start with market definition." But the Division in every one of its complaints since the release of the 2010 Guidelines has stuck to a traditional market definition analysis. As you said, the court in the *H&R Block* case also extensively quoted the 2010 Guidelines and performed a traditional market analysis. When do you expect the Division or courts will move away from a traditional market analysis?

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POZEN: Carl Shapiro talked about this at the Fall Forum in 2010, and he hit the nail on the head on that question. The idea behind the revisions was providing increased transparency into how we conduct merger analyses and how we go about determining whether a merger violates Section 7 of the Clayton Act. When we go forward and plead a case in court, the Division will continue to plead a product market. That is what courts expect to see, and that's what our complaints include. How we plead a case in court in a complaint so that judges and defendants can understand and apply the law is one thing. How we conduct our analyses internally and evaluate competitive effects is another.

ANTITRUST SOURCE: You also noted in your 2011 Antitrust Fall Forum speech that the Guidelines reflect what has been Division practice for years. Do you see any areas in need of improvement?

POZEN: One can always improve—for example, if we can get better data, if we can get better computers to analyze the data. And new analytical tools may come to light that we need to describe or test. So while we can always improve in our specific application of those principles to any particular matter or add a description of any new tools or analysis we're employing in our review, the Guidelines themselves are solid. One final bit of background on the Guidelines is that we put them out in draft and solicited comments on them. The final version reflects a lot of input from a broad range of stakeholders.

ANTITRUST SOURCE: Shifting from horizontal merger analysis to vertical mergers, the Division has brought a number of high-profile vertical merger cases recently, including Comcast/NBCU, LiveNation/Ticketmaster, and Google/ITA. Yet the DOJ and FTC have not put out official guidelines for vertical mergers since 1984. Is there any consideration being given to issuing updated vertical merger guidelines?

POZEN: Each of those cases presented its own unique facts, of course. Ticketmaster, for instance, had an important horizontal overlap involving ticket sales, which led to structural divestitures. But it also included a conduct remedy aimed at the vertical issues that case presented. In general, as we described in our competitive impact statements in those matters, we approached those cases with a scalpel as opposed to a blunt instrument, seeking to ensure that the playing field remained open yet avoiding overly interfering with the market. We addressed some of those issues in our revised Guide to Merger Remedies, which clarifies that we generally look for struc-

tural remedies in the horizontal merger context but we will not shy away from conduct remedies in the vertical merger context and also provides significant transparency into that analysis.

In terms of your specific question on vertical merger guidelines, I don't see us updating the guidelines any time soon. But you never know what my successors may choose to do, so I don't want to foreclose the possibility. More generally, however, our Merger Remedies Guide and competitive impact statements describe the sort of considerations that drive our analysis of vertical mergers.

ANTITRUST SOURCE: The *Wall Street Journal* and others have recently commented on what they perceive to be escalating tensions between the DOJ and FTC on clearance issues.² What are your thoughts on this perception? Is there any consideration being given to reviving the Clearance Agreement from 2002?

POZEN: Those reports are old news, and exaggerated. Our relationship with the FTC is as strong as it ever has been and has been strong since I walked in the door in 2009. Contrast that to what we walked into in 2009. There had been very public disagreements between the Department and the FTC on reverse payments' legal analysis and on the Department's report on Section 2 of the Sherman Act. AAG Varney withdrew the Section 2 report. She noted that tremendous work and effort went into it and that it was a valuable resource, but that it no longer reflected the views of the Department. So that brought the Department and the FTC much closer. In the reverse payments area, we had an opportunity to work with the Solicitor General's Office and the FTC on the *Cipro* case and then again on the *K-Dur* case to develop a position regarding reverse payments that is a rebuttable presumption. The two agencies grew much closer in their analysis on those issues. We also worked on the revised Horizontal Merger Guidelines, which was a great success. And with respect to clearance, virtually all matters are cleared with absolutely no issue because there's a clear division of responsibilities between the two agencies. There are certain industries that are evolving and changing where we both have expertise. But we don't fight about those areas. We work together to ensure the best results for consumers. That was the attitude that Christine Varney championed and I have carried forward.

Also worth noting is we've just inaugurated working sessions with the FTC. We had our first one on February 28. In past eras with different budgets, there were management retreats attended by both FTC and Division officials. We can't do that now in view of today's budgets, so we approached the FTC about working sessions that would allow us to hone our skills together. Jon Leibowitz and I kicked off the February session, and it was a packed house at the FTC conference center and people participated via video conference. We discussed some of the issues involved in government litigation to help hone our skills. I'm hoping that's a legacy that will be carried forward, helping to improve what is already a good working relationship.

ANTITRUST SOURCE: The U.K. is evaluating the possibility of consolidating the Competition Commission and the Office of Fair Trading; France recently merged its competition agencies into a single Autorité de la Concurrence; and under Brazil's new competition law, the former triangular institutional system is being merged into one agency, the Administrative Council for Economic Defence (CADE). What are your views on this trend towards streamlining agencies and their func-

² Thomas Catan, *This Takeover Battle Pits Bureaucrat vs. Bureaucrat*, WALL ST. J., Apr. 12, 2011, available at http://online.wsj.com/article/SB10001424052748703784004576221100894386950.html?mod=WSJ_hp_MIDDLENexttoWhatsNewsThird.

tions? Do you think there are reasons that may justify a merger of the antitrust responsibilities of the DOJ and the FTC?

POZEN: Some of these issues were raised in my oversight hearing. I will say the same thing here: We live in the system that we live in, and I'm not going to comment on any potential changes. We do the best we can with the system we have.

ANTITRUST SOURCE: The Division was successful in blocking the *H&R Block* merger in court. What, from your perspective, are the key lessons from the case?

POZEN: There has been a trend of defendants seeking to move antitrust cases to their home turf through motions to change venue. One of the first things that the defendants did in *H&R Block* was to try to move this case to Kansas City. We resisted the motion and won. So one important lesson is to anticipate and be prepared to resist forum shopping.

With regard to the merits decision, Judge Beryl Howell's opinion was terrific and incredibly thorough. As others have noted, her eighty-plus page opinion reads like an antitrust treatise. She went through the documents, testimony, and other evidence and carefully applied the law to the specific facts of the case. It's a great precedent that will be guiding merger law for years to come. In terms of litigation, Joe Wayland, our Deputy AAG for litigation, led an excellent team. He's an innovative trial lawyer and approached the case with an interesting, compelling strategy. He believes in telling a clear story, and in *H&R Block* we told that story through the merging parties' own documents and executives, whom we called in our case as hostile witnesses. And his opening and closing statements were extremely persuasive because they made it clear that precedent supported the government's case. He made it very clear to the judge that we were well within the existing jurisprudence of the D.C. Circuit and that liability should be found. And finally I'll again highlight the Judge's extensive reliance on the revised Horizontal Merger Guidelines. Her citations affirmed our view that the revised Guidelines and the increased transparency they bring to the merger review process are a significant contribution. Overall, *H&R Block* was a great victory for the Division—our first litigated merger victory since 2003.

ANTITRUST SOURCE: The Division recently announced that it closed several investigations into the wireless industry, namely Google's acquisition of Motorola Mobility and the acquisitions by Apple, Microsoft, and Research in Motion of certain Nortel patents. The Division's closing letter³ indicated that the basis for the Division's concern was raising rivals' costs or foreclosure, which are concerns more common under Section 2 than Section 7. Is this an example of an investigation concerned with "exclusionary conduct"—something recognized for the first time as a possible Section 7 concern in the 2010 Merger Guidelines—rather than unilateral or coordinated conduct?

POZEN: Those cases were interesting because they dealt with the intersection of antitrust law and intellectual property. We have a history at the Division of trying to find the right balance between protecting intellectual property rights and making sure intellectual property isn't used to harm competition. Those three transactions were before us at the same time, and we engaged in an

³ Statement of the Department of Justice's Antitrust Division on Its Decision to Close Its Investigations of Google Inc.'s Acquisition of Motorola Mobility Holdings Inc. and the Acquisitions of Certain Patents by Apple Inc., Microsoft Corp. and Research in Motion Ltd. (Feb. 13, 2012), available at http://www.justice.gov/atr/public/press_releases/2012/280190.htm.

extensive review of them, including by our intellectual property experts in our Legal Policy Section. We concluded that the proposed transactions did not violate Section 7 because they did not increase any incentive or ability to harm competition. But we also indicated in our closing statement that we would be monitoring the situation, particularly the ways that standard essential patents are utilized. Regarding your specific question, we analyzed the transactions as vertical mergers, so the revised Horizontal Merger Guidelines were not specifically at issue. Our closing statement provides a detailed explanation of our analysis.

ANTITRUST SOURCE: The closing statement suggests that the Division's decision was based in part on public commitments by Google, Apple, and Microsoft concerning their licensing policies. Why was the Division content to rely on a public commitment, rather than a consent decree in this case?

The antitrust laws as written and interpreted are extraordinarily flexible, and they can be applied effectively to any industry, including technology industries.

POZEN: Competition in the relevant markets is significantly affected by market participants' interactions with standard-setting organizations, as well as associated FRAND and RAND commitments. Microsoft and Apple made commitments not to seek injunctions, and that was important to our analysis. Google also made commitments, which, as we noted in our statement, were not as robust as Apple and Microsoft's commitments. We considered all three letters when we assessed the competitive effects.

ANTITRUST SOURCE: An argument that one often hears and was advanced in the *Microsoft* case was that antitrust is ill-suited to high-technology industries as they undergo rapid change because large market shares are necessary to reward firms for the risks of innovating. What are your thoughts on this view? Was this a consideration in the *AT&T/T-Mobile* case?

POZEN: I strongly disagree with that view. The antitrust laws as written and interpreted are extraordinarily flexible, and they can be applied effectively to any industry, including technology industries. That being said, we are of course mindful of the potential for rapid change in any technology industry we investigate. But we have to make sure that there aren't bottlenecks in these rapidly expanding markets and that the playing field is open and fair. The key is to strike the right balance. To achieve that balance, as I said before, when assessing remedies in this area, we employ a scalpel as opposed to a blunt instrument. Here at the Division we have a group of career lawyers who are experts in analyzing technology markets. They have worked in evolving technology industries covering lots of different sectors, including telecommunications, health care, and software. Our *H&R Block* case, for instance, involved do-it-yourself tax software. Technology is so important to our world and very important to the U.S. economy. Innovation is how our economy grows, and allowing competition to flourish ensures that innovation thrives.

ANTITRUST SOURCE: A number of representatives in Congress wrote a letter to President Obama asking him to approve the *AT&T/T-Mobile* transaction. They pointed out, among other things, that it would bring jobs back to America from overseas and could create tens of thousands of new jobs for Americans. To what extent does the Division consider factors extraneous to the competitive implications of a transaction?

POZEN: The antitrust laws ensure an open and fair playing field, allowing competition to flourish. Competition drives innovation, and innovation is what drives our economy and creates jobs.

That's how job creation fits into our mission—promoting competition is what leads to a more robust economy.

ANTITRUST SOURCE: In 2010, the Antitrust Division and the Department of Agriculture held a series of workshops to explore competition issues affecting the agricultural sector. What did the Division learn from this process and will there be a report this year about its findings?

POZEN: Those workshops were an incredible undertaking. Our Legal Policy Section and our special advisor for agriculture Mark Tobey worked closely with the USDA and forged a strong partnership in the process of setting up those workshops and going forward after them. The Secretary of Agriculture and the Attorney General were both personally engaged and attended the workshops. Those workshops explored the intersection of agriculture policy and competition. At typical antitrust conferences, the audience is full of antitrust lawyers and business executives. In contrast, our workshops were attended by industry participants—farmers and ranchers. And we provided an open microphone where people could raise issues with us and the USDA. We learned so much about what was going in the industry. We learned a lot about the intersection of the agricultural policy and antitrust. And we carry that with us every day. That learning has, for instance, helped inform our enforcement actions in the agricultural section, including the Dean Foods/Foremost merger and our *George's* action in the Shenandoah Valley. That learning has also helped us in matters where we didn't bring an enforcement action, such as the Perdue/Coleman matter, where we issued a closing statement explaining our approach to the issues. I have an article in *Antitrust* magazine discussing some of these issues.⁴ The hearings also strengthened our relationship with USDA.

ANTITRUST SOURCE: MFN clauses appear to have received a lot of attention at the Division, including the Division's challenge to Blue Cross Blue Shield of Michigan's use of MFN clauses in its contract with providers and reports of investigations of health plans' use of similar provisions in other states. What has prompted the recent interest in these contractual provisions?

POZEN: That action grew out of our investigation of Blue Cross Blue Shield of Michigan's attempt to acquire Physicians Health Plan of Mid-Michigan (PHP). The proposed acquisition would have resulted in market shares exceeding 90 percent in certain areas within Michigan. We told the parties that we were going to challenge that transaction, and they abandoned it. In the course of that investigation, we came across the MFNs that Blue Shield was using in Michigan. Our complaint lays out our allegations in detail, but in short we found the MFNs to have distorted competition and stifled the growth of rivals and their potential to undermine Blue Cross's market power. In general, we're very concerned about the lack of entry in markets characterized by high market shares. We made clear at the time we brought the case that we were going to look across the health care industry at these kinds of contractual arrangements, and we continue to do so. That's prompted us to look at MFNs in other industries. It's not that all MFNs lead to competitive harm. But we take a close look at them when employed by firms with significant market power, not only in the health care sector but also in other industries.

⁴ Sharis A. Pozen, *Agriculture and Antitrust: Dispatches and Learning from the Workshops on Competition in Agriculture*, ANTITRUST, Spring 2012, at 8.

ANTITRUST SOURCE: There is relatively little guidance from the courts or either enforcement agency about the circumstances under which MFNs may be anticompetitive. Has the Division by itself or in conjunction with the FTC considered releasing enforcement guidelines for MFNs or other contractual provisions that reference rivals?

POZEN: Our chief economist, Fiona Scott Morton, has addressed some of these issues in her writings and speeches. And our court papers in *Blue Cross* speak for themselves. More generally, we have made it a point of emphasis to issue robust competitive impact statements so the antitrust community gets a clear picture of how we analyze competitive effects. For instance, our closing statement in our Wichita Falls matter—involving, again, a dominant firm in the health care arena using contractual provisions to maintain market power—provides a detailed discussion of our concerns.⁵ So guidelines are not the only way that we can explain our enforcement intentions.

These cases highlight another important priority at the Division: vigorous civil non-merger enforcement. In addition to our health care cases, we've brought, for instance, actions against high-tech companies that secretly agreed not to recruit the other's employees. We're also in active litigation against American Express regarding contractual provisions that we believe harm competition. We settled our case against MasterCard and Visa involving these contractual rules.⁶ So we've been active in the civil non-merger area, focusing on contractual arrangements that stifle entry.

ANTITRUST SOURCE: Earlier, you mentioned budget austerity. Last year, the Division announced a proposal to close four regional offices. Could you give us an update on where this stands? More generally, are you concerned about the current austere budgetary environment affecting the Antitrust Division's mission?

POZEN: We work hard to ensure that we use the money in our budget efficiently and effectively. I'll briefly mention our criminal program. Last year we had about sixty cases and this year we have about ninety. In the first six months of this year, we've collected close to a billion dollars in criminal fines, and that will just keep going up. We've spent most of this interview talking about our civil program, and, as I've noted, our criminal program is extremely active too. With regard to office closures, the process is ongoing. We have a notification process in place with Congress, and that's all I have to report for now.

ANTITRUST SOURCE: You have said that you plan to step down April 30. What current programs or initiatives would you like your successor to continue or emphasize?

POZEN: I'll leave that to my successor, Joe Wayland. I have every faith that he and the Division will continue to vigorously enforce the antitrust law and continue the efforts that we have started in all areas. We have a fabulous team here, and we have a fabulous career staff who are committed to protecting competition and consumers. I expect another seamless transition.

ANTITRUST SOURCE: Thank you for talking with us today about what is happening at the Antitrust Division and in the world of antitrust. ●

⁵ Competitive Impact Statement, *United States v. United Regional Health Care System*, Civ. No. 7:11-cv-00030 (N.D. Tex. Feb. 25, 2011), available at <http://www.justice.gov/atr/cases/f267600/267653.pdf>.

⁶ *United States v. American Express Co.*, No. 10-CV-4496 NGG RE, 2011 WL 2974094 (E.D.N.Y. Jul. 20, 2011).

Contracts That Reference Rivals As an Antitrust Category

Jonathan M. Jacobson and Daniel P. Weick

Some vertical arrangements affect more than the terms of dealing between the contracting parties themselves; they also affect, directly or indirectly, the terms available to a contracting party's competitors. So, for example, an agreement between a supplier and a customer that the customer will purchase from that supplier exclusively necessarily means that, for the duration of the agreement, rivals of the supplier will be unable to contract with the customer in question.

Policymakers at the Department of Justice's Antitrust Division have recently focused on a wide variety of these "contracts that reference rivals" (CRRs) as a source of potential antitrust concern, at least when deployed by firms with market power.¹ The policymakers recognize that various efficiency justifications exist for the many different types of contracts in issue. Because, however, all types of CRRs affect, in some respect, the contract terms that may be available to the contracting party's rivals, these agreements may each, in theory, both diminish the ability of rivals to compete and provide a vehicle for firms to learn their rivals' terms of sale. In some instances, these effects may create or enhance market power or otherwise lead to consumer harm. This is the concern that appears to have informed recent DOJ enforcement actions against "most-favored nations" (MFN) clauses (which require one party to guarantee the other that it is receiving contractual terms as good or better than any arrangement made by its rivals² and "non-discrimination" rules or clauses (NDR) (which require a party to guarantee that it will not disfavor the contracting party's products relative to those of its competitors).³ There seems to be an insufficient appreciation, however, of the important differences between the various varieties of CRRs, and the fact that these differences may contribute to both the competitive effects and the justifications for the provisions' use. These differences should therefore be taken into account in deciding whether or not CRRs violate the antitrust laws.

CRRs can be deployed as a mechanism for raising rivals' costs. However, as with all practices that raise rivals' costs, it is often difficult to distinguish between efficient contracting activities and truly exclusionary practices. Few things raise rivals' costs more than intense competition, but that does not mean that anything wrong is afoot. Practices that raise rivals' costs are anticompetitive

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¹ Deputy Assistant Attorney General Fiona Scott Morton coined the "CRR" phrase to cover certain types of vertical contracts that require and convey horizontal information, indirectly, from one rival to another. See Fiona Scott Morton, Deputy Asst. Atty Gen. for Econ. Analysis, U.S. Dep't of Justice, Contracts that Reference Rivals, Remarks at the Georgetown University Law Center Antitrust Seminar 2 (Apr. 5, 2012), <http://www.justice.gov/atr/public/speeches/281965.pdf> [hereinafter *Remarks*]; see also *Interview with Fiona Scott Morton, DAAG for Economic Analysis at the DOJ, ANTITRUST*, Spring 2012, at 14, 17–18 [hereinafter *Interview*] (discussing CRRs).

² See, e.g., Complaint, United States v. Blue Cross Blue Shield of Mich., 809 F. Supp. 2d 665 (E.D. Mich. 2011) (No. 2:10-cv-15155-DPH-MKM) (challenging Blue Cross Blue Shield of Michigan's use of MFNs), available at <http://www.justice.gov/atr/cases/f263200/263235.pdf>.

³ See, e.g., Complaint, United States v. Am. Express Co., No. 1:10-cv-04496-NGG-CLP, 2011 U.S. Dist. LEXIS 78835 (E.D.N.Y. July 20, 2011) (challenging non-discrimination provisions), available at <http://www.justice.gov/atr/cases/f262800/262864.pdf>.

only when they do not reflect competition on the merits and artificially create or enhance power over price or output.⁴

Correspondingly, many types of contracts reference rivals, at least implicitly, and the analysis of each type of contract will depend highly on factual context—even when deployed by dominant firms. This becomes clear when the varieties of CRRs are disaggregated and the differences in their justifications and potential pitfalls are considered. There is no question that the CRR categorization can provide valuable insights into some of the potential effects of contractual provisions. But a close look into the specific type of provision and the actual factual context in which it is used is still required even after identifying an agreement as a CRR.

Some Varieties of CRRs

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Many contracts contain at least an implicit reference to rivals. As noted above, exclusive dealing provisions imply that the party agreeing to exclusivity will not deal with the other party's competitors for the agreement's duration. Loyalty discounts provide that buyers will purchase, at a minimum, a stated percentage of their requirements in return for the discount, which means that they cannot purchase that portion from anyone else. Even a simple purchase of, say, an automobile in most cases implies that the buyer will not purchase a car from a rival dealer for at least a year or two.

Unsurprisingly, these contracts are ordinarily lawful. To the extent competitive concerns exist, they arise when a firm with market power uses contractual terms that may impair materially the ability of rivals to enter and expand. Impairment of rivals is a necessary condition for anticompetitive effects to arise, but it is not a sufficient condition. The traditional rule of reason still governs to determine whether the net effect of the arrangement is materially harmful to consumers, because entry or expansion by rivals can be deterred by either exclusionary conduct or aggressive but legitimate competition. Although the former harms consumers, the latter does not.

The most commonly disputed types of CRR provisions, including exclusive dealing, loyalty discounts, and bundling, have been discussed many times elsewhere.⁵ With the notable exception of the outlier *LePage's* case on bundling,⁶ the general approach to these types of vertical agreements, as used by dominant firms, tracks the D.C. Circuit's opinion in *United States v. Microsoft Corp.*⁷ Courts recognize that "imposing upon a firm with market power the risk of an antitrust suit every time it enters into [an exclusive] contract, no matter how small the effect, would create an unacceptable and unjustified burden upon any such firm."⁸ They therefore apply the rule of reason to determine whether the restraints have a plausible procompetitive justification and, if so,

⁴ See, e.g., Thomas G. Krattenmaker & Steven C. Salop, *Anticompetitive Exclusion: Raising Rivals' Costs to Achieve Power over Price*, 96 YALE L.J. 209, 211–22 (1986) (noting difficulty of defining standards for exclusionary conduct).

⁵ Commentary and case law on these types of agreements are discussed, for example, in Jonathan M. Jacobson, *Exclusive Dealing, "Foreclosure," and Consumer Harm*, 70 ANTITRUST L.J. 311 (2002) [hereinafter *Exclusive Dealing*]; Jonathan M. Jacobson, *Exploring the Antitrust Modernization Commission's Proposed Test for Bundled Pricing*, ANTITRUST, Summer 2007, at 23 [hereinafter *Bundled Pricing*]; Jonathan M. Jacobson, *A Note on Loyalty Discounts*, ANTITRUST SOURCE, June 2010, http://www.americanbar.org/content/dam/aba/publishing/antitrust_source/Jun10_Jacobson6_24f.authcheckdam.pdf [hereinafter *Loyalty Discounts*].

⁶ *LePage's Inc. v. 3M*, 324 F.3d 141, 154–57 (3d Cir. 2003) (en banc) (condemning above-cost bundled discounts). *Contra, e.g.*, *Cascade Health Solutions v. PeaceHealth*, 515 F.3d 883, 900–03 (9th Cir. 2008) (rejecting *LePage's* and requiring proof of below-cost pricing to condemn bundled discounts); ANTITRUST MODERNIZATION COMMISSION, REPORT & RECOMMENDATIONS 94–100 (2007) (criticizing *LePage's*), available at http://govinfo.library.unt.edu/amc/report_recommendation/amc_final_report.pdf.

⁷ 253 F.3d 34 (D.C. Cir. 2001) (per curiam).

⁸ *Id.* at 70; *accord, e.g.*, *Bayou Bottling, Inc. v. Dr Pepper Co.*, 725 F.2d 300, 304 (5th Cir. 1984).

whether their procompetitive benefits outweigh their anticompetitive effects.⁹ Importantly, the burden of proof stays with the plaintiff. The burden of presenting justifications will shift to the defendant only if the plaintiff demonstrates anticompetitive effects. But even with that shifting, the burden of proof remains with the plaintiff to show the net effects of the restraint.¹⁰

This article focuses on three less commonly challenged arrangements: MFNs, NDRs, and retail preference agreements. MFNs are used by buyers to ensure that they receive equally favorable prices from sellers on their purchases and by sellers to make sure that their buyers are not paying others more. Their use is prominent in the health care sector, where health care insurers have frequently required a health care provider to guarantee that they receive the lowest rates the provider offers.¹¹ NDRs typically require a buyer to refrain from steering its customers to a competing alternative. One prominent example of such an NDR clause has been in agreements between credit card companies and merchants, where the credit card companies require merchants who accept the card to refrain from disparaging their cards, from steering consumers to other payment methods, or from charging a fee for the use of their cards.¹² Lastly, retail preference agreements are used to secure access to the best shelf placement, promotional periods, or types of promotional treatment. Many of the cases involving these agreements arise from arrangements between food or beverage suppliers and food retailers to ensure that the supplier's products are promoted and displayed more prominently than those of its rivals.¹³

The common question addressed here is whether agreements of this sort should be treated differently from other (non-CRR) types of vertical agreements. As discussed below, there is no one-size-fits-all answer. There are significant differences in the respective effects and efficiencies of these agreements. Care must be taken to ensure that these differences are considered individually and that these agreements are not lumped into a single CRR category for antitrust analysis. Otherwise, courts and agencies might find themselves condemning practices without real proof of anticompetitive harm.

Judicial Approaches

MFNs. MFNs have been the subject of a number of antitrust challenges, and a fairly substantial body of case law has developed around them. While most government suits have ended in con-

⁹ See 253 F.3d at 70–71 (condemning Microsoft's exclusive contracts in light of Microsoft's market power and its lack of procompetitive justifications).

¹⁰ See Jacobson, *Exclusive Dealing*, *supra* note 5, at 367.

¹¹ See, e.g., *Blue Cross & Blue Shield United of Wis. v. Marshfield Clinic*, 65 F.3d 1406, 1415 (7th Cir. 1995) (Posner, C.J.) (approving HMO's MFN agreements).

¹² See, e.g., Amended Complaint ¶¶ 28–29, *United States v. Am. Express Co.*, No. 1:10-cv-04496-NGG-CLP, 2011 U.S. Dist. LEXIS 78835 (E.D.N.Y. July 20, 2011), ECF No. 57 (describing American Express's nondiscrimination provisions), available at <http://www.justice.gov/atr/cases/f265400/265401.pdf>.

¹³ See, e.g., *El Aguila Food Prods. Inc. v. Gruma Corp.*, 301 F. Supp. 2d 612, 628–32 (S.D. Tex. 2003), *aff'd*, 131 Fed. App'x 450 (5th Cir. 2005) (upholding the legality of Gruma's "customer marketing agreements" for tortillas); *Louisa Coca-Cola Bottling Co. v. Pepsi-Cola Metropolitan Bottling Co.*, 94 F. Supp. 2d 804, 813–16 (E.D. Ky. 1999) (finding no antitrust violation in Pepsi's "calendar marketing agreements"); *Coca-Cola Co. v. Harmar Bottling Co.*, 218 S.W.3d 671, 688–91 (Tex. 2006) (same for Coke). Retail preference agreements are not "exclusive dealing" agreements because the retailer is always permitted to sell competing wares and, in most cases, to promote them in all but the featured package. These agreements are correctly viewed as a type of CRR, however, because a key term in each is that rivals will not be promoted (at least in the promoted package) during the designated period of the preferentially treated supplier's promotion. Although different from MFNs and NDRs, retail preference agreements share the characteristic that a rival will be likely to learn about (from the retailer), and ultimately condition its own deal on, a competitor's terms. As an example, if Coke has contracted with a retailer to run a special on 12-pack can during the week of July 4, Pepsi will learn that it cannot promote the same package during that week and will have to vie for some alternative promotional period.

sent decrees prohibiting enforcement of the challenged MFNs,¹⁴ several private cases and a few government proceedings have gone through trial court and appellate litigation. Early cases tended to dismiss challenges to MFNs out of hand.¹⁵ In *Ocean State*, for example, the First Circuit held that “a policy of insisting on a supplier’s lowest price—assuming that the price is not ‘predatory’ or below the supplier’s incremental cost—tends to further competition on the merits and, as a matter of law, is not exclusionary.”¹⁶ The Seventh Circuit similarly indicated that “[m]ost favored nations’ clauses are standard devices by which buyers try to bargain for low prices”—although, on rehearing, it did allow that “[p]erhaps, as the Department of Justice believes, these clauses are misused to anticompetitive ends in some cases[.]”¹⁷

Early cases tended to dismiss challenges to MFNs out of hand. . . . Several more recent cases, however, have gone the other way.

Several more recent cases, however, have gone the other way. One important case was the DOJ’s challenge to MFNs used by an insurer in the *Delta Dental* case.¹⁸ The concern there was that, through the use of MFNs, the insurer blocked entry by lower-cost, lower-premium insurers. The MFN provided that, if dentists offered lowered prices to other insurers (or even to uninsured patients), the same lower prices would have to be offered to Delta. Delta represented the dominant portion of dentist revenue. So saying that Delta would get the same lower prices meant that dentists had no incentive to reduce their prices to others to encourage entry or expansion by another insurer. Doing so would decrease the dentist’s revenues across the board.¹⁹ The district court distinguished *Ocean State* on this basis, denied the defense’s motion to dismiss,²⁰ and the case settled soon afterward.²¹

The most important recent development is the DOJ’s suit against Blue Cross Blue Shield of Michigan (BCBSM), still pending. The claim is that the insurer used a combination of standard MFNs and “MFN-plus” clauses (requiring that health care providers charge competing insurers more than they charge BCBSM) to enhance its market power in various local health insurance

¹⁴ See, e.g., *United States v. Or. Dental Serv.*, No. C95-1211 FMS, 1995 U.S. Dist. LEXIS 21042 (N.D. Cal. filed July 17, 1995); *RxCare of Tenn., Inc.*, 121 F.T.C. 762 (1996).

¹⁵ For a comprehensive survey of the cases prior to 1995, see Anthony J. Dennis, *Most Favored Nation Contract Clauses Under The Antitrust Laws*, 20 U. DAYTON L. REV. 821, 825–43 (1995).

¹⁶ *Ocean State Physicians Health Plan, Inc. v. Blue Cross & Blue Shield of R.I.*, 883 F.2d 1101, 1110 (1st Cir. 1989); see also *Kartell v. Blue Shield of Mass., Inc.*, 749 F.2d 922, 929 (1st Cir. 1984) (Breyer, J.) (“[E]ven if the buyer has monopoly power, an antitrust court . . . will not interfere with a buyer’s (nonpredatory) determination of price.”). But see *United States v. Delta Dental of R.I.*, 943 F. Supp. 172, 176–80 (D.R.I. 1996) (denying motion to dismiss and distinguishing *Kartell* and *Ocean State* on the grounds, *inter alia*, that the government alleged the MFNs at issue increased consumer prices whereas the prior cases involved lower consumer prices).

¹⁷ *Blue Cross & Blue Shield United of Wis. v. Marshfield Clinic*, 65 F.3d 1406, 1415 (7th Cir. 1995) (Posner, C.J.). The latter phrase was added to the opinion after the DOJ and the Federal Trade Commission filed an amicus brief in support of rehearing. Brief for the United States and Federal Trade Commission as Amici Curiae in Support of Petition for Rehearing, filed Oct. 2, 1995, *Blue Cross & Blue Shield United of Wis. v. Marshfield Clinic*, 65 F.3d 1406 (7th Cir. 1995) (Nos. 95-1965 & 95-2140), available at <http://www.justice.gov/atr/cases/f0400/0421.pdf>. That amicus brief, in hindsight, appears to have been a turning point in the judicial treatment of MFNs.

¹⁸ *Delta Dental*, 943 F. Supp. 172.

¹⁹ See Complaint ¶¶ 16–18 & 31, *id.* 943 F. Supp. 172 (No. 96-113-P), available at <http://www.justice.gov/atr/cases/f0500/0594.htm>.

²⁰ *Id.* at 179–80.

²¹ *United States v. Delta Dental of R.I.*, No. 96-113-P, 1997 U.S. Dist. LEXIS 11239 (D.R.I. July 2, 1997). Similarly, in *Reazin*, the Tenth Circuit treated the use and effect of MFNs as supporting evidence of market power and left open the possibility that use of MFNs may justify imposition of antitrust liability. *Reazin v. Blue Cross & Blue Shield of Kan., Inc.*, 899 F.2d 951, 971 & n.30 (10th Cir. 1990) (observing “[t]here was also considerable testimony on the effect of Blue Cross’ most favored nations clauses, and the jury could reasonably have concluded that that clause contributed to Blue Cross’ power over price” and reserving judgment on the question “of whether use of the most favored nations clause could itself violate section 2”).

In contrast to the relatively substantial (if divided) case law on MFNs, there have been few challenges to NDRs, and no court has ever found the use of an NDR unlawful under the antitrust laws.

markets.²² The problem identified in the DOJ's complaint is that, if a dominant insurer can insist on the use by all or most health care providers of MFNs that prevent them from giving more favorable rates to new entrants or smaller firms seeking to expand—as in *Delta Dental*—competitive entry and expansion will be impeded and the dominant firm will be protected from the prospect of competition. The district court denied the defendant's motion to dismiss, finding “it is plausible that the MFNs entered into by Blue Cross with various hospitals in Michigan establish anticompetitive effects as to other health insurers and the cost of health services in those areas.”²³ A competing insurer, Aetna, has filed a follow-on suit mirroring the DOJ's allegations.²⁴

NDRs. In contrast to the relatively substantial (if divided) case law on MFNs, there have been few challenges to NDRs, and no court has ever found the use of an NDR unlawful under the antitrust laws. In 2010, the DOJ brought suit against American Express, Visa, and MasterCard challenging the credit card companies' separate NDRs,²⁵ and the clauses have also been the subject of private litigation.²⁶ The core of the allegations made by the DOJ is that an NDR may increase total acceptance costs to retailers by preventing retailers from steering consumers to lower-cost methods of paying.²⁷ No dispositive motion or other opportunity for a judicial discussion of the merits has been filed. MasterCard and Visa both entered into consent decrees to resolve the DOJ suit.²⁸ American Express, however, continues to defend against the government and private cases.

Retail Preference. Retail preference agreements, like MFNs, have been the subject of multiple antitrust suits, despite (or perhaps because of) their ubiquity in promotional efforts. Courts have generally upheld them as procompetitive, and no court has imposed antitrust liability for such agreements.²⁹ For example, in *Coca-Cola Co. v. Harmar Bottling Co.*,³⁰ litigated under Texas antitrust law, the Texas Supreme Court found that Coke's “calendar marketing agreements,” which required, inter alia, that retailers provide Coke products with preferential advertising, displays, and shelf space during key selling weeks of the year, did not violate the antitrust laws because they did not have a proven anticompetitive effect. Specifically, the court found that the plaintiffs had

²² See Complaint ¶¶ 1–6, *United States v. Blue Cross Blue Shield of Mich.*, 809 F. Supp. 2d 665 (E.D. Mich. 2011) (No. 2:10-cv-14155-DPH-MKM), available at <http://www.justice.gov/atr/cases/f263200/263235.pdf>.

²³ *Id.* at 674.

²⁴ Complaint ¶¶ 18–19, *Aetna Inc. v. Blue Cross Blue Shield of Mich.*, No. 2:11-cv-15346-BAF-RSW (E.D. Mich. Dec. 6, 2011). A motion to dismiss is pending. See Defendant Blue Cross Blue Shield of Michigan's Motion to Dismiss Aetna's Complaint, *id.*, No. 2:11-cv-15346-BAF-RSW (E.D. Mich. Jan. 27, 2012), ECF No. 11.

²⁵ Complaint, *United States v. Am. Express Co.*, No. 1:10-cv-04496-NGG-CLP, 2011 U.S. Dist. LEXIS 78835 (E.D.N.Y. July 20, 2011), available at <http://www.justice.gov/atr/cases/f262800/262864.pdf>.

²⁶ *E.g.*, *In re Am. Express Anti-Steering Rules Antitrust Litig.*, 764 F. Supp. 2d 1343 (E.D.N.Y. 2011) (No. 1:11-md-02221) (ordering coordinated or consolidated pretrial proceedings for four pending private antitrust actions filed in the Eastern and Southern Districts of New York).

²⁷ Amended Complaint ¶¶ 1–4, *United States v. Am. Express Co.*, No. 1:10-cv-04496-NGG-CLP, 2011 U.S. Dist. LEXIS 78835 (E.D.N.Y. July 20, 2011), ECF No. 57, available at <http://www.justice.gov/atr/cases/f265400/265401.pdf>.

²⁸ *Id.*, No. 1:10-cv-04496-NGG-CLP, 2011 U.S. Dist. LEXIS 78835 (entering final judgment as to MasterCard and Visa).

²⁹ *Sun-Drop Bottling Co. v. Coca-Cola Bottling Co.*, 604 F. Supp. 1197 (W.D.N.C. 1985), involved a clause requiring Coca-Cola's products to be the “lowest” price in the store. Although “it appeared obvious to the court” that this was a form of vertical price fixing, “admittedly illegal” under the then-current per se rule, the requested preliminary injunction was nevertheless denied for failure to demonstrate irreparable harm because the clause had been removed with Coca-Cola's representation that it would not be reinstated, and the case eventually settled. *Id.* at 1199. In the wake of *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, 551 U.S. 877 (2007), however, the concern raised by the *Sun-Drop* court should no longer be an issue today.

³⁰ 218 S.W.3d 671 (Tex. 2006).

failed to demonstrate “harm to competition in the market,” notwithstanding allegations that Coke had a market share in excess of 75 percent.³¹ The court held that “[the] existence of the CMAs alone cannot prove Coke engaged in predatory or anticompetitive conduct.”³²

The Seventh Circuit, in an opinion authored by Judge Easterbrook, reached a similar conclusion. In *Menasha Corp. v. News America Marketing In-Store, Inc.*,³³ the court rejected an antitrust claim based on preferential and exclusive positioning agreements entered by the largest provider of in-store coupon dispensers. The court found that retailers—“the consumers of couponing services”—preferred to have such deals in place, and observed that “[w]hen the consumers favor a product or practice, and only rivals squawk, the most natural inference is that the complained-of practice promotes rather than undermines competition.”³⁴ Similar claims were also rejected by the Fourth Circuit in *RJR v. Philip Morris*,³⁵ and by the Fifth Circuit in the *Gruma* case.³⁶

Can these disparate practices (e.g., MFNs, NDRs, and retail preference agreements) usefully be grouped under one CRR heading for purposes of antitrust analysis? Although it is true that all CRRs are subject to a rule-of-reason analysis, that is as far as the similarity goes.

Policy Analysis

Can these disparate practices (e.g., MFNs, NDRs, and retail preference agreements) usefully be grouped under one CRR heading for purposes of antitrust analysis? Although it is true that all CRRs are subject to a rule-of-reason analysis, that is as far as the similarity goes. Each of the three kinds of agreements discussed above has its own set of potential efficiencies and potential pitfalls, and focus on the individual features of the agreement is therefore important when applying the rule of reason.³⁷

MFNs. MFNs can carry a potential for serious consumer harm. When used by dominant firms or collectively by the leading firms in an industry, MFNs can stabilize prices at elevated levels by removing seller incentives to discount to other buyers, as in *Delta Dental*³⁸ and *duPont/Ethyl*.³⁹ They can also inhibit competitive entry by preventing entrants from gaining access to the more favorable terms they may need to compete, as alleged in *Blue Cross of Michigan*.⁴⁰ The clauses

³¹ *Id.* at 688–90.

³² *Id.* at 690. To the same effect, see *Louisa Coca-Cola Bottling Co. v. Pepsi-Cola Metropolitan Bottling Co.*, 94 F. Supp. 2d 804 (E.D. Ky. 1999); *Beverage Mgmt., Inc. v. Coca-Cola Bottling Corp.*, 653 F. Supp. 1144 (S.D. Ohio 1986).

³³ 354 F.3d 661 (7th Cir. 2004).

³⁴ *Id.* at 663. There have been a number of cases filed against News America advancing similar allegations. One of them, brought by Valassis, generated a nine-figure jury verdict before settling. See *Valassis Commc'ns, Inc. v. News Am. Inc.*, No. 06-10240, 2011 U.S. Dist. LEXIS 63495 (E.D. Mich. June 15, 2011) (order adopting the report and recommendation of the panel of special masters).

³⁵ *R.J. Reynolds Tobacco Co. v. Philip Morris Inc.*, 199 F. Supp. 2d 362 (M.D.N.C. 2002) (promotional program giving retailers funding incentives to display Marlboro and other Philip Morris cigarettes not unlawful; rivals could gain display space through continuous bidding), *aff'd*, 67 Fed. App'x 810 (4th Cir. 2003).

³⁶ *El Aguila Food Prods. Inc. v. Gruma Corp.*, 301 F. Supp. 2d 612 (S.D. Tex. 2003), *aff'd*, 131 Fed. Appx. 450 (5th Cir. 2005).

³⁷ For a discussion of justifications for exclusive arrangements generally, see Jacobson, *Exclusive Dealing*, *supra* note 5, at 357–60.

³⁸ *United States v. Delta Dental of R.I.*, 943 F. Supp. 172 (D.R.I. 1996) (prices stabilized by dominant firm use of MFNs).

³⁹ *E.I. du Pont de Nemours & Co. v. FTC*, 729 F.2d 128 (2d Cir. 1984) (MFNs used collectively but without conspiracy by three leading firms, stabilizing market prices; *held*, no violation of FTC Act § 5, reversing the FTC). As the facts of the *duPont/Ethyl* case make clear, MFNs can have anticompetitive, price-elevating effects, even when used by firms without market power, if the agreements are used by multiple firms in an interlocking (albeit noncollusive) manner. The Second Circuit held, however, that the existence of those effects was not sufficient to establish an antitrust violation, even under Section 5 of the FTC Act. That holding has been questioned. See David H. Marks & Jonathan M. Jacobson, *Price-Fixing: An Overview*, 30 ANTITRUST BULL. 199, 225–26 (1985).

⁴⁰ Complaint ¶ 47, *United States v. Blue Cross Blue Shield of Mich.*, 809 F. Supp. 2d 665 (E.D. Mich. 2011) (No. 2:10-cv-14155-DPH-MKM), available at <http://www.justice.gov/atr/cases/f263200/263235.pdf>. Also significantly, an insurer that may seek to offer a low-cost, limited network plan by contracting with a single hospital would be prevented from doing so if the hospital had to give a dominant incumbent the same discounts. See Scott Morton, *Interview*, *supra* note 1, at 16.

can be especially problematic when, as also alleged in *Blue Cross*, the MFN goes beyond merely requiring that the buyer receive the best deal and instead requires that all other buyers pay substantially more for the covered services.⁴¹

MFNs are not without competitive justifications. Perhaps the most prevalent justification is the one described by Judge Posner, namely that “[m]ost favored nations’ clauses are standard devices by which buyers try to bargain for low prices, by getting the seller to agree to treat them as favorably as any of their other customers.”⁴² Correspondingly, it is argued, by ensuring the buyer’s access to the lowest supplier price, MFNs provide an inducement for increasing output and enhancing consumer choice. Using health care again as an example, a dominant insurer may be reluctant to provide coverage in its broad network for a provider’s services if that provider can help the insurer’s rivals compete more effectively against it by offering them lower prices. Without the MFN serving as a safeguard against such a scenario, a small provider may not be able to get coverage in the large insurer’s network at all. So MFNs in this context can broaden provider access to subscribers by inducing a dominant insurer to include the provider in its broad network.

MFNs can also address a type of free-rider problem. A supplier may benefit from association with a buyer’s goodwill and yet it may have reduced incentives to include the buyer in its marketing efforts if the buyer is paying more to another supplier. It has also been argued that, in long-term contracts, MFNs can facilitate efficient price adjustment (as buyers adjust the price paid when the prices of the seller’s rivals change), and that, correspondingly, the absence of MFN provisions may deter the parties’ entry into stable long-term contractual relationships *ex ante*.⁴³

Each of these justifications may prove valid, even important, in any given case. Still, as efficiency justifications go, none of them seems overwhelmingly powerful in the abstract, particularly given the empirical work documenting the general tendency of MFNs to increase prices.⁴⁴ MFNs are useful when used by smaller firms as a device to attract desirable customers (or suppliers) and to provide them with an incentive to do business they might otherwise forgo. But when imposed by dominant firms, the potential for anticompetitive effects can be substantial, and the justifications generally thin. In particular, although nominally ensuring the buyer the lowest available supplier price, MFNs will tend to have the effect of inhibiting price competition that would lead to lower prices marketwide. As to the potential for reduced transaction costs from the use of MFNs (e.g., by expediting the bidding process), this should rarely, if ever, justify a dominant firm’s use of MFN. The reduction in transaction costs eliminates the very dynamics that lead to vigorous price competition. The most naked form of price fixing reduces transaction costs in much the same way,

⁴¹ Complaint ¶ 45, *Blue Cross Blue Shield*, 809 F. Supp. 2d 665 (No. 2:10-cv-14155-DPH-MKM). A significant concern in health care markets is that a dominant health insurer with a large market share may be able to coerce health care providers into accepting barely sustainable rates while, at the same time, charging inflated premiums to employers or other insurance purchasers. This can create a circumstance where the providers must charge smaller insurers seeking to enter rates that are substantially higher to recoup losses incurred from their dealings with the monopsonist—and this can result with or without the use of MFNs. When providers must charge entrants discriminatorily high rates, potential competitors will be unable to challenge the dominant insurer because their cost structure will be higher and they will not have a practical ability to compete with the dominant firm on rates to be charged to subscribers—even if the rates are excessive. The upshot is the classic collection of competitive harms: reduced output and quality of services, higher consumer prices, and illegitimate extraction of monopoly rents. *Accord* Scott Morton, *Remarks*, *supra* note 1, at 13.

⁴² *See* *Blue Cross & Blue Shield United of Wis. v. Marshfield Clinic*, 65 F.3d 1406, 1415 (7th Cir. 1995).

⁴³ *See* Keith J. Crocker & Thomas P. Lyon, *What Do “Facilitating Practices” Facilitate: An Empirical Investigation of Most-Favored-Nation Clauses in Natural Gas Contracts*, 37 J.L. & Econ. 297, 298, 301 (1994).

⁴⁴ *See* Scott Morton, *Remarks*, *supra* note 1, at 12 & n.15 (collecting studies).

but the cost saving from not having to worry about what your rival is charging is never a legitimate defense.⁴⁵ Enforcer skepticism about MFNs is therefore not entirely unwarranted.

NDRs. NDRs are commonly viewed as being similar to MFNs,⁴⁶ but in fact generally have fewer harmful consequences. In health care, a provider's "no steering" clause does not prevent the payer from negotiating whatever reimbursement rates with the provider it may choose; does not prevent the insurer from bargaining to pay lower (or higher) rates to other providers; and does not prevent the provider from negotiating different rates with other insurers. Similarly, a credit card company's NDR with a merchant prevents the merchant from steering customers to other, possibly lower-priced cards, but it has no effect on the price ("interchange fee" or in some cases "merchant discount") that the merchant pays whenever a customer uses the card.⁴⁷ The merchant is free to negotiate higher, lower, or different rates with other card companies as the merchant elects. At the same time, the credit card companies are free to compete in offering different rates to the merchants they seek to sign up.

The justifications for NDRs in the health care industry may be significant. A provider who agrees to be "in network" with a given insurer has granted that insurer the goodwill and promotional benefit associated with the provider's brand and reputation—benefits that will be appropriated without compensation if the insurer then steers patients to other providers. The provider may have also discounted its rates to the insurer in return for an expectation of volume, but the incentive to do so will have been eliminated if the provider then steers the expected volume elsewhere. Cooperative arrangements in the development of new programs and treatments may also be retarded, as a provider will not want to share its proprietary research with an insurer that is funneling the provider's business somewhere else.

The justifications in the credit card industry are similar and substantial. First, there is a free-rider problem whenever a credit card brand attracts a customer into a store. If a store then steers the customer into using a different card, it has benefited from the card company's promotional efforts without paying for it. The upshot is that the card company's incentives to continue investing in activities that bring customers into the store are diminished, with negative effects on interbrand competition and card acceptance market output.⁴⁸ Second, and relatedly, notwithstanding the argument that steering to a lower-priced card may facilitate expansion by the lower-priced card company, that very expansion is riddled with other free-rider problems: while the higher-priced card company's promotional efforts encourage its cardholders to enter the store, it is the lower-priced card company that reaps the benefit without payment—with the same negative effects on investment incentives. Third, a merchant's interchange or discount rate may be based on an expectation of a certain volume of transactions; if that volume is not forthcoming, the rate may have to be increased. And, fourth, a smaller credit card company may be vulnerable to the efforts of larger firms to induce merchants to deny acceptance of the smaller rival's brand, in which case

⁴⁵ See, e.g., *Freeman v. San Diego Ass'n of Realtors*, 322 F.3d 1133, 1152 (9th Cir. 2003) (rejecting purported procompetitive justifications for price fixing).

⁴⁶ See Nicholas Economides, *Competition Policy Issues in the Consumer Payments Industry*, in *MOVING MONEY: THE FUTURE OF CONSUMER PAYMENT* 113, 118–19 (Robert E. Litan & Martin Neil Baily eds., 2009) (lumping MFNs and NDRs together as one mechanism by which credit card networks make it more difficult for merchants to respond to card fee differences).

⁴⁷ See Dennis W. Carlton & Alan S. Frankel, *The Antitrust Economics of Credit Card Networks*, 63 ANTITRUST L.J. 643, 645–48 (1995) (surveying development of credit card industry payment structures).

⁴⁸ See *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 52–57 (1977).

NDRs provide a self-preservation mechanism, important as a defensive measure against strong rivals seeking exclusivity.⁴⁹

These efficiencies all serve to increase output on the card acceptance side of the two-sided, credit card market. There are efficiencies on the cardholder acquisition side as well. First, credit card companies have a legitimate interest in preventing the disparagement of their brands from merchants who benefit from accepting the card. A customer steered away from one brand of card is essentially being told that that card is inferior to another card and that the cardholder should not be using it. Second, a card company may reasonably conclude that allowing customers to be steered away from its brand will diminish its ability to provide desirable reward programs and other card features, thus harming its ability to sign new cardholders, and reducing demand for and utilization of its cards overall.

The essence of the argument against NDRs is that discrimination by customers in a lower-priced rival's favor would improve that rival's prospects of expanding more. Preventing that discrimination is harmful, it is argued, because rivals would do better in the absence of the NDR; and merchants would pay less for credit cards if they could freely steer.⁵⁰ The argument, however, ignores (i) the negative effects on market output (on both sides of the market) that are likely to occur if these provisions are banned; and (ii) the competition that precedes the implementation of these provisions. Importantly, merchants do not agree to NDRs in a vacuum. An NDR is just one of many components of a contractual relationship with a credit card company, with benefits inuring to, and obligations flowing from, both sides of the contract, including, importantly, the willingness of cardholders to spend more in establishments that accept their chosen brand of card.⁵¹ Except in the truly rare case where a credit card company faces no competition at all, a merchant who does not want an NDR can go elsewhere.

Finally, it seems strange to tell a company it cannot bargain for protection against downstream discrimination. Our country has a long tradition of prohibiting discrimination and, even in the business context, some types of discrimination have long been the focus of specific Con-

⁴⁹ In the *American Express* case, the NDR protects American Express against opportunistic behavior by its larger rivals, Visa and MasterCard. American Express cards are accepted by far fewer merchants than those that accept Visa and MasterCard, and its network is unusually vulnerable to efforts by those larger firms to induce merchants to decline acceptance of the card. The DOJ's complaint alleges a narrow "travel and entertainment card" submarket in which American Express supposedly has market power, Amended Compl. ¶¶ 41–50, *United States v. Am. Express Co.*, No. 1:10-cv-04496-NGG-CLP, 2011 U.S. Dist. LEXIS 78835 (E.D.N.Y. July 20, 2011), ECF No. 57, available at <http://www.justice.gov/atr/cases/f265400/265401.pdf>, but it also acknowledges the broader "general purpose credit and charge card" market in which American Express is a comparatively minor player. *Id.* ¶¶ 34–40. Visa and MasterCard are significantly larger than American Express in the broader market, and the DOJ has already demonstrated that those companies have significant market power in that broader market. *United States v. Visa U.S.A., Inc.*, 344 F.3d 229, 238–40 (2d Cir. 2003). Even though it may be true that NDRs limit the ability of credit card merchants and retailers to create discounts for the use of particular cards (see Scott Morton, *Interview*, *supra* note 1, at 17), such programs can just as easily be used by the more dominant firms to marginalize smaller players. American Express's "self-defense" justification needs to be viewed in that context.

⁵⁰ Certain complaints also focus on harm to merchants from consumer rewards programs. See Adam J. Levitin, *Priceless? The Economic Costs of Credit Card Merchant Restraints*, 55 U.C.L.A. L. REV. 1321, 1357 (2008) (arguing that NDR provisions "make it impossible for merchants to avoid the externality of rewards programs and other perks offered to card users from which merchants derive no benefit"). That argument does not feature prominently in the DOJ complaint and ignores the two-sided nature of competition in the market. Card companies compete against one another, not just for merchant patronage, but for cardholders. Rewards programs are a central feature of the competition for cardholders, and NDRs are important to ensure that cardholders reap the benefits of that competition when presenting their chosen card to a merchant.

⁵¹ See Sujit Chakravorti, *Theory of Credit Card Networks: A Survey of the Literature*, 2 REV. NETWORK ECON. 50, 51–54 (2003) (discussing variety of credit card market participants).

gressional prohibition.⁵² In the antitrust context generally, moreover, it is clear that, absent the most unusual circumstances, firms cannot be forced to deal with customers or suppliers who will treat them less favorably.⁵³ It is therefore difficult to envisage a scenario in which an NDR should be held unlawful.

Retail Preference Agreements. Retail preference agreements are CRRs as well but are quite different from MFNs or NDRs. The proponent does not want equal treatment with rivals; it wants *better* treatment.⁵⁴ In a typical arrangement, a supplier will bargain with a retailer for preferential shelf space, promotional displays, inclusion in newspaper ads, and/or a reduced price at retail. The agreements often include provisions requiring that the supplier have the only (or most prominent) ad in its category, that it have the best and/or most shelf space and the largest and most prominent display in the store, and that the promotional activity in issue occur during key sales weeks (such as July 4th or Thanksgiving). They are almost always very short-term. A “calendar marketing agreement,” for example, will typically schedule a weekly or monthly promotional calendar over the course of a year, with each week or month contestable before the calendar is set. Promotional activity of this sort is quite valuable and can result in very substantial incremental sales (or “lift”). To get this kind of preferred treatment at retail, suppliers must offer large discounts.

Retail preference agreements are associated with recognized efficiencies. The inducement for the supplier’s steep discount is the preferential treatment over its rivals; without that preference, the discounts would be less frequent. For example, Pepsi is not going to provide a supermarket thousands of dollars in discounts for a promotion if the first thing a consumer sees on entering the store is a large display of two-liter Coca-Cola. Exclusivity (or at least preferential treatment) is key to inducing the investment Pepsi is making. These agreements, moreover, are almost always associated with intense “competition for the contract.”⁵⁵ Retailers maximize their own returns by playing one supplier off against another to get the best deal, and the implied promise of preferential treatment is their currency.⁵⁶ Outlawing retail preference agreements would have the perverse effect of eliminating one of the key ways for stimulating interbrand competition.⁵⁷

Retail preference agreements are CRRs as well but are quite different from MFNs or NDRs. The proponent does not want equal treatment with rivals; it wants better treatment.

⁵² *E.g.*, Robinson-Patman Act, 15 U.S.C. §§ 13–13b, 21a; Telecommunications Act of 1996, 47 U.S.C. §§ 251(c)(2)(C) & (D); Preventing Undue Discrimination and Preference in Transmission Services 70 Fed. Reg. 55,796 (Sept. 23, 2005) (notice of inquiry), [available at http://www.gpo.gov/fdsys/pkg/FR-2005-09-23/pdf/05-19003.pdf](http://www.gpo.gov/fdsys/pkg/FR-2005-09-23/pdf/05-19003.pdf).

⁵³ *See Verizon Commc’ns Inc. v. Law Offices of Curtis V. Trinko LLP*, 540 U.S. 398, 408 (2004).

⁵⁴ These types of agreements are not addressed in Deputy Assistant Attorney General Scott Morton’s taxonomy of CRRs, but are properly viewed as a species of CRR for the reasons addressed *supra* note 13.

⁵⁵ *See Paddock Publ’ns, Inc. v. Chicago Tribune Co.*, 103 F.3d 42, 45 (7th Cir. 1996) (Easterbrook, J.) (“Competition-for-the-contract is a form of competition that antitrust laws protect rather than proscribe, and it is common.”).

⁵⁶ *See Benjamin Klein & Kevin M. Murphy, Exclusive Dealing Intensifies Competition for Distribution*, 75 ANTITRUST L.J. 433, 447, 448 (2008) (“[W]hen the supermarket informs [two] manufacturers that it will feature only one brand, the supermarket is able to obtain much more favorable terms for its shelf space because it is promising to deliver all of its consumers to the manufacturer of the featured brand. . . . Competition between manufacturers for the exclusive retailer shelf space in our example, therefore, will lead to an equilibrium price of . . . manufacturer marginal cost.”).

⁵⁷ The argument has been made that “the procompetitive effect of exclusive dealing is strongest when firms are symmetric, but weaker (or even absent) if the exclusive manufacturer has substantial market power.” Hans Zenger, *When Does Exclusive Dealing Intensify Competition for Distribution? Comment on Klein & Murphy*, 77 ANTITRUST L.J. 205, 211 (2010). However, the argument neglects the ability of retailers (even those without market power) to “shift the share of sales in a product category in favor of one or another supplier” and thus induce competition for the contract. *See Benjamin Klein & Kevin M. Murphy, How Exclusivity is Used to Intensify Competition for Distribution—Reply to Zenger*, 77 ANTITRUST L.J. 691, 691 (2011). This, in fact, appears to have been the case in at least one major appellate decision. *See NicSand, Inc. v. 3M Co.*, 507 F.3d 442, 453–55 (6th Cir. 2007) (en banc) (noting retailer demands for exclusivity and displacement of once dominant firm as preferred partner).

Conclusion

The concept of CRRs as an antitrust category of restraints has intuitive appeal and some real utility. The impact on rivals of such contractual provisions presents a number of issues common to each case—for example, whether the firm imposing the provision has significant market power. But, consistent with a rule-of-reason approach, there are also key differences from provision to provision in terms of both their effects and justifications. No case seems to warrant requiring the defendant to prove justification before the plaintiff is required to show actual harm to competition. As the D.C. Circuit noted in *Microsoft*, there is a social cost to forcing firms, even dominant ones, to justify every ordinary business agreement they enter.⁵⁸ A careful analysis of each practice, including its circumstances and case-specific facts, will always be necessary,⁵⁹ and the burden should remain on the party claiming an antitrust violation to prove its case. A blanket rule or categorization for CRRs would likely create confusion and undermine interbrand competition by discouraging firms from using all competitive tools at their disposal. Proper rule-of-reason analysis thus requires disaggregating the various types of CRR. ●

POSTSCRIPT

On April 11, 2012, there was an important new development regarding antitrust enforcement against CRRs. The DOJ filed suit against Apple, Inc. and six prominent book publishers, charging a conspiracy among them to utilize a uniform agency model for retail e-book sales, allowing them to raise retail prices, reinforced through an MFN providing that none of the publishers' e-books could be sold for any less than the price on Apple's iBookstore. The complaint alleged:

Apple and the Publisher Defendants recognized that coupling Apple's right to all their e-books with its right to demand that those e-books not be priced higher on the iBookstore than on any other website effectively required that each publisher Defendant take away retail pricing control from all other e-book retailers, including stripping them of any ability to discount or otherwise price promote e-books out of the retailer's own margins.⁶⁰

Three of the publishers have settled and entered into a consent decree. The case continues against Apple and the non-settling publishers.

⁵⁸ *United States v. Microsoft Corp.*, 253 F.3d 34, 70 (D.C. Cir. 2001) (“[I]mposing upon a firm with market power the risk of an antitrust suit every time it enters into such a contract, no matter how small the effect, would create an unacceptable and unjustified burden upon any such firm.”).

⁵⁹ *See Chicago Bd. of Trade v. United States*, 246 U.S. 231, 238 (1918) (“The true test of legality is whether the restraint imposed is such as merely regulates and perhaps thereby promotes competition or whether it is such as may suppress or even destroy competition. To determine that question the court must ordinarily consider the facts peculiar to the business to which the restraint is applied; its condition before and after the restraint was imposed; the nature of the restraint and its effect, actual or probable. The history of the restraint, the evil believed to exist, the reason for adopting the particular remedy, the purpose or end sought to be attained, are all relevant facts.”).

⁶⁰ Complaint ¶ 66, *United States v. Apple, Inc.*, No. 1:12-cv-2826 (S.D.N.Y. Apr. 11, 2012), available at <http://www.justice.gov/atr/cases/f282100/282135.pdf>.

Book Review

An Innovative Approach to Teaching Innovation

Herbert Hovenkamp

Innovation and Competition Policy: Cases and Materials—An Open Source Casebook

2011–2012

Reviewed by Leon B. Greenfield and Hartmut Schneider

Herbert Hovenkamp's new casebook, *Innovation and Competition Policy*,¹ is an innovation in and of itself—and not only because it breaks with the age-old rule that law school casebooks must be heavy, expensive, and outdated almost from the moment of purchase. The book is available only as a collection of PDF files, so that its incremental weight for the ordinary laptop or iPad-carrying reader is zero. More importantly, the book is free to all, subject only to a modest use restriction. And the book hopefully will benefit from the near real-time amendments made possible by its electronic-only format. Professor Hovenkamp explains that it was the need for frequent updating and the “unacceptably high cost of law school casebooks” that drove his decision to depart from more traditional publication methods.²

Professor Hovenkamp's book also is a substantive innovation. Although there are several excellent casebooks and treatises on antitrust, intellectual property (IP), and their intersection, this new casebook adds a unique contribution to the literature. As Professor Hovenkamp explains, the casebook “differs from IP/antitrust casebooks in that it considers numerous sources of competition policy in addition to antitrust, including those that emanate from intellectual property laws themselves, and also related issues”³ This is apparent in the discussion of patent doctrines that rarely find a prominent place in literature geared toward an antitrust audience⁴ and also in the book's excursions into neighboring areas of the law, such as telecommunications.⁵

The author emphasizes that *Innovation and Competition Policy* is not an “‘IP/antitrust’ casebook because it adopts a broad perspective on competition and innovation.”⁶ That means, among other things, that the book embodies a wide range of views on a longstanding question at the heart of both antitrust and intellectual property law: how should the law best maximize returns to society given the frequent tension between creating incentives for pioneering innovations and promoting

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¹ HERBERT HOVENKAMP, *INNOVATION AND COMPETITION POLICY*, 2011–2012, <http://www.uiowa.edu/~ibl/InnovationCompetitionPolicyCasebook.shtml> [hereinafter *INNOVATION AND COMPETITION POLICY*].

² Herbert Hovenkamp, *Hovenkamp Discusses His New Open Source Antitrust-IP Casebook*, ANTITRUST & COMPETITION POL'Y BLOG, Nov. 14, 2011, http://lawprofessors.typepad.com/antitrustprof_blog/2011/11/guest-post-by-herb-hovenkamp-hovenkamp-discusses-his-new-open-source-antitrust-ip-casebook-.html [hereinafter Hovenkamp blog].

³ *Id.*

⁴ See, e.g., Chapter 1 and its discussion of patent doctrines that determine the scope of the claim as a matter of patent law.

⁵ See, e.g., *Talk Am., Inc. v. Mich. Bell Tel.Co.*, 131 S. Ct. 2254 (2011); *INNOVATION AND COMPETITION POLICY*, *supra* note 1, ch. 8, at 47–53 (discussing *Talk America* decision).

⁶ Hovenkamp blog, *supra* note 2.

rivalry among firms? We see this conundrum in the separate realms of antitrust and intellectual property and when the two fields intersect. It is apparent that antitrust lawyers must know some intellectual property law, and intellectual property specialists must be conversant in antitrust to counsel clients and handle their disputes.

Professor Hovenkamp's book is organized into ten chapters, each available as a separate PDF file. Some chapters are relatively traditional in scope, such as the discussion of the law of tying involving intellectual property rights (Chapter 2), the chapter on intellectual property misuse (Chapter 7), and the chapter on post-sale and related distribution restraints involving intellectual property rights (Chapter 10). Other chapters reflect the book's more expansive scope, taking the reader deep into the law of intellectual property (e.g., Chapter 4, "Competition Policy and the Patent System," and Chapter 5, "Competition and Innovation in Copyright and the DCMA") or addressing conceptual or policy questions (e.g., Chapter 9, "The Innovation Commons"). Most chapters devote significant attention to the historical development of innovation and competition policy doctrines, and the book generally focuses on carefully edited original text with judiciously few author's notes. The book is a treasure trove of materials on innovation and competition policy that will appeal not only to students of antitrust, but also to practitioners in their daily work, who will benefit from easy access to foundational cases.

More than 580 pages of cases and notes are not easily summarized, but a brief review of some of the main subjects Professor Hovenkamp presents illustrates his approach.

Professor Hovenkamp's book is organized into ten chapters, each available as a separate PDF file.

Innovation Versus Rivalry and the Boundaries of the Patent Right

Professor Hovenkamp begins with a topic that could hardly be more fundamental to innovation and competition policy, but may be relatively unfamiliar to many antitrust lawyers: defining the scope of the claim as a matter of patent law. He includes a substantial excerpt from *Wright Co. v. Herring-Curtiss Co.*,⁷ where the court gave a broad construction to patent claims of the Wright brothers to determine that Glenn Curtiss, an aggressive early rival, had infringed with his own aircraft—even though the “defendants have constructed their machine somewhat differently from [the Wright brothers’] and do not at all times and on all occasions operate the same on the Wright principle.”⁸ In his notes following the case, Professor Hovenkamp explains that “[t]he granting of very broad patent rights can permit a pioneer patentee to exclude variations that build in some way on the pioneer’s patent.”⁹ Although broad patent claims might be justified as a way to promote more innovation, “it seems fairly clear that broad patent grants reduce competition by permitting pioneers to exclude rival technologies; whether broader scope produces more innovation is very much an open question.”¹⁰

Antitrust lawyers and courts are used to struggling with questions of how to distinguish between a monopolist lawfully enjoying the fruits of its innovation and a monopolist misusing its power to exclude competition. Patent law encounters a different but similar question: how best to draw the boundary within which the patentee is granted the legal privilege to exclude? Drawing both types of lines in the right place is vitally important to maximizing society's innovation potential.

⁷ 204 F. 597 (W.D.N.Y. 1913).

⁸ *Id.* at 614.

⁹ INNOVATION AND COMPETITION POLICY, ch. 1, at 15.

¹⁰ *Id.*

Providing incentives to innovate while avoiding undue stifling of rivalry has also been a common theme in courts' treatment of defenses to patent enforcement. In Chapter 4, the casebook presents the recent case of *Therasense, Inc. v. Becton, Dickinson and Co.*,¹¹ in which the Federal Circuit substantially raised the standards for proving that a patent is unenforceable because of inequitable conduct before the Patent and Trademark Office (PTO). In raising the showing required for both the patentee's bad intent and the materiality of misstatements, the court explicitly took into account the effects of the defense on patentees' incentives and ability to assert their patent rights. After observing that a finding of inequitable conduct is the "atomic bomb" of patent law,¹² the court cited a study showing that 80 percent of patent infringement cases involved claims of inequitable conduct. The court then wrote:

While honesty at the PTO is essential, low standards for intent and materiality have inadvertently led to many unintended consequences, among them increased adjudication cost and complexity, reduced likelihood of settlement, burdened courts, strained PTO resources, increased PTO backlog, and impaired patent quality. This court now tightens the standards for finding both intent and materiality in order to redirect a doctrine that has been overused to the detriment of the public.¹³

This is reminiscent of the concerns about over-intervention and its potential to deter innovation or hard competitive conduct that the Supreme Court has expressed in ruling for defendants in Section 2 cases, such as *LinkLine*, *Trinko*, and *Brooke Group*.¹⁴

Lest one believe that economic learning invariably influences the outcome of defenses to patent enforcement, Professor Hovenkamp addresses doctrines of per se patent misuse that owe more to (arguably misplaced) fears about a patentee extending the scope of any monopoly conveyed through the patent grant than to concerns about economic efficiency. A prominent example is the *Brulotte* rule,¹⁵ which (with certain exceptions developed over time) prohibits a patentee from enforcing an agreement for the payment of royalties beyond the expiration of the patent. Judge Posner, among others, has pointed out that at least as a matter of economic logic, it is not clear why a patentee and licensee should be prohibited from structuring royalty payments to extend beyond the term of patent, if they believe doing so will maximize their collective gains from the transaction.¹⁶ By collecting post-expiration royalties, the patentee cannot impermissibly extend the patent's duration or demand more for access to its invention than it could extract dur-

¹¹ 649 F.3d 1276 (Fed. Cir. 2011).

¹² *Id.* at 1288 (citing *Aventis Pharma S.A. v. Amphastar Pharms., Inc.*, 525 F.3d 1334, 1349 (Fed. Cir. 2008) (Rader, J., dissenting)).

¹³ *Id.* at 1290.

¹⁴ See *Pac. Bell Tel. Co. v. linkLine Commc'ns, Inc.*, 129 S. Ct. 1109, 1120 (2009) ("To avoid chilling aggressive price competition, we have carefully limited the circumstances under which plaintiffs can state a Sherman Act claim by alleging that prices are too low."); *Verizon Commc'ns Inc. v. Law Offices of Curtis V. Trinko*, 540 U.S. 398, 407, 413–14 (2004) (observing that "[t]he opportunity to charge monopoly prices—at least for a short period—is what attracts 'business acumen' in the first place; it induces risk taking that produces innovation and economic growth," and that the "cost of false positives counsels against an undue expansion of § 2 liability"); *Brooke Grp. Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 226 (1993) (noting the cost of erroneous antitrust intervention against low prices, which are often the "very essence of competition").

¹⁵ *Brulotte v. Thys Co.*, 379 U.S. 29 (1964).

¹⁶ *Scheiber v. Dolby Labs., Inc.*, 293 F.3d 1014 (7th Cir. 2002). Although the court sharply criticized the *Brulotte* rule, it ruled for the licensee because it determined it was duty bound to apply the Supreme Court's decision on the facts of the case.

¹⁷ *Id.* at 1017–18; see also European Commission, Guidelines on the Application of Article 81 of the EC Treaty to technology transfer agreements, 2004 O.J. (C 101) 2, ¶ 159 ("[T]he parties can normally agree to extend royalty obligations beyond the period of patent validity . . . without falling foul of Article 81(1). Once these rights expire, third parties can legally exploit the technology in question and compete

ing the life of the patent.¹⁷ Another example is *Zenith Radio Corp. v. Hazeltine Research, Inc.*,¹⁸ which holds that it will often constitute per se misuse for a patentee to charge royalties on all products that a licensee produces, whether or not a particular product embodies the technology covered by the licensed patents. Again, one can fairly question why parties that find it most efficient to structure royalty payments in this way—e.g., because it promotes ease of reporting and monitoring for royalty collection purposes—should be prohibited from doing so, at least absent a finding that the structure had a tendency to exclude rival technologies that outweighs any procompetitive benefits from the arrangement.

Defining the Limits of the Privilege to Exclude

Defining how antitrust law shapes the boundaries of the statutory right to exclude—and therefore the balance between innovation and rivalry—can be particularly complex where intellectual property rights convey monopoly power and disputes arise about whether the IP owner must give access by licensing third parties. In Chapter 8, Professor Hovenkamp focuses on this tension between the privilege to exclude inherent in IP rights and potential antitrust liability for exclusion. The casebook actually begins this discussion with the opposite question: might it violate the antitrust laws to provide intellectual property *to everyone for free*, and under licensing conditions that perpetuate access free of charge? In his unsuccessful attack on open source licensing for the Linux operating system, Daniel Wallace argued that it did—claiming in a nutshell that he was foreclosed from competing with Linux because Linux is available at an “unbeatable price.”¹⁹ The court quickly dismissed Mr. Wallace’s claim, rejecting, among other theories, a predatory pricing argument for ignoring that software available for free will not lead to monopoly prices in the future.²⁰

Professor Hovenkamp then turns to more traditional arguments, presenting the familiar monopoly leveraging cases in which defendants were alleged to have used intellectual property to extend monopoly positions in one market to another: the 9th Circuit’s 1997 decision in *Image Technical Services v. Eastman Kodak Co.*;²¹ the Federal Circuit’s 2000 decision in *In re Independent Service Organizations Antitrust Litigation (Xerox)*;²² and the European Court of First Instance’s 2007 decision in *Microsoft Corp. v. Commission*.²³ These cases highlight not only the challenges that U.S. courts have faced in applying Section 2 where alleged exclusion results, at least in part, from the exercise of intellectual property rights, but also the continued divergence between U.S. and European antitrust and competition law on this question. Whether this divergence continues has vital implications, particularly given the recent parallel reviews in the United States, Europe,

with the parties to the agreement. Such actual and potential competition will normally suffice to ensure that the obligation in question does not have any appreciable anti-competitive effects.”).

¹⁸ 395 U.S. 100 (1969).

¹⁹ Wallace v. IBM Corp., 467 F.3d 1104, 1106 (7th Cir. 2006).

²⁰ *Id.*

²¹ 125 F.3d 1195 (9th Cir. 1997) (upholding Section 2 claim where defendant failed to offer valid business justification for refusal to license intellectual property).

²² 203 F.3d 1322, 1327 (Fed. Cir. 2000) (declining to follow *Image Technical Services* and holding that the patent holder “may enforce the statutory right to exclude others from making, using, or selling the claimed invention free from liability under the antitrust laws” so long as there is no indication of illegal tying, fraud, or sham litigation).

²³ Case T-201/04, 2007 E.C.R. II-3601 (Ct. First Instance), available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:62004A0201:EN:HTML> (analyzing Microsoft’s refusal to license interoperability information to competing manufacturers of server operating systems under European competition law and agreeing with the Commission that Microsoft’s conduct was exclusionary).

In Chapter 8, Professor Hovenkamp focuses on this tension between the privilege to exclude inherent in IP rights and potential antitrust liability for exclusion.

and Asia of conduct that potentially implicates both competition and patent laws—especially in the telecommunications area.²⁴

Remedies: A Fine Balance

Once questions about the scope of the patent and its interaction with antitrust principles have been resolved, remedies become the next focus of the competition and innovation debate. Chapter 3 of the book is devoted to remedies and how to compensate inventors for unauthorized use of their inventions without over-detering legitimate innovation that has some connection with the infringement. Professor Hovenkamp uses *Andreas v. Volkswagen of America, Inc.*²⁵ to illustrate that unauthorized use of intangible property does not typically result in physical damage or may not even diminish enjoyment by the owner. This can present unique challenges in determining the appropriate remedy for infringement: if the property is unharmed and the owner suffers no immediate detriment, is it appropriate to compensate at all? And if the answer is “yes” because society wants to prohibit free riding and preserve incentives to innovate, how does one compensate the owner for infringement?

Mr. Andreas alleged that Audi infringed copyrights by using copyrighted text in a voice-over to the TV launch commercial for the Audi TT Coupe. The district court agreed, and a jury awarded Mr. Andreas \$570,000, or 10 percent of Audi’s profits from domestic sales of the TT Coupe during the time that the allegedly infringing commercial aired. On appeal, Audi argued that the damages were speculative: Mr. Andreas suffered no immediate harm, and it was impossible to determine whether Audi TT buyers were swayed by the use of Mr. Andreas’s copyrighted work or something else, e.g., the engineering or design of the car. The Eighth Circuit disagreed, holding that Congress placed the burden on the infringer to establish the portion of profits attributable to factors other than the infringement.²⁶ Because Audi had failed to carry this burden, the court allowed the jury award to stand.

Two recent cases at the end of Chapter 3 carry forth the theme of how best to define the scope of patent remedies, this time in the context of the ongoing innovation and competition debate pitting “pure” rights holders—entities that do not practice the inventions they own—against manufacturers that use patented technologies.²⁷ *Ricoh Co. v. Quanta Computer, Inc.*²⁸ reflects the trend among lower courts since the Supreme Court’s decision in *eBay Inc. v. MercExchange*²⁹ to deny injunctions to non-practicing entities (NPEs) for fear that the threat of an injunction provides NPEs

²⁴ Cf., e.g., Press Release, U.S. Dep’t of Justice, Statement of the Department of Justice’s Antitrust Division on Its Decision to Close Its Investigations of Google Inc.’s Acquisition of Motorola Mobility Holdings Inc. and the Acquisitions of Certain Patents by Apple Inc., Microsoft Corp. and Research In Motion Ltd. (Feb. 13, 2012), available at http://www.justice.gov/atr/public/press_releases/2012/280190.htm; Press Release, European Comm’n, Mergers: Commission Approves Acquisition of Motorola Mobility by Google (Feb. 13, 2012), available at <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/12/129&format=HTML&aged=0&language=EN&guiLanguage=en>; Joaquin Almunia, Speech Before the Internal Market and Consumer Protection Committee (Feb. 28, 2012), available at <http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/12/131&format=HTML&aged=0&language=EN&guiLanguage=en> (noting complaints against licensing practices by Motorola).

²⁵ 336 F.3d 789 (8th Cir. 2003).

²⁶ *Id.* at 799.

²⁷ See, e.g., Tom Ewing & Robin Feldman, *The Giants Among Us*, 2012 STAN. TECH. L. REV. 1; Colleen V. Chien, *From Arms Race to Marketplace: The Complex Patent Ecosystem and Its Implications for the Patent System*, 62 HASTINGS L.J. 297 (2010).

²⁸ Case No. 06-cv-462-BCC, 2010 WL 1607908 (W.D. Wis. Apr. 19, 2010).

²⁹ 547 U.S. 388 (2006).

“undue leverage in negotiations” with parties seeking to practice their inventions.³⁰ And the discussion in *IP Innovation v. Red Hat, Inc.*³¹ of royalty calculation where the claimed invention was only “one of over a thousand components included in the accused products” is a good example of the thorny issues involved in calculating reasonable royalties for patent infringement.³²

* * * *

Professor Hovenkamp’s collection of cases and materials is both thought provoking and extraordinarily useful—and the price cannot be beat. His casebook should be on the shelf (or e-reader) of every practitioner who deals with issues of innovation and the legal and economic doctrines related thereto, and would be a great basis for students learning about those issues. ●

³⁰ *Id.* at 396 (Kennedy, J., concurring).

³¹ 705 F. Supp. 2d 687 (E.D. Tex 2010).

³² *Id.* at 690. NPEs are typically not entitled to ordinary damages because they do not practice their inventions. In *IP Innovation*, the plaintiff alleged that a “workspace switching feature” of Red Hat’s and Novell’s Linux-based operating system infringed certain of its patents. The plaintiff’s damages expert had included in his proposed royalty base all of Red Hat’s and Novell’s revenues from subscriptions to the accused operating system, despite evidence that the claimed invention was only one among more than a thousand components, that users did not buy operating systems based on their workspace switching feature, and that the plaintiff’s expert’s starting royalty rate was significantly above existing royalty rates for licenses to the patents-insuit. For these and other reasons, the court excluded the expert’s testimony on *Daubert* grounds.

Paper Trail: Working Papers and Recent Scholarship

Editors' Note: Editor Allan Shampine reviews Greg Werden's response to criticisms of the use of market definition in antitrust analysis and litigation, and editor John Woodbury looks at a paper by Jonathan Baker on the importance of exclusion to antitrust and the need for it to be viewed as prominently as collusion. Send suggestions for papers to review, or comments, to page@law.ufl.edu or jwoodbury@crai.com.

—WILLIAM H. PAGE AND JOHN R. WOODBURY

Gregory J. Werden, *Why (Ever) Define Markets? An Answer to Professor Kaplow* (Working Paper Feb. 13, 2012)

http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2004655

Market definition has been a staple of antitrust analysis and litigation for decades.¹ In recent years there has been a move to deemphasize the use of market definition, and, in particular, the use of market shares as a measure of market power.² In a 2010 article, Professor Louis Kaplow argued that market definition (which he termed “delineation”) should be abandoned entirely in antitrust.³ In the paper under review here, Gregory Werden, Senior Economic Counsel in the Antitrust Division of the U.S. Department of Justice, provides a spirited defense of market definition and explains the purposes for which it is still useful in modern antitrust analysis.⁴

According to Werden, one of the most valuable contributions of market definition has little to do with economics and everything to do with clarity. An antitrust case “is a narrative about actual or likely competitive effects consisting of the actors, the scene, and the action—i.e., competition and the challenged conduct.” (p. 14) Defining a relevant market “allows the essence of the narrative to be packed into a single sentence.” (p. 15) It tells the audience who the actors are, the backdrop they are playing against, and the basics of what has been done. Defining a market forces the parties to determine the most important actors and to focus on them. It also assures at least the possibility of competitive harm because the hypothetical monopolist test requires that the hypothetical monopolist be able to raise price in the relevant market.

Even so, Werden agrees that if competitive harm can be established directly, then defining a market may add an unnecessary layer of complexity, muddying the waters and distracting the audience from the direct evidence. In this context, Werden discusses the FTC's challenge to a hospital merger in Chicago based on a finding that elimination of competition as a result of the merger led to significant increases in prices.⁵ The FTC used that finding to infer a relevant mar-

¹ See *United States v. E.I. du Pont de Nemours & Co.*, 351 U.S. 377, 380 (1956).

² See Dennis W. Carlton, *Market Definition: Use and Abuse*, 3 COMPETITION POLY INT'L 1, Spring 2007; ANTITRUST MODERNIZATION COMMISSION, REPORT AND RECOMMENDATIONS 52 (2007), available at http://govinfo.library.unt.edu/amc/report_recommendation/toc.htm.

³ Louis Kaplow, *Why (Ever) Define Markets?*, 124 HARV. L. REV. 437 (2010).

⁴ The paper also discusses certain limitations in Professor Kaplow's proposed analytical alternatives, the assumptions behind market definition, and the relationship between market definition and direct tests of market power. This review focuses on the paper's discussion of the current uses of market definition rather than the technical debate.

⁵ *Evanston Nw. Healthcare Corp.*, FTC Dkt. No. 9315, 2007 WL 2286195 (2007).

ket but could have dispensed with market definition entirely. Arguably, the use of market definition only distracted from the core argument of the case—that prices had gone up as a result of the merger. That argument is simple and easy for any audience to understand. When competitive harm can be demonstrated simply and directly, as in this example, market definition may be unnecessary and even counterproductive.

Unnecessary complexity may not be the only limitation on using market definition. Indeed, there are also instances when market definition is difficult to carry out, such as in industries with differentiated goods. Werden acknowledges this difficulty but argues that the alternatives are also imperfect. For example, a narrowly defined market involving differentiated goods risks excluding relevant substitutes, but a broadly defined market may fail to isolate the major competitive forces. “Hence, the market can be too small or too large but perhaps never just right.” (p. 11) However, the tools available for quantitative analysis of differentiated goods mergers without defining a market have their own limitations. Models of competition include assumptions, and data must be available for elasticities of demand to be estimated. Werden argues that some industries do not fit comfortably within commonly used models of competition, and data may not be available to determine the relevant elasticities with any precision.

In addition, Werden discusses the benefits of market definition when analyzing coordinated effects. For example, the Horizontal Merger Guidelines note that by replacing the “hypothetical monopolist” with a “hypothetical profit-maximizing cartel,” the market definition process can determine the optimal scope for collusion. As with unilateral effects, other tools can sometimes substitute for market definition, but those tools cannot always be applied.

Finally, market definition is closely related to market share—an intuitive measure of market power that is deeply entrenched in antitrust analysis.⁶ Defining markets using the hypothetical monopolist test provides some basis for associating high market shares with market power. The process of defining a market also requires determining what products and locations are sufficiently close substitutes that entry in those substitutes could constrain market power.⁷ However, the relationship between shares and market power is not precise. Indeed, Professor Kaplow has argued that high market shares are such a poor measure of market power that they should not be used at all. Werden believes the value of market definition in providing some economic meaning to market shares as a measure of market power will depend on the alternative methods available for measuring market power, the industry in question, and the activity being investigated. If there are better measures available, then arguably there is no value in defining a market. However, all methods of estimating market power have limitations. Multiple methods are often used in any given case, and Werden argues that market definition and market shares, imperfect as they are, still have a useful role to play, particularly for screening cases in the early stages of litigation, and so should be kept in the practitioner’s toolbox.

Werden acknowledges that market definition and market shares should receive less emphasis than they currently do. Where direct evidence of competitive harm is available, market definition may be unnecessary and distracting. There are also cases where market definition is particularly difficult, such as in industries with differentiated goods. The use of market shares to establish

⁶ Professor Kaplow argued that the only purpose of market definition is to allow an inference about market power based on market shares. While Werden argues that there are other reasons to define markets, it is certainly the case that one benefit of doing so is providing some basis for using market shares to infer market power.

⁷ As the paper notes, easy entry into the production of a close substitute makes it difficult to maintain supracompetitive prices regardless of a product’s market share.

market power after a market is defined, while intuitive, may or may not carry much economic weight, depending on how appropriate the market definition is and how well the effects of entry have been estimated. However, despite its imperfections, market definition often remains a useful tool in analyzing antitrust cases. In particular, defining a market can impose discipline on the analysis, separate the important factors from background influences, and add clarity and power to the narrative of the case.

In response to Werden's defense of market definition, Professor Kaplow would likely argue that modern economic tools can estimate market power directly, and a direct demonstration of market power is simpler and more precise than traditional market definition. However, such economic tools are still unfamiliar to many practitioners, and to virtually all jurors. Market definition, by contrast, is well understood in the field and can be expressed in simple English. Particularly with a lay audience, such as a jury, the narrative power of market definition may be important. With a more sophisticated audience, or when the direct demonstration of market power is itself straightforward, market definition may or may not be useful.

That said, habit and tradition tend to cause practitioners to begin with market definition even when the narrative power of market definition is more limited, such as in differentiated goods industries. The relationships among differentiated goods are more complex than with commodities, which makes the market definition narrative more complex. If complexity is inevitable, then the use of less familiar economic tools that may offer more precision becomes more appealing. However, practitioners should not be limited to an either/or choice regarding market definition. Market definition and direct analysis of market power are often successfully used together. ●

—ALLAN L. SHAMPINE

Jonathan Baker, Exclusion as a Core Competition Concern (Feb. 8, 2012)

http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2001579

In this paper, former FTC and FCC chief economist Jonathan Baker argues that in terms of enforcement policy and court opinions (although it's not clear that Baker means to include the latter), exclusionary conduct as an antitrust concern has inappropriately taken a back seat to various forms of horizontal collusion. He argues that this is in part due to an unfounded "rhetorical consensus" that vertical restraints are more likely to benefit competition and consumers than collusion. To counter this consensus, Baker explains that exclusionary conduct concerns raise parallel issues to collusion concerns, and that the legal rules governing litigation for the two sets of concerns are themselves equally parallel. Further, Baker contends that there is no policy-based reason for providing more antitrust wiggle-room for exclusionary conduct than for collusion. He closes by discussing the enforcement implications of his argument for symmetrical treatment of exclusionary and collusion concerns.

Along the way, Baker provides an overview of Chicago/Post-Chicago differences on the competitive significance of exclusionary practices, summarizes the various types of exclusionary practices (and offers a new taxonomy of such practices), likens the "exclusion problems" to the collusion problems, and discusses the basis for a truncated review of exclusionary practices akin to that used for collusion. And therein lies the central problem of the paper: there are so many facets discussed (in some cases) in very summary form that it can be difficult to keep track of where the pieces fit in the Baker puzzle or whether they really are part of the puzzle at all. Baker may view the extensive discussion of exclusionary strategies as a necessary predicate to his case

for equal treatment of collusion and exclusion under the law but one might wonder whether the detail distracts too much from the main point.

The “Rhetorical Consensus”

At the very beginning of the paper, Baker contends that “exclusionary conduct is commonly relegated to the periphery in contemporary antitrust discourse, while price-fixing, market division and other forms of collusion are placed at the core of competition policy.” (p. 1) He summarizes this view as “the current rhetorical consensus over the lesser priority for exclusion.” (p. 3) Further, he notes, “The more that exclusion is downplayed rhetorically, the more that its legitimacy as a subject for antitrust enforcement will be undermined and the greater the likelihood that antitrust rules will eventually change to limit enforcement against anticompetitive foreclosure when they should not.”⁸ (pp. 7–8)

Some initial questions about the paper include what Baker means by “discourse” about and “downplaying” of exclusionary concerns. Baker cites the views of enforcers, such as former FTC Chairman Timothy Muris and former Assistant Attorney General for Antitrust Thomas Barnett, both of whom support a hands-off approach to anticompetitive claims arising from vertical restraints. Yet, these enforcers might be regarded as squarely in the Chicago School. Thus, their views are not particularly surprising.

But even enforcers who are not so aligned with the Chicago School may approach exclusionary claims more cautiously than collusion claims. For example, in a recent letter to ICANN, the more enforcement-oriented current Justice Department noted that “because there are often efficiencies to vertical integration, the Antitrust Division typically requires a showing of market power before it considers whether a vertical arrangement poses serious competitive concerns.”⁹ To put this in the parlance of decision theory, even a more enforcement-prone Antitrust Division appears more cautious when condemning vertical restraints than collusion because of the concern about the cost of false positives (erroneous convictions). So, in terms of agency discourse, it would appear that qualitatively speaking, both those rooted in the Chicago School and those not so rooted are cautious when evaluating exclusionary claims. But quite obviously, those in the Chicago School are much more committed to per se legality for vertical restraints, while those who are not suggest careful analysis before litigation.

With respect to “discourse” by antitrust practitioners and academics, Baker himself notes the absence of any consensus about the extent to which vertical practices can be anticompetitive and should be aggressively prosecuted. In fact, Baker highlights these differences. He notes the rhetorical consensus is surprising, in part, because of the “significant divide between Chicago school and post-Chicago antitrust commentators . . . over their views on exclusionary conduct.” (p. 5) While many practitioners would agree that the divide is significant, it is unlikely that those in the Post-Chicago camp suggest intervening in vertical relationships without restraint. There is certainly much more of a continuum of views than Baker seems to suggest.

⁸ Baker uses the terms “foreclosure” and “exclusion” interchangeably. (n. 1)

⁹ Letter from James J. Tierney, Antitrust Division, U.S. Dept. of Justice, to Lawrence E. Strickling, Assistant Secretary for Communications and Information, U.S. Dep’t of Commerce (June 14, 2011), available at http://www.ntia.doc.gov/files/ntia/publications/ntia_icann_letter_06162011.pdf. This letter was subsequently forwarded by the Commerce Department to ICANN. Similarly, in a recent presentation, Deputy Assistant Attorney General Fiona Scott Morton noted that with respect to naked agreements to limit price, it is presumed that the anticompetitive effects would dwarf any efficiencies. But there may well be efficiencies with vertical contracts although those contracts can also exclude rivals. “In the face of this variety . . . each case or situation is evaluated on the merits.” Fiona Scott Morton, Contracts that Reference Rivals (Apr. 5, 2012), available at <http://www.justice.gov/atr/public/speeches/281965.pdf>.

In his review of court opinions, he also concludes that the rhetorical consensus is surprising because “during the modern era . . . the Supreme Court and the appeals courts have addressed exclusionary conduct without consistently favoring either defendants or plaintiffs.” (p.6) Yet, he then describes the *Trinko* decision as one that “encapsulates” the issues he wants to address in this paper: “The sweeping rhetoric of Justice Scalia’s opinion for the Court—all dicta—minimizes the competitive concern arising from a monopolist’s unilateral exclusionary acts.” (p. 8)

Describing the rhetorical consensus as reflected in the *Trinko* opinion is itself far too sweeping. As I noted, there is much more of a continuum of views, ranging from per se legality to cautious consideration of anticompetitive claims associated with vertical restraints versus collusion. It is surely not “either/or.” As a result, Baker’s apparent claim that the current consensus reflects Justice Scalia’s views in *Trinko* distracts readers from his key argument—that being more cautious in enforcement and in the law in matters involving potential exclusion than in matters involving potential collusion is unwarranted.

So, in sum, if there is no consensus in practitioner, enforcement agency, or legal discourse, it’s hard to identify what Baker really means by a “rhetorical consensus.” It could be simply that Baker means (contrary to his reliance on *Trinko*) that there is a general view—more or less extreme—that the burden of enforcers and plaintiffs in exclusion matters should be greater than that in collusion matters. This broader rhetorical consensus is all that Baker needs as a set-up to his subsequent discussion so there is no need to demonstrate a more extreme rhetorical consensus.

Exclusion as Collusion

In Baker’s view, a key economics argument for treating exclusionary concerns as if they are as compelling as collusion concerns is that exclusion is in fact just another manifestation of collusion-like conduct. Using Baker’s example, if Coke were a dominant firm and RC had become a potentially aggressive rival, then Coke could come to horizontal terms with RC and vice versa—an outcome Baker would characterize as a “voluntary cartel.”¹⁰ (p. 14) Alternatively, Coke could act to raise the costs of RC by interfering with its ability to distribute its cola or to have the cola bottled. Baker would characterize that outcome as an “involuntary cartel.” (p. 15) But at least in the first instance, whether it’s voluntary or involuntary, the outcome is qualitatively the same: lower output and higher prices than otherwise would be the case.¹¹

Both as an analytic roadmap to identifying and proving anticompetitive exclusion and as a prelude to his discussion of the legal review of anticompetitive exclusionary claims, Baker identifies what he calls the three problems that an excluding firm must solve, as method, sufficiency, and profitability: “identifying a practical method of exclusion, excluding rivals sufficient to ensure that competition is harmed, and assuring profitability of their exclusionary strategy.”¹² (p. 16)

For example, if Coke is to exclude RC from supermarket shelves, that method must be sufficient to eliminate or greatly reduce the prospects that RC will obtain retail distribution. If there are other

¹⁰ For ease of exposition, I assume that Pepsi has merged with Coke and the soda industry only includes RC and Coke.

¹¹ However, if the bargain with distributors requires a sharing of the rents between Coke and the distributors, the distributors’ rents may generate some benefits for consumers as well that would not be a factor in “naked collusion” matters where RC and Coke share the rents themselves. For example, the excess payments that the distributors receive for exclusivity or restricting RC’s access to distribution may lead to more or larger stores, resulting in benefits for consumers. As noted below, exclusion by Coke may be inexpensive, in which case these additional benefits don’t come into play. It may also be that these benefits are not cognizable. Still, this example suggests that there can be outcome differences between a “voluntary” and “involuntary” cartel.

¹² Throughout his discussion of these problems, Baker never hesitates to add the significance of considering whether the efficiencies from the practices offset the anticompetitive effects (although he eschews the “balancing” terminology).

alternative methods of obtaining distribution (presumably, without any significant increase in distribution costs), then the exclusion fails the method test.

Suppose Coke succeeded in excluding RC from supermarket shelves. That outcome might not harm soda competition if Coke failed to exclude other RC-like soda providers (or larger rivals): “[A]ny remaining competition—whether from rivals not excluded or not fully excluded, from entrants, or from among the excluding firms themselves [must] not undermine the ability of the excluding firms to raise market prices.” (p. 17) If that has not been or is not likely to be true, then the exclusion would fail the sufficiency test.¹³

If the exclusionary method was sufficient to harm competition, then the question is whether such an exclusionary strategy would be profitable. For example, the purchase of an exclusionary right by Coke in supermarkets could be inexpensive if supermarkets believed that if they didn’t acquiesce to Coke’s demands, Coke would pull its products from the shelves. Alternatively, it could be very expensive for Coke to acquire that exclusivity if the purpose was to deny RC access to distribution and distributors would have otherwise found RC to be a popular and profitable rival to Coke.

For the record, I have merely skimmed the surface of Baker’s discussion of these three problems so as to focus on his main story—that exclusionary conduct should not be relegated to a lesser antitrust status than collusion. Baker offers illustrations of the three exclusion problems through numerous detailed examples and discussion of the underlying conceptual issues. Through the course of those illustrations, Baker effectively describes a roadmap for antitrust analysis of exclusionary claims. While that discussion is interesting and informative in its own right—and I urge readers not to skim that section—it is a detour from his main story.

Parallels in the Legal Rules Governing Exclusionary Claims

Having made the point that in antitrust economics, anticompetitive exclusion as an involuntary cartel raises concerns that parallel those in collusion matters, Baker then observes the legal parallels between the rules governing collusion and exclusion. Both, for example, can be evaluated under a similar rule of reason approach. In the case of collusion claims, the inquiry focuses on whether the cartel has solved three problems: reaching agreement, devising a scheme for deterring cheating, and developing a strategy for preventing new competition. In the case of exclusionary claims, the analogous focus is effectively on whether the three exclusionary problems—method, sufficiency, and profitability—are “solved” by the exclusionary strategy.

But reaching full equivalence for collusion and exclusion also requires a way for the courts to condemn the exclusionary conduct via a quick look or a truncated rule of reason. Baker observes that under Section 1 of the Sherman Act, a horizontal restraint can be condemned on a quick look basis if: (1) there is an agreement among rivals; (2) there are facts suggesting harm to competition; and (3) there is no plausible efficiency justification. He also notes that the second element can be satisfied if the conduct is per se illegal (price fixing and market division) or “by showing that [the] anticompetitive effect is intuitively obvious based on a facial analysis of the agreement.”¹⁴ (p. 29)

In the case of exclusion, truncation would mean “avoiding a detailed analysis of whether the excluding firms solved their ‘exclusion problems’: method, sufficiency, and profitability. In exclu-

¹³ Baker is careful to distinguish between prospective effects of an exclusionary practice recently adopted vs. retrospective effects of an ongoing practice.

¹⁴ For the retrospective evaluation of conduct, that element can be satisfied “through actual effects evidence demonstrating that competition has been harmed.” (p. 29)

sion cases . . . courts routinely truncate their review to limit the analysis of sufficiency and profitability.” (p. 31) Baker argues that under a parallel truncated rule for exclusionary conduct, a vertical restraint would be found anticompetitive if “the excluding firms foreclose competition from all significant rivals . . . and the exclusionary conduct lacks a plausible efficiency justification.” (p. 32) As an example, suppose that Coke used exclusive agreements for shelf space with the effect that RC was harmed. Under Baker’s truncated rule of reason, the court could infer harm to competition “from proof of only three elements: that Coke excluded RC, a significant rival, that Coke could exclude all other significant rivals (if any) through similar means; and that the agreement had no plausible efficiency justification.”¹⁵ (pp. 31–32) In terms of the exclusion problems, the profitability of the strategy is inferred.

While Baker argues that his truncated approach to exclusion can be regarded as “synthesizing the leading cases [of exclusionary conduct]” (p. 32), he acknowledges that the courts have not characterized their opinions in this way. For example, if it can be shown that the excluding firm has market power, could it be inferred that “all significant rivals, actual or potential, are excluded from proof that one such rival has been excluded?” (p. 34) What business justifications would trigger a full rule of reason review? Can this truncated review be applied to predatory pricing cases, or would such truncation be precluded by the Supreme Court’s focus on evidence of below-cost pricing and recoupment?

Baker acknowledges that these questions (and others) need resolution but, even if resolved, I am skeptical about a truncated review, especially in light of his predatory pricing example. While Baker argues that the “special rules” governing predatory pricing have their roots in a perhaps erroneous view that price predation is rare, he never explains how his proposed truncated review would result in more efficient or sounder decisions than the current focus on below-cost pricing and recoupment.¹⁶ Perhaps instead, under Baker’s proposal, one can never apply a truncated rule of reason to predation because a potential efficiency is built into the practice—lower prices benefit consumers. But if efficiency arguments eliminate the truncated approach for predation, could not the same be said for most vertical restraints? After all, their use (in many if not most cases) would likely have at least facially plausible efficiency justifications, which is far less likely to be true in collusion matters.¹⁷ Following that logic, truncation for exclusionary claims will only be rarely applicable.

My concerns notwithstanding, Baker concludes that given the parallels in the full rule-of-reason assessment of exclusion and collusion and the apparent parallels (my characterization) in the truncated review (including burden-shifting which I have not discussed), “the courts do not place a higher burden on plaintiffs seeking to demonstrate anticompetitive exclusionary conduct.” (p. 26)

Policy Issues with Equal Treatment of Collusion and Exclusion

Having concluded that as a matter of economics, collusion and exclusion can be thought of as addressing cartel issues and that the legal framework does not impose a higher burden on plain-

¹⁵ On this last point, I assume that Baker is assuming that Coke failed to provide any plausible business rationale for the practice, i.e., effectively “overbuying” shelf space.

¹⁶ This is the conventional-wisdom concern that aggressive pursuit of predation will result in substantial false positives, given the difficulties of distinguishing predatory from competitive pricing. Indeed, Baker makes this very point in his discussion of predation, highlighting the concern that “permitting plaintiffs to bring antitrust claims arising from low prices would chill competition on price.” (n. 168)

¹⁷ Clearly, there are horizontal collaborations that can be grounded in efficiencies, such as joint ventures, standard setting, and joint marketing. Thus, again, it’s a matter of degree.

tiffs in exclusion matters as compared to collusion matters, Baker then considers whether as a matter of policy, plaintiffs should in fact bear a greater burden in exclusionary matters. Here Baker reviews conclusions based on a decision-theoretic or error-cost approach (i.e., designing rules that minimize the total costs of making errors) that defendants should have an edge over plaintiffs and enforcers. That is, he considers arguments that “false positives ([erroneous] convictions) are more likely or more costly for exclusionary violations than for collusive ones, while false negatives ([erroneous] acquittals) are less likely and less costly for exclusion than collusion.” (p. 37)

Specifically, he reviews the following kinds of claims (among others):

- a. That false negatives are of little concern because of the self-correcting nature of markets and that false positives discourage innovation. Baker takes issue with both premises, but notes that if true, that would apply to all antitrust, not just when considering exclusionary practices.
- b. That courts are ill-equipped to conduct the “detailed factual assessments required to determine whether firms can solve their exclusion problems or to compare the harms from exclusionary conduct against the pro-competitive benefits.” (p. 40) But he notes that the rule of reason evaluation of collusion claims requires the same kind of factual assessments.
- c. That the “single monopoly profit” analysis means that the exclusionary practices can’t make matters worse. But Baker notes that the circumstances that would justify invoking that analysis are very limited.

To be sure, these arguments have been made in favor of more lenient treatment for exclusionary conduct, and Baker may well be correct in dismissing them. However, when he addresses what I regard to be the core error-cost concern that efficiencies are (much) more likely to be associated with vertical agreements than horizontal agreements, with the resulting higher costs of false positives, his discussion borders on the cryptic. Citing *Leegin*, he asserts that the studies that reach this conclusion “do not discriminate between exclusionary and collusive explanations for vertical agreements . . . [and] so cannot provide a basis for downplaying exclusion relative to collusion.” (p. 42)

And that’s (almost) all he wrote. Given how significant this concern is and how the evaluation of false positives in vertical restraint enforcement and litigation can be analogized to those in the predatory pricing context discussed above, this is easily the most disappointing discussion in the paper. The (a)–(c) arguments above (and the others discussed by Baker) are clearly relevant. But it strikes me that the driving force for concern for the cost of false positives in exclusionary cases is the view that vertical practices are more likely to be linked to efficiencies than collusion.¹⁸ One Baker-like response could well be, “No problem”—a full rule of reason approach would be applied where there is a plausible efficiency justification for the exclusionary practice. That would make sense to me, but given Baker’s focus on a truncated review of exclusionary practices, I suspect he would disagree.

Enforcement Implications

Baker argues that if exclusionary concerns are considered to be on a par with collusion concerns, the current rhetorical consensus would be replaced with one that recognizes that parity and would protect that parity “against pressure for modifications that would limit enforcement.” (p. 46)

¹⁸ Baker does seem to take this concern on more directly in a footnote, but his response seems to rely on litigation outcomes rather than whether underlying efficiencies are more likely with vertical than horizontal constraints. See n.189.

Baker also notes that that shift would increase deterrence to the extent that the current rhetoric leads firms to conclude that anticompetitive exclusion is unlikely to be challenged, increasing the incentives to engage in such behavior. Further, it could increase the priority that the enforcement agencies place on pursuing anticompetitive exclusionary claims. Yet, given limited enforcement resources, if it is even somewhat more likely that vertical restraints rather than horizontal restraints have plausible efficiency grounds, then an enforcement tilt towards collusion would also be efficient (assuming a comparable cost of false negatives). Again, the question would be how much of a tilt is efficient.

Along the Way . . .

What I have done here is to focus on the more novel aspects of the Baker paper. However, there are a number of other discussions in the paper that I have not addressed in any detail but are worth the read. In particular, Baker provides numerous examples of vertical practices that have the effect of creating an “involuntary cartel” and summarizes the questions that need to be addressed in establishing competitive harm from those practices. Baker also offers a new taxonomy for categorizing anticompetitive vertical practices that may be useful, highlighting in particular the issues of concern with respect to the purchase of exclusionary rights (as well as a mode of analysis).¹⁹

Summing Up

While I believe that Baker’s use of the dicta in *Trinko* creates a strawman with respect to the “rhetorical consensus,” there surely is a qualitative consensus that the agencies and the courts should tilt the playing field towards the defendants when evaluating the competitive effects of allegedly exclusionary practices, but considerable disagreement about how large that tilt should be. Baker may have made a good case for a more level playing field. As my concern about Baker’s error-cost analysis suggests, some may find that the paper is less convincing in suggesting that there should be no tilt. At the end of the day and as a general matter, it would be difficult to find the kind of varied efficiency rationales associated with vertical restraints that would ever match those in a horizontal collusion matter. There may well be the equivalent of “naked” exclusion (such as leveling a rival’s distribution facilities), but typically, these matters will not be so clear cut.²⁰ ●

—JOHN R. WOODBURY

¹⁹ A related taxonomy can be found in Michael H. Riordan & Steven C. Salop, *Evaluating Vertical Mergers: A Post-Chicago Approach*, 63 ANTITRUST L.J. 513 (1995).

²⁰ Baker prefers the term “plain exclusion” for such matters because the phrase “naked exclusion” is in economics associated with one of the leading papers on exclusion. Eric B. Rasmussen, J. Mark Ramseyer & John S. Wiley, *Naked Exclusion*, 76 AM. ECON. REV. 921 (1986).

Made in U.S.A: Time for a Change?

Randy Shaheen, Amy Mudge, and Annie Lee

The Federal Trade Commission's enforcement of Made in USA (MIU) claims has a long and somewhat tumultuous history. This may be in part because unlike many other aspects of the FTC's consumer protection mission, how the FTC interprets and enforces MIU claims is thought by many to have significant economic ripple effects. So long as advertisers believe the claim is important to consumers' purchase decisions, so the theory goes, they will make manufacturing and sourcing choices that favor the maintenance and creation of U.S. jobs and decrease reliance on "job-killing" imports.

But the effects of MIU policy are far from clear, and there are many questions that could be asked. Has the MIU policy encouraged manufacturers to source more inputs domestically or has it, in fact, discouraged them? And does the current policy reflect consumers' perceptions in an increasingly international economy? If not, and if it is potentially operating to discourage use of the claim and sourcing of inputs domestically, is it time for the FTC to reevaluate its existing MIU policy?

History of the Policy

FTC enforcement against MIU claims goes back at least seventy-two years. In *Vulcan Lamp Works, Inc.*, an advertiser entered into a consent decree arising from claims on cartons and cards that its incandescent lamps were "Made in USA" when the bulbs were imported from Japan.¹

A 1964 consent order found an MIU claim to be misleading because the products contained substantial Japanese inputs and were not "wholly of domestic origin."² However, the consent order prohibited the use of the claim only when any "substantial" item or part was made in any foreign country. Four years later, several FTC advisory opinions, issued in response to questions about what percentage of foreign-made components an MIU product could contain, affirmed that the standard for such claims was that they "must be made in [their] entirety in the United States" and must not contain "foreign made components of a substantial nature."³

In 1994, Congress amended the FTC Act to address MIU label claims. The amendment, which is still currently in place, states in part:

To the extent any person introduces, delivers for introduction, sells, advertises, or offers for sale in commerce a product with a "Made in the U.S.A." or "Made in America" label, or the equivalent thereof, in

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¹ *Vulcan Lamp Works, Inc.*, 32 F.T.C. 7 (1940).

² *Windsor Pen Corp.*, 64 F.T.C. 454 ¶¶ 5–6 (1964).

³ 74 Op. Fed. Trade Comm'n 1673 (1968); *see also* 73 Op. Fed. Trade Comm'n 1321 (1968) (when presented with the question as to what percentage of foreign-made components a product could contain without additional disclosures as to the origin of the content, the FTC issued advisory opinions indicating that a product labeled Made in U.S.A. "would constitute an affirmative representation that the product was made in its entirety in the United States").

order to represent that such product was in whole or substantial part of domestic origin, such label shall be consistent with decisions and orders of the Federal Trade Commission issued pursuant to section 45 of this title. This section only applies to such labels. Nothing in this section shall preclude the application of other provisions of law relating to labeling. The Commission may periodically consider an appropriate percentage of imported components which may be included in the product and still be reasonably consistent with such decisions and orders.⁴

A pair of complaints issued in the same year against two running shoe companies⁵ prompted a two-year review of the FTC's MIU standard, including a public workshop and the collection of consumer survey evidence. The purpose of the review was to analyze the standard in light of changing global economic realities and consumer understanding of the claims.⁶

In May 1997, the Commission proposed a significant revision to its MIU standard. Products claiming "Made in USA" under the proposal would have to be "substantially" made in the United States. To meet this standard, the Commission proposed two safe harbors. The most relevant one required that the product's last substantial transformation take place in the United States and at least 75 percent of manufacturing costs be of domestic origin.⁷

The proposed revisions to the MIU standard were greeted by opposition from consumers, consumer groups, trade associations, unions, and politicians. They asserted that a weakened MIU standard would lead manufacturers to reduce their U.S. inputs to the minimum necessary to claim MIU.⁸ In response to this opposition, some commenters suggested modifying the proposed revisions to the MIU standard to raise the threshold percentage of manufacturing costs required to be incurred domestically.

The Commission's proposed revisions and other reform efforts fell flat. In December 1997, the Commission decided, in response to the overwhelming number of comments submitted in opposition to the change, to abandon its proposed modification to the MIU standard and to retain the "all, or virtually all" standard. At the same time, the Commission issued an Enforcement Policy Statement (Policy Statement), which provided additional guidance on how the FTC would evaluate MIU claims.⁹ The Policy Statement, which is still in effect, states:

[W]hen a marketer makes an unqualified claim that a product is "Made in USA," it should, at the time the representation is made, possess and rely upon a reasonable basis that the product is in fact all or virtually all made in the United States. A product that is all or virtually all made in the United States will ordinarily be one in which all significant parts and processing that go into the product are of U.S. origin. In other words, where a product is labeled or otherwise advertised with an unqualified "Made in USA" claim, it should contain only a de minimis, or negligible, amount of foreign content.¹⁰

⁴ 15 U.S.C. § 45a.

⁵ *New Balance Athletic Shoe, Inc.*, FTC Dkt. No. 9268, 1996 WL 532845 (Sept. 3, 1996); *Hyde Athletic Indus., Inc.*, 122 F.T.C. 427 (1996). Both orders were finalized in December 1996.

⁶ Request for Public Comment in Preparation for Public Workshop Regarding "Made in USA" Claims in Product Advertising and Labeling, 60 Fed. Reg. 53,922-02 (proposed Oct. 18, 1995).

⁷ The other safe harbor would have required that the last substantial transformation of the product and each of its significant inputs take place in the United States. Request for Public Comment on Proposed Guides for the use of U.S. Origin Claims, 62 Fed. Reg. 25,020-01 (proposed May 7, 1997).

⁸ Alan Kline, *Groups Want No Slack on 'USA' Label*, WASH. TIMES, June 19, 1997, at B10.

⁹ Enforcement Policy Statement on U.S. Origin Claims, 62 Fed. Reg. 63,756-01 (Dec. 2, 1997).

¹⁰ *Id.* at 63,768.

This suggests that the companies failed to understand how the Commission interprets “Made in USA” claims and thought, for example, that the product only had to be produced at a U.S. manufacturing facility.

In addition, the final assembly or processing (i.e., the last substantial transformation) of a product must occur domestically for a manufacturer to use an unqualified “Made in U.S.A.” statement. Unlike the revisions the Commission had proposed, there is no bright-line safe harbor for domestic content. Case-by-case considerations include the proportion of U.S. manufacturing costs in relation to foreign costs and how far removed the foreign content is from the finished product. Reasonable consumer expectations and the nature of the product are the primary guiding principles for the Commission when evaluating whether enforcement action is warranted.¹¹ In our experience, the Commission has permitted the claim when domestic content has been as low as approximately 90 percent.

The Policy Statement also provides standards for making qualified claims of U.S. origin. Qualified claims are permitted for the product as a whole and with respect to specific components or processes. These can include “Made in USA of U.S. and Imported Parts” or “__% U.S. Parts.”

Application of the Current Standard

Commission enforcement activity has been intermittent but ongoing. The Commission has obtained consent orders from a number of manufacturers settling allegations of MIU violations, including The Stanley Works, a U.S. toolmaker;¹² USDrives Corporation, a manufacturer and seller of CD ROM drives;¹³ American Honda Motor Company, Inc., a lawn tractor manufacturer;¹⁴ Jore Corporation, a manufacturer of power tool accessories;¹⁵ and Enhanced Vision Systems, a maker of magnification devices.¹⁶ A number of closing letters have also been issued, indicating possible violations for which the Commission declined to bring an enforcement action.¹⁷

In most, if not all, of these cases, the violation was clear cut and not simply one where the parties might have disagreed, for example, over how to calculate domestic costs. This suggests that the companies failed to understand how the Commission interprets “Made in USA” claims and thought, for example, that the product only had to be produced at a U.S. manufacturing facility.

Other companies are aware of the FTC’s standard but find it increasingly difficult to meet. In some cases, domestic components are available but at a much higher price than imports, and manufacturers have to weigh whether consumers will pay more for a product labeled “Made in

¹¹ *Id.* at 63,768–69.

¹² Stanley Works, No. FTC File No. 982-3570, 1998 WL 951191 (Jan. 1998) (respondent’s advertising campaigns promoted its line of wrenches and wrench sets as being American-made; respondent also manufactured these products for other large tool companies, and in both instances a significant portion of the wrench components were of foreign origin).

¹³ USDrives Corp., FTC File No. 982-3587, 1999 WL 21298 (1999) (respondent’s CD ROM drive packaging prominently displayed national symbols (i.e., bald eagle, American flag, Statue of Liberty), as well as red, white, and blue lettering of the company name. “Made in China” appeared in small print, inconspicuously located on side panels on two of its products, although all of the drives identified in the complaint were made in China, of primarily non-U.S. components.).

¹⁴ American Honda Motor Co. Inc., FTC File No. 982-3600, 1999 WL 21295 (Jan. 1999) (respondent’s advertising made the unqualified assertion that certain of its lawn tractors were “Made in America by Honda,” when in fact a substantial portion of its product inputs were made in foreign countries).

¹⁵ Jore Corp., 131 F.T.C. 585 (2001) (respondent’s packaging and labeling of certain power tool accessories both explicitly and implicitly [through prominent use of the American flag] represented that products were Made in U.S.A. A fine print disclaimer indicated that “global components” were used in the making of the items).

¹⁶ Enhanced Vision Sys., Inc., FTC No. C-4265, 2009 WL 2979771 (Sept. 3, 2009) (respondent’s advertisements for its magnification products represented that two of its lines were “Made in the U.S.A.” when a significant portion of the components were of foreign origin).

¹⁷ Closing Letters from Elaine D. Kolish, Associate Director of the FTC Bureau of Consumer Protection Enforcement Division, to Armary Sponge Company, The Ducane Corporation, Enderes Tool Company, and In The Swim (June 24, 2011), available at <http://www.ftc.gov/os/statutes/madeusa/closing.shtm>.

USA” and, if so, how much more. In other cases, manufacturers cannot source sufficient U.S. components to meet the FTC’s standard because domestic component suppliers no longer exist. The Policy Statement permits an exemption, in some cases, for raw materials like vanilla that cannot be sourced domestically, but fails to provide a similar exemption for components that are not manufactured in the United States. Given the rapid pace with which manufacturing operations are moving overseas,¹⁸ the lack of a component exemption is likely becoming increasingly problematic for domestic producers.

This problem is exacerbated by a California law, in existence since 1945, which prohibits Made in U.S.A. claims “when the merchandise *or any article, unit, or part thereof*, has been entirely or substantially made, manufactured, or produced outside of the United States.”¹⁹ The statute lay relatively unnoticed until two fairly recent class actions were filed.²⁰ In *Kwikset*, which went to the California Supreme Court on a class certification issue that related to standing rather than the underlying MIU standard, the lower court found the defendants to have violated the MIU standard because the products in question, locks, were touted as American-made but contained screws and pins made in Taiwan.²¹ As a result of the attention focused on the California statute, and the difficulty of labeling and advertising differently in California, companies may be reluctant to make MIU claims when virtually any inputs are from outside the United States.

[I]t is increasingly impractical or impossible for U.S.-based companies to meet the current MIU domestic content standard.

Viability of the Standard in Today’s Marketplace

As noted above, it is increasingly impractical or impossible for U.S.-based companies to meet the current MIU domestic content standard. Companies that would like to make an MIU claim but find that it is impossible or economically impractical to do so can either make the claim and risk an enforcement action by the FTC or a public or private action in California state court; not make any MIU claim; or make a qualified claim such as “Made in USA of U.S. and Imported Parts.”

A qualified MIU claim may be the least attractive of these options. Under federal fair labeling laws, a U.S. manufacturer must list its place of business²² so consumers, regardless of any MIU or qualified MIU claim, will see a U.S. address on the label. The FTC permits such labeling without triggering MIU scrutiny so long as it is not overly prominent.²³ Thus, U.S. manufacturers may be better off just including their address,²⁴ rather than including a disclaimer that only serves to focus attention on the product’s use of some imported parts.²⁵

¹⁸ Stacy Curtin, *Sen. Sanders Spurs Return to ‘Made in America’: Says U.S. Future Depends on It*, DAILY TICKER, June 16, 2011, <http://finance.yahoo.com/blogs/daily-ticker/sen-sanders-spurs-return-made-america-says-u-125105935.html> (“In the last 10 years, 50,000 factories in America have shut down’ due to free trade policies like the North American Free Trade Agreement” (quoting Senator Bernie Sanders)).

¹⁹ CAL. BUS. & PROF. CODE § 17533.7 (2012) (emphasis added).

²⁰ *Colgan v. Leatherman Tool Group, Inc.*, 38 Cal. Rptr. 3d 36 (Cal. Ct. App. 2006); *Benson v. Kwikset Corp.*, 62 Cal. Rptr. 3d 284 (Cal. Ct. App. 2007).

²¹ *Kwikset*, 62 Cal. Rptr. 3d at 297.

²² 16 C.F.R. § 500.5 (2012).

²³ Fed. Trade Comm’n, Bureau of Consumer Protection, *Complying with the Made in USA Standard* (Dec. 1998), available at <http://business.ftc.gov/documents/bus03-complying-made-usa-standard>.

²⁴ Up until 1997 the FTC took the position that there was a rebuttable position that consumers would understand a product to be MIU if it was not otherwise labeled with a country of origin. 62 Fed. Reg. 25,020–01, 25,047.

²⁵ There is a “gap” between the FTC’s MIU standard and Customs’ country of origin requirements. Under country of origin standards, a product does not have to be labeled as imported from another country so long as the “last substantial transformation” of the product took place in the United States. 19 U.S.C. § 1304. Thus, a product might not qualify as MIU because it contains significant imported components but it does not have to be labeled as originating from outside the U.S. because it was manufactured (i.e., “substantially transformed”) in the United States.

Once a manufacturer decides it will not or cannot label its product as “Made in USA” and, if a qualified claim is not an attractive marketing option, there is little reason for the manufacturer not to source imported components whenever they are cheaper than their domestic counterparts. This not only costs U.S. jobs, it potentially accelerates the flight of manufacturing overseas, thus making it harder for others to meet the MIU standard as well. If the MIU standard were less difficult to meet, more manufacturers might find it practical to meet and continue sourcing domestically.

Consider this hypothetical: a company recognizes that it is too costly or not possible to maintain the de minimis amount of foreign content required by the FTC to substantiate an MIU claim. Its marketing department decides that a qualified MIU claim is not a likely selling point. Under this scenario, the company might then decide to source overseas any content that is cheaper (and perhaps of comparable quality) to its domestic counterpart. If the FTC’s MIU standard, however, required only 50 percent or 75 percent domestic content, then that same company might find it possible to make an MIU claim and source less content overseas than it might have under the stricter standard. At the same time, of course, companies that were able to meet the de minimis standard might now source more content overseas. Which of these two alternatives is the most likely? Although no studies appear to address this issue, it seems likely to be the former. Given the economic significance of this question, it may well be, as we suggest, an issue that the FTC may wish to examine.

Of course, the FTC is not charged with creating U.S. jobs or stimulating the economy but with preventing consumer deception. However, the consumer perception rationale for the FTC’s current standard was not particularly strong to begin with and has likely only weakened further given the increasing globalization of the economy. Back in 1995, the FTC commissioned a survey asking a series of questions related to “Made in USA” claims.²⁶ When asked whether they agreed with a MIU claim for a product that had 70 percent U.S. cost, 67 percent of respondents strongly or somewhat agreed (versus 75 percent when the U.S. cost was at 90 percent). When asked “What Does a ‘Made in the USA’ Label Mean?” only 6.3 percent of consumers responded “All Made in US.” Finally, and perhaps most significantly, when asked whether an MIU statement “suggests or implies anything about where the parts that went into the product were manufactured?” only 11 percent of respondents agreed that it suggested or implied “anything about how much of the parts that went into the product were manufactured in the United States.” Even assuming that the survey was well-designed, such a percentage is well below what would typically be considered relevant.²⁷

There is little reason to believe that the consumer perception evidence in support of the current standard has strengthened in the sixteen years since the survey was done. Consumers are likely even more cognizant of the fact that commerce is increasingly global in nature and that more and more components are manufactured overseas. Even if consumers were not predisposed to adopt a more “liberal” interpretation of MIU, they are frequently exposed to statements by opinion leaders and the media that MIU means that the product comes from a U.S. manufacturing facility. This likely serves to further influence consumers’ understanding of the phrase.

For example, President Obama in a recent speech said that it was not enough to invent products here; we should also be “building” them here so that they can be stamped “Made in

²⁶ Fed. Trade Comm’n, Made in USA Study Summary of Results (Jan. 25, 1997) (on file with authors).

²⁷ See, e.g., Sara Lee Corp. v. Kayser-Roth Corp., 81 F.3d 455, 466–67 & n.15 (4th Cir. 1996) (finding 15–20 percent consumer confusion sufficient to constitute deception).

If the MIU standard were less difficult to meet, more manufacturers might find it practical to meet and continue sourcing domestically.

America.”²⁸ In other widely publicized remarks, including a story in *USA Today*, U.S. Senator Bernie Sanders expressed similar concerns, lamenting the closing of U.S. factories and the prevalence of goods available at the Smithsonian that were labeled as “Made in China” and pushed the museum to sell products “Made in USA.”²⁹ The media also routinely publishes stories that interpret “Made in USA” to mean that the product was manufactured at a U.S. factory, not that its component parts were necessarily produced within the United States.³⁰

If the President and many businessmen and reporters do not interpret “Made in USA” to mean that “all or virtually all” of the costs are domestic, most consumers may not either, particularly given the influential role of the media on consumer perceptions.³¹

Reevaluation of the Current MIU Policy

It has been fifteen years since the FTC last reviewed its MIU policy. The passage of time and the increasing movement of manufacturing overseas have only strengthened the case for the FTC to reevaluate its standards for making an MIU claim. In doing so, it may be useful for the FTC to consider the difficulty of finding domestic sources for components, the cost “surcharge” typically associated with an MIU claim, how widely qualified claims are used by manufacturers, how “Made in USA” claims are understood by consumers, and the role of MIU claims in supporting U.S. competitiveness in the global economy. In the meantime, companies need to be mindful of the FTC and California MIU requirements and make only substantiated (or appropriately qualified) MIU claims. ●

²⁸ President Barack Obama, Remarks by the President at Signing of the America Invents Act at the Thomas Jefferson High School, Alexandria, Va. (Sept. 16, 2011), <http://www.whitehouse.gov/the-press-office/2011/09/16/remarks-president-signing-america-invents-act> (“We need to continue to provide incentives and support to make sure the next generation of manufacturing takes root not in China or in Europe, but right here in the United States—because it’s not enough to invent things here; our workers should also be building the products that are stamped with three proud words: Made in America.”).

²⁹ Nicole Gaudiano, *Smithsonian Shop Sells U.S.-Made Gifts*, USA TODAY, June 9 2011, http://www.usatoday.com/money/industries/retail/2011-06-08-smithsonian-buy-american-products-gifts_n.htm. At least one Smithsonian museum opened up a gift shop that carried 100 percent American-made goods, a claim that is likely the equivalent of MIU under the FTC’s Enforcement Policy. In the Senator’s remarks there is no discussion about where the components come from, and it is clear from both the Senator’s remarks and the article that accompanied them that the entire focus is on whether the manufacturing facilities that make the finished goods are located in the United States. See Curtin, *supra* note 17.

³⁰ For example, ABC ran an extensive series on “Made in America” in October 2011, with one of the stories featuring a “Made in USA” clothing line. This manufacturer of this clothing line was distinguished from another clothing manufacturer that has “factories outside the U.S.” See Susanna Kim, *Club Monaco Launches ‘Made in the USA’ Men’s Collection*, ABC NEWS, Oct. 28, 2011, <http://abcnews.go.com/Business/MadeInAmerica/club-monaco-high-end-retailers-market-made-usa/story?id=14829784>. The feature article for the series is entitled “Made in America: A Brief History of U.S. Manufacturing” and is rife with discussions of factories, manufacturing, and assembly lines but does not discuss the origin of component parts processed on the U.S. based assembly lines. Bradley Blackburn & Eric Noll, *Made in America: A Brief History of U.S. Manufacturing*, ABC NEWS, Feb. 17, 2011, <http://abcnews.go.com/Business/made-america-middle-class-built-manufacturing-jobs/story?id=12916118>.

³¹ For an illustration of further confusion in this area, see ALAN UKE, *BUYING AMERICA BACK* (2012). According to an article in *BloombergBusinessweek*, Uke argues that Made in USA means that the product was “assembled” or “substantially transformed” in this country but some or all of the components could have originated elsewhere. Nick Leiber, *Could Better Labels Shrink the Trade Deficit*, BLOOMBERGBUSINESSWEEK, Apr. 19, 2012, <http://www.businessweek.com/articles/2012-04-19/could-better-labels-shrink-the-trade-deficit>. This sounds similar to the Country of Origin test used by the Customs Department for imported products (but not those labeled “Made in USA”) and also suspiciously similar to what we argue is the most likely consumer understanding of MIU—that products so labeled came from U.S. factories. However, this is not the current FTC standard.