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Analyzing *High-Tech Employee*: The Dos and Don'ts of Proving (and Disproving) Classwide Antitrust Impact in Wage Suppression Cases

Kevin Caves and **Hal Singer** examine the econometric approach employed by plaintiffs' expert to prove classwide antitrust injury in *In re High-Tech Employee*. They contrast that approach to the qualitative arguments relied on by the defendants' experts and caution that heavy reliance on abstract methodological critiques in the face of econometrically intensive evidence is a risky strategy.

The FTC's Revised Fred Meyer Guides: Back to the Sixties

Irv Scher examines the FTC's recently revised Guides for Advertising Allowances and Other Merchandising Payments and Services, popularly known as the Fred Meyer Guides. He argues that the FTC erred by taking a step away from *GTE Sylvania* and *Volvo* and towards promoting intrabrand over interbrand competition.

The Academic Research Path of Professor Francine Lafontaine, Director, FTC Bureau of Economics

Roger Blair examines the professional background of **Francine Lafontaine**, newly appointed FTC Bureau of Economics Director. He describes her entry into the antitrust world from her research into franchising and characterizes her as an empirically based economist who will demand solid evidence before using theory to advance public policy.

Book Review: A Harsh Report Card on the Merger Enforcement Process

Robert Skitol describes some of the key findings in **John Kwoka**'s new book assessing the U.S. antitrust agencies' merger enforcement record. Based on his findings that a significant number of both cleared and challenged mergers result in anticompetitive price increases, Kwoka calls for the agencies to undertake more retrospective analyses of their merger review programs.

Analyzing *High-Tech Employee*: The Dos and Don'ts of Proving (and Disproving) Classwide Antitrust Impact in Wage Suppression Cases

Kevin Caves and Hal Singer

In re High-Tech Employee is a high-profile class action alleging that top executives at some of Silicon Valley's most prominent companies, including Apple, Google, Intel, and Adobe, conspired to restrict recruiting and hiring of high-tech workers as a mechanism for suppressing compensation. The class, which consists of approximately 60,000 technical, creative, and research and development employees, was certified in October 2013.[1] In May 2014, a proposed settlement of approximately $324.5 million was announced, only to be rejected in August 2014 by the district court, which found that the proposed amount "falls below the range of reasonableness."[2] With trial scheduled for April 2015, a new proposed settlement of approximately $415 million was filed with the court as this article went to press.[3]

The class action followed on the heels of a Department of Justice (DOJ) investigation in which the DOJ concluded that the defendants had entered into a web of bilateral agreements prohibiting "cold calling," which "disrupted the competitive market forces for employee talent"[4] and "substantially diminished competition to the detriment of the affected employees who were likely deprived of competitively important information and access to better job opportunities."[5] The DOJ investigation revealed substantial documentary evidence, as well as evidence of direct communications among the defendants. For example, Apple and Google allegedly maintained internal "Do Not Call Lists" containing the names of rival companies whose employees could not be solicited.[6] When Apple complained to Google that the agreement had been violated, Google allegedly responded with an internal investigation, subsequently reporting the results to Apple.[7]

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[1] Order Granting Plaintiffs' Supplemental Motion for Class Certification, High-Tech Employee Antitrust Litig., No. 11-CV-02509 (N.D. Cal. Oct. 24, 2013).

[2] Order Denying Plaintiffs' Motion for Preliminary Approval of Settlements with Adobe, Apple, Google, and Intel, High-Tech Employee Antitrust Litig., No. 11-CV-02509 (N.D. Cal. Aug. 8, 2014); *see also* Jeff Elder, *Silicon Valley Tech Giants Discussed Hiring, Say Documents*, Wall St. J., Apr. 20, 2014; *see also* Dan Levine, *Judge Rejects $324.5 Million Settlement over Apple, Google Hiring*, Reuters, Aug. 8, 2014.

[3] Notice of Motion and Motion for Preliminary Approval of Class Action Settlement; Memorandum of Points and Authorities in Support Thereof, High-Tech Employee Antitrust Litig., No. 11-CV-02509 (N.D. Cal. Jan. 15, 2015); *see also* Megan Geuss, *Apple, Google Give High Tech Workers an Extra $90 Million in "No-Poach" Suit*, Ars Technica (Jan. 15, 2015), http://arstechnica.com/tech-policy/2015/01/apple-google-give-high-tech-workers-an-extra-90-million-in-no-poach-suit/.

[4] Competitive Impact Statement, United States v. Adobe Systems, Inc., Case No. 1:10-cv-01629 (D.D.C. Sept. 24, 2010), *available at* http://www.justice.gov/atr/cases/adobe.htm.

[5] *Id.*

[6] *Id.*

[7] *Id.*

In another exchange, Apple CEO Steve Jobs allegedly warned Google founder Sergey Brin in 2005 that "[i]f you hire a single one of these people, that means war."[8]

Yet when the plaintiffs' theory of wage suppression is scrutinized with a view to developing a defensible proof of common impact, it becomes clear that the plaintiffs' path was far from straightforward, particularly in light of the difficulties encountered by plaintiffs in prior class actions alleging wage suppression, such as *Reed v. Advocate Health Care*.[9] The complicating factors in *High-Tech Employee* included (1) an alleged web of bilateral agreements spanning various time periods (as opposed to a single agreement encompassing all defendants); (2) a diverse array of class member job descriptions and compensation structures, with significant variation both within and between defendants; and (3) a lack of explicit wage fixing on the part of the defendants.

Apple CEO Steve Jobs allegedly warned Google founder Sergey Brin in 2005 that "[i]f you hire a single one of these people, that means war."

The plaintiffs' economic expert employed an econometrically intensive approach to proving classwide impact, drawing on a two-stage framework developed in prior wage suppression litigation. In contrast to the plaintiffs' data-driven strategy, the defendants' expert rebuttals tended to rely heavily on abstract methodological critiques. In certifying the class, the district court rejected these rebuttals, finding instead that the plaintiffs had presented a common and viable method for demonstrating classwide antitrust injury.

An examination of the court's findings in *High-Tech Employee*, along with the evidence proffered by experts for both the plaintiffs and the defense, offers insights into some of the "do's and don'ts" of proving (and disproving) classwide impact in wage suppression cases in particular and in antitrust class actions more generally.

The Plaintiffs' Proof of Impact

The plaintiffs' expert adopted a two-step methodology to demonstrating classwide impact, previously developed and deployed in *Johnson v. AzHHA*.[10] The first step requires the expert to identify a plausible economic theory, along with corroborating evidence, connecting the challenged conduct to a generalized anticompetitive effect (in this case, general wage suppression). In the second step, the expert must demonstrate the existence of a plausible mechanism (such as a rigid compensation structure) that would transmit these anticompetitive effects to all or a large share of the proposed class.[11] In *High-Tech Employee*, the plaintiffs' expert relied primarily on econometric analyses designed to show (1) that the alleged anti-solicitation agreements suppressed wages generally by imposing an informational asymmetry that inhibited the process of price discovery; and (2) that the defendants' implicit and explicit emphasis on internal equity—the notion that employees doing the same work should generally receive similar compensation—created uniform and rigid compensation structures, leading to classwide impact.

Step 1: General Wage Suppression. The plaintiffs' theory of general wage suppression was rooted in the economics of information. According to the plaintiffs' expert, the practice of cold calling (if permitted) would transmit information on salaries and benefits across both employees and

[8] Elder, *supra* note 2.

[9] No. 06 C 3337, 2009 Dist. LEXIS 89576 (N.D. Ill. 2009). *See also* Robert E. Bloch & Scott P. Perlman, Reed v. Advocate Health Car*e: Anatomy of Class Certification Proceedings in a Wage Conspiracy Case*, ANTITRUST, Summer 2010, at 63–70.

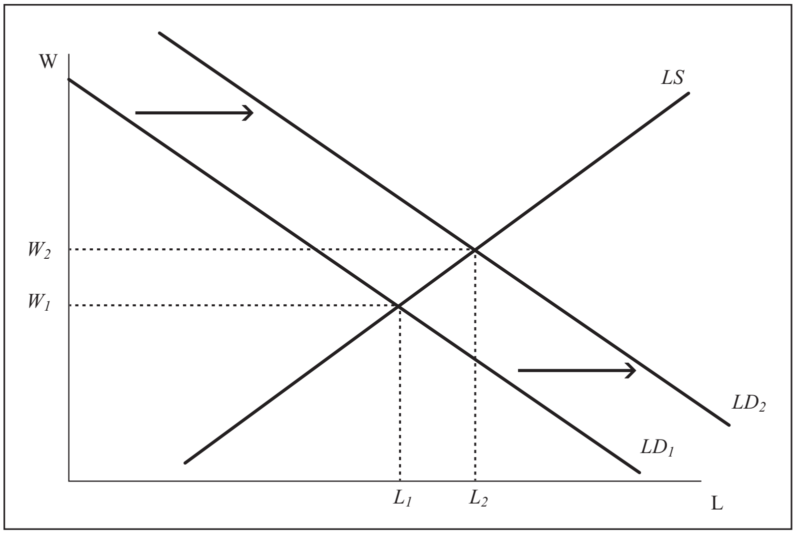
[10] Johnson v. Ariz. Hosp. & Healthcare Ass'n (AzHHA), No. CV 07-1292-PHXSRB, 2009 WL 5031334 (D. Ariz. July 14, 2009). Both authors served as consultants for the plaintiffs in *Johnson*. *See also* Hal J. Singer, *Economic Evidence of Common Impact for Class Certification in Antitrust Cases: A Two-Step Analysis*, ANTITRUST, Summer 2011, at 34–39.

[11] Order Granting Plaintiffs' Supplemental Motion for Class Certification at 53, High-Tech Employee Antitrust Litig., No. 11-CV-02509 (N.D. Cal. Oct. 24, 2013) (noting that the plaintiffs' expert "followed a roadmap widely accepted in antitrust class actions that use evidence of general price effects plus evidence of a price structure to conclude that common evidence is capable of showing widespread harm to the class," and citing *Johnson*, 2009 WL 5031334, at *8, *11).

employers, ultimately influencing the market wage. This would facilitate wage adjustment through the standard model of supply and demand in the labor market, according to which employees and employers are symmetrically informed about labor market conditions. In this case, an increase in the demand for high-tech labor would result in a temporary shortage, which would rapidly be alleviated as the shortage is simultaneously "discovered" by both employers and employees, with both the market wage and the employment level rising to equate supply and demand.

More precisely, in the absence of impediments to price discovery, wages and employment are given by the intersection of labor supply *LS* and labor demand *LD* (see Figure 1). When labor demand shifts outward, the equilibrium wage rises (from W_1 to W_2) as does the equilibrium employment level (from L_1 to L_2). After the adjustment, demand is once again equal to supply.

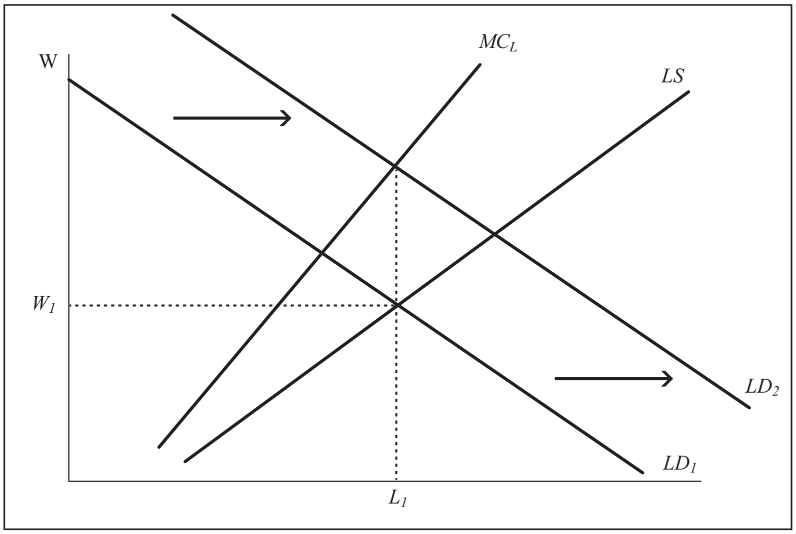
Figure 1: Wage & Employment Growth Under Competition



The plaintiffs' expert observed that this price discovery mechanism could be subverted if employers collectively could prevent employees from learning that others would be willing to hire them for more than what they are currently earning. A "temporary" shortage then could become permanent, with employers collectively willing to accept a smaller workforce in exchange for lower rates of compensation (just as a monopolist accepts lower output in exchange for higher prices). Under collusion, employers perceive the marginal cost of labor, MC_L, which lies above the *LS* curve, because colluding firms (unlike their competitive counterparts) perceive that an increase in collective hiring levels pushes up the equilibrium wage (see Figure 2). Optimal wage and employment levels (from employers' perspectives) are now given by the intersection of the MC_L curve and labor demand. Thus, even when the demand for labor increases substantially, employment and compensation remain stuck at L_1 and W_1, because the marginal cost to employers of expanding employment would exceed the marginal benefit. Employees, for their part, do not perceive any shortage in the labor market, and are therefore unable to bid up compensation from the initial level.[12]

[12] For ease of exposition, we have drawn the curves in Figure 2 to guarantee that an expansion in labor demand does not generate any increase in equilibrium compensation or employment levels. In general, compensation and employment may well increase under collusion, albeit at a slower pace than under competition.

Figure 2: Effect of Collusion on Wage & Employment Growth



The plaintiffs' expert presented an econometric analysis designed to test this theory, using a "Conduct Regression" that sought to explain variation in real annual employee compensation (the dependent variable), with variation in the alleged anticompetitive conduct (calculated as the proportion of months in a given year during which the employer in question was subject to one or more of the anti-solicitation agreements), and other explanatory variables, including employee age, gender, and years at company, employer revenue, and number of new hires.[13] Based on the Conduct Regression, the plaintiffs' expert concluded that the alleged anticompetitive conduct was associated with lower average levels of compensation at each defendant, resulting in aggregate damages of approximately $3 billion. The court agreed that the analysis "was capable of showing that Defendants' total expenditures on compensation [were] less than they would have been in the absence of anti-solicitation agreements and thus capable of showing classwide damages."[14]

Step 2: Rigid Compensation Structure. To show that the average wage suppression measured by the Conduct Regression resulted in classwide impact, the plaintiffs sought to complete their two-step proof by presenting evidence of a rigid compensation structure. If present, such a structure would imply that any wage suppression would have been transmitted across the class because compensation levels across employees would tend to move together. The plaintiffs appealed to the economic literature on labor markets showing that, in order to facilitate long-term contracting for labor, firms may institute commitment devices and loyalty-building mechanisms, including the "sharing of [a firm's] rewards with more equality than a market might otherwise produce."[15] The plaintiffs also pointed to evidence that the defendants placed a premium on "internal equity."[16] That evidence included using software to compare employee compensation across peer groups, advising managers that internal equity was a "prime consideration when setting and

[13] Order Granting Plaintiffs' Supplemental Motion for Class Certification at 59, High-Tech Employee Antitrust Litig., No. 11-CV-02509 (N.D. Cal. Oct. 24, 2013).

[14] *Id.* at 60.

[15] *Id.* at 56.

[16] *Id.* at 66.

adjusting salaries,"[17] and actively monitoring compensation structures to address discrepancies within and across job titles.[18]

The plaintiffs' expert also presented econometric analyses designed to prove the existence of a pricing structure. First, to demonstrate compensation rigidity within a given job title, the plaintiffs' expert regressed individual compensation data on several variables, such as age, number of months at the company, gender, location, title, and employer.[19] According to this analysis, approximately 90 percent of individual compensation could be explained by these "Common Factors," suggesting the existence of a compensation structure built around these factors, at least within a given job title.[20]

Second, to demonstrate compensation rigidity across job titles, the plaintiffs' expert estimated analogous regressions designed to compare the "movement over time of the average compensation of each title with the average compensation of the firm's Technical Class."[21] That is, for each defendant, the average compensation paid for a given job title in a given time period was regressed on the average compensation across all technical employees in all job titles in the same time period (and in the prior period), as well as on other variables thought to influence compensation, including the firm's revenue growth and the rate of job growth in the region.[22] Separate regressions were estimated for each job title within each company.[23] These regressions measure the extent to which an increase in the average compensation paid to all technical employees within a given firm is statistically associated with an increase in compensation for a given job title at that firm. For example, a regression specific to software engineers at Adobe would measure the extent to which an increase in average compensation across all technical employees at Adobe is statistically associated with an increase in average compensation for only Adobe's software engineers.

According to the plaintiffs' expert's regressions, the "vast majority" of employees fall within job titles or groups for which (1) the gains for the titles or groups are shared broadly at the same time, and (2) the gains for some are shared with others in different job titles in the subsequent year.[24] The court found that this result, combined with the Common Factors regressions, "bolsters the plaintiffs' theory that there is a wage structure in place under which an impact on some employees would have resulted in an impact to all or nearly all employees."[25] The court also found this econometric evidence to be "consistent with the documentary evidence that suggests that Defendants maintained a formal wage structure and valued internal equity."[26]

Defendants' Rebuttals and Court's Findings

In attempting to defeat class certification, the defendants and their experts relied less on quantitative analysis, focusing instead on qualitative arguments and broad methodological critiques.

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17 *Id.*

18 *Id.*

19 *Id.* at 58.

20 *Id.*

21 *Id.* at 60–61.

22 *Id.* at 60–63.

23 *Id.* at 62.

24 *Id.*

25 *Id.* at 72.

26 *Id.*

In attempting to defeat class certification, the defendants and their experts relied less on quantitative analysis, focusing instead on qualitative arguments and broad methodological critiques.

Their primary arguments were (1) that compensation practices did not follow a rigid structure and instead were highly individualized; and (2) that the plaintiffs' expert's analyses were rendered unreliable by methodological and statistical flaws.

To rebut the plaintiffs' claim of a rigid compensation structure, the defendants claimed that compensation was "set by hundreds of different managers who were directed to differentiate pay and reward high achieving employees."[27] However, because these claims were based "principally on declarations from top management in their human resources, recruitment, compensation, and benefits departments," which were "drafted for the specific purpose of opposing Plaintiffs' class certification motion,"[28] the court found this evidence to have "diminished probative value."[29]

The defendants' experts argued that the plaintiffs' regressions suffered from endogeneity bias as a result of an (unspecified) omitted variable, noting that an endogeneity problem "arises when some of the same unmeasured common factors drive both the independent and dependent variables."[30] The court was unpersuaded, noting that the defendants had failed to specify what the omitted variable might be, or how its exclusion might have altered the results of the plaintiffs' expert's analysis.[31] The defendants' experts also argued—at a purely conceptual level—that the plaintiffs' statistical evidence did not constitute proof of causation.[32] The court rejected this argument as well, favorably citing the plaintiffs' expert, who noted that economists "analyze correlations, which are routinely used . . . to draw causal conclusions when supported by compelling frameworks and complementary information."[33]

The defendants' experts also reported that, after correcting for within-firm correlations in compensation levels, the plaintiffs' expert's regression results were statistically insignificant at conventional significance levels.[34] But the court found that this "did not provide a sufficient basis to conclude that the Conduct Regression failed to provide a reliable methodology for the purposes of class certification,"[35] noting that even the defendants' expert had conceded that a "model's results need not necessarily be statistically significant to be reliable."[36]

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[27] *Id.* at 65.

[28] *Id.*

[29] *Id.* at 67.

[30] *Id.* at 73.

[31] *Id.* at 74.

[32] *Id.* at 74–75.

[33] *Id.* at 75.

[34] Specifically, the defendants argued that the plaintiffs' expert should have used "clustered" standard errors. *Id.* at 80–81. The use of clustered standard errors allows for the regression error term to be correlated within a pre-defined cluster. For example, one might hypothesize that salary structures at Defendant *A* are subject to common, unobserved shocks that differ systematically from those at Defendant *B*. If left uncorrected, this heteroskedasticity can lead to false conclusions regarding the precision of econometric instruments, which may invalidate statistical inference. *See, e.g.*, JEFFREY M. WOOLDRIDGE, INTRODUCTORY ECONOMETRICS: A MODERN APPROACH 264–99 (4th ed. 2009).

[35] Order Granting Plaintiffs' Supplemental Motion for Class Certification at 81, High-Tech Employee Antitrust Litig., No. 11-CV-02509 (N.D. Cal. Oct. 24, 2013).

[36] *Id.* The court revisited the issue of statistical significance when it denied the defendants' motion to exclude the testimony of the plaintiffs' expert on *Daubert* grounds. While acknowledging "ample evidence" that the one-, five-, and ten-percent significance levels are indeed conventional among statisticians, the court noted that the choice of a significance level involves tradeoffs between the risks and costs of "Type I" and "Type II" errors. The Court also cited scholarly evidence that "the conventional [significance] levels should not be blindly applied in every case but that a level should be selected after a careful consideration of the particular study at hand." *See* Order Re: Defendants' Motions Regarding Dr. Leamer and Defendants' Joint Motion for Summary Judgment Based on Motion to Exclude Testimony of Dr. Leamer at 25–29, High-Tech Employee Antitrust Litig., No. 11-CV-02509 (N.D. Cal. Apr. 4, 2014).

The defendants' experts also argued that "[b]y averaging the compensation of all employees who hold the same job title [the plaintiffs' expert] necessarily wipes out the very thing he is supposed to be measuring—the significant variation in individual employees' compensation."[37] The court rejected this argument, noting (1) that averaging does not mask variation across job titles (only within them); and (2) that the plaintiffs' Common Factors analysis had used employee-specific data that was not averaged.[38]

The defendants unsuccessfully raised some of the same critiques in their motion to exclude the testimony of the plaintiffs' expert on *Daubert* grounds. In addition, they claimed that the plaintiffs had failed to distinguish econometrically between the effect of the challenged conduct and the effects of other, unchallenged agreements. For example, there was evidence that Google had entered into do-not-cold-call agreements with non-defendant companies,[39] and the plaintiffs' expert had conceded that his Conduct Regression—which used a variable indicating the share of the months of the year during which the challenged agreements were in effect—would pick up the compensation suppression effects stemming from anything that was applicable to the class period from 2005 to 2009 when the variable is turned on.[40] However, the court rejected "the rationale underlying Defendants' argument—that *Comcast* holds that a damages model must precisely segregate out effects of every possible factor, including legal conduct, that could impact the dependent variable, in order to be admissible under *Daubert*"[41]—in favor of "well-established Supreme Court and Ninth Circuit authority holding that damages in antitrust cases often cannot, and therefore need not, be proven with exact certainty."[42] Also rejected was the defendants' claim that the plaintiffs' expert "cannot rely on his conduct regression to establish the existence of classwide impact when he admits the model is incapable of showing that each class member was injured."[43] The court dismissed this as a "misleading characterization,"[44] given that the plaintiffs' expert had never claimed that the Conduct Regression would prove classwide impact, and instead had presented it as "reliable proof that the anti-solicitation agreements had a *general* impact on the class."[45]

Lessons for Plaintiffs and Defendants

The record in *High-Tech Employee* suggests that, even in the absence of explicit wage fixing, and even in the presence of substantial differences within and across defendant firms, wage suppression claims may be found amenable to common proof provided that there is sufficient documentary support, buttressed by econometric evidence yielding outcomes consistent with the plaintiffs' reading of the documents. The plaintiffs' expert can implement the two-step proof of

[37] Order Granting Plaintiffs' Supplemental Motion for Class Certification at 70, High-Tech Employee Antitrust Litig., No. 11-CV-02509 (N.D. Cal. Oct. 24, 2013).

[38] *Id.* at 71–72.

[39] Order Re: Defendants' Motions Regarding Dr. Leamer and Defendants' Joint Motion for Summary Judgment Based on Motion to Exclude Testimony of Dr. Leamer at 29, High-Tech Employee Antitrust Litig., No. 11-CV-02509 (N.D. Cal. Apr. 4, 2014).

[40] *Id.* at 29–30.

[41] *Id.* at 33.

[42] *Id.*

[43] *Id.* at 43–44.

[44] *Id.* 44.

[45] *Id.*

impact developed in *Johnson* by using one set of regressions to show average wage suppression, and a second set of regressions to show rigidity in the defendants' compensation structures, both within a given job category and across different job categories.[46]

From the point of view of defendants, *High-Tech Employee* suggests that heavy reliance on abstract methodological critiques is a risky strategy, especially when the plaintiffs offer an econometrically intensive proof of impact. In general, had the defendants' arguments been complemented by more empirical analysis to demonstrate their relevance, they might have been more persuasive to the court.

For example, the plaintiffs' empirical proof of the rigidity of the defendants' compensation structures, which relied on correlations between average firm-wide compensation and compensation for individual job titles, might have been susceptible to a more data-driven rebuttal. Presumably such a rebuttal would emphasize that any factor that increases compensation for a given job title must, by definition, increase the firm-wide average. Experts for the defense could have quantified this bias using instrumental variables techniques,[47] through sensitivity analyses, or both. It also appears likely that the defendants themselves may have been able to identify real-world factors that would have contributed to this bias, focusing on large changes in compensation for the most common job titles at a given firm.

From the point of view of defendants, High-Tech Employee *suggests that heavy reliance on abstract methodological critiques is a risky strategy . . .*

Another empirical rebuttal could involve testing other implications of the plaintiffs' theory. If the plaintiffs' theory has multiple implications, and some are demonstrably absent from the data, that could raise serious questions about the reliability of plaintiffs' proof of impact. For example, the plaintiffs' theory alleges that the challenged agreements, in addition to suppressing compensation, also suppressed recruiting and hiring. One could test whether the challenged agreements actually were associated with less hiring activity using much of same data utilized in the plaintiffs' Conduct Regression, repurposing the number of new hires as the dependent variable. If the challenged agreements were found to be positively associated with new hiring activity, or if the relationship were found to be statistically indistinguishable from zero, some of the underpinnings of plaintiffs' proof of impact could come into question.[48]

In summary, the plaintiffs' success in obtaining class certification in *High-Tech Employee* strongly suggests that, when the plaintiffs' experts use econometric tools to prove impact, the defendants' experts should reply in kind, or risk forfeiting opportunities to convince the court that any apparent weaknesses in the plaintiffs' proof of impact actually render it unreliable in practice. Broad topics such as endogeneity bias or the proper thresholds for statistical significance almost always can be argued from either side and are unlikely to be effective unless their empirical relevance to the case at hand can be demonstrated convincingly. ●

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[46] This is not to say that a price structure cannot be proven in other ways—for example, by proof that transaction prices rarely deviate from posted prices, or when they do, they do so in formulaic debits or credits that would be perpetuated in the but-for world.

[47] A suitable instrumental variable should be correlated with average compensation, yet uncorrelated with unobserved factors that shift individual job title compensation. For example, if the dependent variable in the regression is for Adobe software engineers, one candidate for an instrumental variable might be the average compensation across Adobe technical employees excluding software engineers.

[48] Employers have the incentive and ability to suppress wages only if they face an upward-sloping supply curve—that is, only if additional hiring places upward pressure on wages. To see this, note that there would be no mechanism for wage suppression if the *LS* curves in Figures 1 and 2 were flat, rather than upward sloping.

The FTC's Revised Fred Meyer Guides: Back to the Sixties

Irving Scher

On September 24, 2014, the Federal Trade Commission issued revised *Guides for Advertising Allowances and Other Merchandising Payments and Services* (Guides), commonly referred to as the Fred Meyer Guides, which became effective November 10, 2014.[1] Those revisions, including the FTC's Discussion of Public Comments and Changes to the Guides (FTC Comments) that accompanied them, fell far short of what was needed to bring the Guides into conformity with a number of Supreme Court rulings directing that the Robinson-Patman Act (R-P or Act) be interpreted narrowly and consistently with the Court's contemporary focus on protecting interbrand competition. Instead, the revisions solely are intended to protect intrabrand competition and, in particular, the perceived needs of small retailers, regardless of the resulting increase in seller and consumer costs.

Background

The FTC issued the original Guides in 1969 in response to a Supreme Court recommendation a year earlier in *FTC v. Fred Meyer, Inc.*[2] The Court there ruled that when a seller offers promotional allowances to its direct-retailer accounts, it must make comparable offers to retailer customers of its distributors. The Court suggested that the FTC issue guidance with respect to compliance problems its ruling might create.[3]

The Guides the FTC issued went beyond that narrow question and addressed most, if not all, issues faced by sellers seeking to comply with the requirements of Sections 2(d) and 2(e) of the R-P Act, which deal with discriminations in the offering of advertising allowances and services to customers.[4] Section 2(d) applies when a seller pays in whole or in part for such advertising and promotional services,[5] while Section 2(e) applies when the seller itself furnishes the advertising services or facilities to retailers.[6]

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1 Guides for Advertising Allowances and Other Merchandising Payments and Services [hereinafter Guides], 79 Fed. Reg. 58,245 (Sept. 29, 2014) (amending 16 C.F.R. pt. 240).

2 FTC v. Fred Meyer, Inc., 390 U.S. 341, 358 (1968).

3 *Id.*

4 15 U.S.C. §§ 13(d), 13(e).

5 Section 2(d) provides:

> It shall be unlawful for any person engaged in commerce to pay or contract for the payment of anything of value to or for the benefit of a customer of such person in the course of such commerce as compensation or as consideration for any services or facilities furnished by or through such customer in connection with the processing, handling, sale, or offering for sale of any products or commodities manufactured, sold, or offered for sale by such person, unless such payment or consideration is available on proportionally equal terms to all other customers competing in the distribution of such products or commodities.

Id. § 13(d).

6 Section 2(e) provides:

> It shall be unlawful for any person to discriminate in favor of one purchaser against another purchaser or purchasers of a commodity bought for resale, with or without processing, by contracting to furnish or furnishing, or by contributing to the furnishing of, any services or facilities

The Guides are neither binding regulations nor independently enforceable. Nonetheless, they are influential as they reflect the FTC's interpretations of the Act, and a number of courts have considered them to be accurate statements of the law.[7] In particular, although the FTC has virtually ceased R-P enforcement during the past 25 years, and there is no reason to expect that it will resume enforcement any time soon, courts have, and likely will continue to rely on the Guides in private R-P litigation.

Until the 2014 revisions, the FTC appeared to be pulling away from some of its earlier R-P positions. The FTC brought an average of 40 R-P cases annually during the first 35 years the Act was in effect, including a number under Sections 2(d) and 2(e).[8] By the 1970s, however, R-P suits by the FTC had dwindled to a trickle,[9] appearing to exhibit the FTC's awareness of the Supreme Court's 1977 declaration in *GTE Sylvania* that interbrand competition "is the primary concern of antitrust law,"[10] rather than the intrabrand competition involved in secondary-line R-P cases.[11] In 1984, the Commission acknowledged that the R-P Act, while intended to assist small businesses, increases costs to consumers.[12]

While the Commission did not scale back the Guides in its 1990 revisions, as might have been expected in light of the Commission's 1984 statement, it has instituted only one R-P case since 1990,[13] and it brought its last case involving Sections 2(d) and 2(e) even earlier, in 1988, a suit the Commission thereafter voluntarily dismissed.[14] In 2006, the Supreme Court, in *Volvo Trucks, North America, Inc. v. Reeder-Simco GMC, Inc.*,[15] reiterating policies expressed in a number of the Court's previous decisions, clearly and emphatically limited the application of the Act, stressing that:

(i) interbrand competition is the primary concern of antitrust law;[16]

(ii) the R-P Act "signals no large departure from that main concern";[17]

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connected with the processing, handling, sale, or offering for sale of such commodity so purchased on terms not accorded to all purchasers on proportionally equal terms.

Id. § 13(e).

7 *See, e.g.*, Portland 76 Auto/Truck Plaza, Inc. v. Union Oil Co., 153 F.3d 938, 945 (9th Cir. 1998) (giving "considerable weight" to the Guides in determining that discriminatory improvements to leased property was not subject to Section 2(e)); Bouldis v. U.S. Suzuki Motor Corp., 711 F.2d 1319, 1329 (6th Cir. 1983) (affirming summary judgment dismissal because defendant followed procedures looked at favorably in the Guides).

8 *See* ABA Antitrust Section, Monograph No. 4, The Robinson-Patman Act: Policy and Law I, at 41 n.158 (1980).

9 *See* John B. Kirkwood & K. Shane Woods, *Robinson-Patman Enforcement at the FTC: Promoting a Level Playing Field While Protecting Consumers*, *in* [2] 48 Ann. Advanced Antitrust Seminar: Distribution & Marketing 621, 623–24 (PLI 2009) (noting that FTC issued only 7 R-P Act final orders in the 1980s).

10 Cont'l T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36, 51–52 n.19 (1977). *See also* Leegin Creative Leather Prods., Inc. v. PSKS, 551 U.S. 877, 889–92 (2001) (refocusing minimum resale price maintenance enforcement to interbrand competition).

11 This article addresses only secondary-line competition among a seller's customers. Primary-line suits brought by one seller against another are not involved in the enforcement of Sections 2(d) and 2(e).

12 Gen. Motors Corp., 103 F.T.C. 641, 695–96 (1984).

13 McCormick & Co., FTC Docket No. C-3939 (Mar. 8, 2000), 2000 WL 264190 (consent order). The complaint had the appearance of a primary-line suit involving an allegedly injured competing seller. There was no below-cost allegation, however, so the Commission claimed only secondary line injury. Ironically, the allegedly disfavored buyers included the A&P, which was the key chain store target of the R-P Act when Congress passed it in 1936.

14 Harper & Row Publishers, Inc., 122 F.T.C. 113 (1996).

15 546 U.S. 164, 180–81 (2006).

16 *Id.* at 180 (quoting Cont'l T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36, 51 n.19 (1977)); *see also* Leegin Creative Leather Prods., Inc. v. PSKS, 551 U.S. 877, 889–92 (2001).

17 *Volvo*, 546 U.S. at 180–81.

(iii) it would "resist interpretation geared more to the protection of existing competitors than to the stimulation of competition";[18]

(iv) it would continue to construe the Act "consistently with broader policies of the antitrust laws,"[19] and;

(v) constructions of the Act should not be extended beyond its prohibitions so as to "help give rise to a price uniformity and rigidity in open conflict with the purposes of other antitrust legislation."[20]

Immediately thereafter, then FTC Chair Deborah Majoras, citing *Volvo*, went even further, urging the presidentially appointed Antitrust Modernization Commission to seek R-P's repeal, stressing that the Act's overall purpose "stands in contrast to the recognized goals of modern antitrust law."[21] The AMC agreed in its 2007 Report,[22] and its recommendation was shortly thereafter endorsed by Professor Joshua Wright, now an FTC Commissioner.[23]

Accordingly, when the FTC announced in December 2012 that it would consider revising the Guides for the first time in 22 years, and sought comments on 14 questions,[24] observers might have anticipated that it would use the occasion to make the Guides more consistent with the Supreme Court's repeated instructions. Four of the seven submissions in response to the FTC's request for comments sought revisions that the commenters claimed would bring the R-P Act's promotional provisions closer to Sherman Act policies,[25] while three organizations, representing independent retailers, essentially favored the status quo.[26]

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[18] *Id.* at 181.

[19] *Id.* (quoting Brooke Grp. Ltd v. Brown & Williamson Tobacco Corp, 509 U.S. 209, 220 (1993), which had quoted Great Atl. & Pac. Tea Co. v. FTC, 440 U.S. 69, 80 n.13 (1979)).

[20] *Id.* (quoting Automatic Canteen Co. of Am. v. FTC, 346 U.S. 61, 63 (1953)); *see also* Jefferson Cnty. Pharm. Ass'n v. Abbott Labs., 460 U.S. 150, 178 (1983) (O'Connor, J., dissenting).

[21] Deborah Platt Majoras, Chairman, FTC, Statement Before the Antitrust Modernization Commission 5 (Mar. 21, 2006), *available at* http://www.ftc.gov/sites/default/files/documents/public_statements/statement-ftc-chairman-deborah-platt-majoras-antitrust-modernization-commission/060321antitrustmodernization.pdf.

[22] ANTITRUST MODERNIZATION COMMISSION, REPORT AND RECOMMENDATIONS, 7 Trade Reg. Rep. (CCH) ¶ 50,222, at 49,949–60 (Apr. 3, 2007).

[23] Josh Wright, *AMC Releases Tentative Recommendations*, TRUTH ON THE MARKET (Jan. 27, 2007), http://truthonthemarket.com/2007/01/27/amc-releases-tentative-recommendations/, and Josh Wright, *Price Discrimination Is Good, Part I*, TRUTH ON THE MARKET (Nov. 30, 2008), http://truthonthemarket.com/2008/11/30/price-discrimination-is-good-part-i/.

[24] Fred Meyer Guides, 77 Fed. Reg. 71,741 (Dec. 4, 2012) (request for public comment).

[25] ABA SECTION OF ANTITRUST LAW, RESPONSE TO THE FTC'S REQUEST FOR PUBLIC COMMENT (Jan. 29, 2013), http://www.ftc.gov/sites/default/files/documents/public_comments/16-cfr-part-240-guides-advertising-allowances-and-other-merchandising-payments-and-services-ftc-file.p123900-563686-00005%C2%A0/563686-00005-85431.pdf; AM. ANTITRUST INST., COMMENT OF THE AM. ANTITRUST INST. (Jan. 29, 2013), http://www.ftc.gov/sites/default/files/documents/public_comments/16-cfr-part-240-guides-advertising-allowances-and-other-merchandising-payments-and-services-ftc-file.p123900-563686-00007%C2%A0/563686-00007-85433.pdf; FOOD MARKETING INST., FRED MEYER GUIDES REVIEW (Jan. 29, 2013), http://www.ftc.gov/sites/default/files/documents/public_comments/16-cfr-part-240-guides-advertising-allowances-and-other-merchandising-payments-and-services-ftc-file.p123900-563686-00009%C2%A0/563686-00009-85438.pdf; RICHARD STEUER, MAYER BROWN LLP, CROSSING THE STREAMS OF PRICE AND PROMOTION UNDER THE ROBINSON-PATMAN ACT (Jan. 29, 2013), http://www.ftc.gov/sites/default/files/documents/public_comments/16-cfr-part-240-guides-advertising-allowances-and-other-merchandising-payments-and-services-ftc-file.p123900-563686-00003%C2%A0/563686-00003-85232.pdf (originally published as Richard M. Steuer, *Crossing the Streams of Price and Promotion Under the Robinson-Patman Act*, ANTITRUST, Fall 2012, at 64).

[26] NAT'L AUTOMOBILE DEALERS ASS'N, FRED MEYER GUIDES REVIEW (Jan. 29, 2013), http://www.ftc.gov/sites/default/files/documents/public_comments/16-cfr-part-240-guides-advertising-allowances-and-other-merchandising-payments-and-services-ftc-file.p123900-563686-00006%C2%A0/563686-00006-85432.pdf; NAT'L COMTY. PHARMACISTS ASS'N, COMMENTS ON THE GUIDES FOR ADVERTISING

The Revised *Fred Meyer* Guides

In the revised Guides and accompanying FTC Comments, the Commission essentially followed the recommendations of the independent retailer organizations. Surprisingly approved by all five Commissioners, the revised Guides ignore the Supreme Court's exhortations about R-P enforcement, and instead reflect throughout anachronistic views protective of intrabrand competition, regardless of the costs to consumers involved, that were in vogue when the Guides were first written in 1969.

The revisions disregard a seller's need to compete effectively against the sellers of other brands—this, despite the recommendation by the Supreme Court in *Volvo* that more favorable treatment be given to a seller's "selective price discounting" when it "fosters competition among suppliers of different brands.[27] In fact, the revisions refer to the importance of interbrand competition only when addressing the manner in which the FTC intends to challenge conduct by buyers under a different statute—Section 5 of the FTC Act.[28] The FTC mentions *Volvo*'s directions regarding how the Act fits into the broader context of antitrust policy, but distinguishes Sections 2(d) and 2(e) because *Volvo* involved only price discriminations covered by Section 2(a).[29]

[T]he revised Guides ignore the Supreme Court's exhortations about R-P enforcement, and instead reflect throughout anachronistic views protective of intrabrand competition . . .

The 2014 revisions to the Guides are significant largely for what the FTC did not do. The revisions include only minor substantive changes, and provide little guidance to sellers or their customers. For example, beyond merely acknowledging the hardly controversial proposition that the Internet can be used as an advertising vehicle, the revisions and FTC Comments provide no guidance as to what constitutes advertising on the Internet, or how a seller should calculate the amount to pay a provider of Internet advertising. Instead, the FTC suggests, with respect to these statutory issues, that "a seller's application of common sense and good faith will be relevant."[30]

In sum, rather than construing the Act in a manner that brings it closer to the basic antitrust principles embodied in the Sherman Act, the Commission did just the opposite. The highlights of what it did and did not do are summarized below, following the order of the FTC Comments to the revisions.

Guide 2—Applicability of the Law. When he was a judge on the First Circuit Court of Appeals, Supreme Court Justice Stephen Breyer stressed that Section 2(e), "like the rest of the Robinson-Patman Act, is aimed at significant harm to competition . . . ."[31] The FTC emphatically rejected this approach, declaring that the promotional provisions do not require any proof of competitive harm because they are intended "to prevent evasions" of Section 2(a), which addresses price discrimination.[32]

Allowances and Other Merchandising Payments and Services (Jan. 29, 2013), http://www.ftc.gov/sites/default/files/documents/public_comments/16-cfr-part-240-guides-advertising-allowances-and-other-merchandising-payments-and-services-ftc-file.p123900-563686-00008%C2%A0/563686-00008-85434.pdf; and Nat'l Grocers Ass'n, Fred Meyer Guides Review (Jan. 29, 2013), http://www.ftc.gov/sites/default/files/documents/public_comments/16-cfr-part-240-guides-advertising-allowances-and-other-merchandising-payments-and-services-ftc-file.p123900-563686-00011%C2%A0/563686-00011-85641.pdf.

[27] Volvo Trucks N. Am., Inc. v. Reeder-Simco GMC, Inc., 546 U.S. 164, 181 (2006).

[28] Guides, 79 Fed. Reg. at 58,247, 58,251.

[29] *Id.* at 58, 247. In *Herbert R. Gibson, Sr.*, 95 F.T.C. 553, 726 (1980), *aff'd*, 682 F.2d 554 (5th Cir. 1982), *cert. denied*, 460 U.S. 1068 (1983), the Commission had stressed: "Because of the easier threshold of proof carved out for Sections 2(d) or 2(e), the Commission and the courts have an obligation to ensure that the jurisdictional prerequisites of those sections are reasonably, and not expansively, construed."

[30] Guides, 79 Fed. Reg. at 58,248.

[31] Allen Pen Co. v. Springfield Photo Mount Co., 653 F.2d 17, 25 (1st Cir. 1981).

[32] Guides, 79 Fed. Reg. at 58,247.

While Congress no doubt intended in 1936 to prevent evasion of Section 2(a), the adoption of Sections 2(d) and 2(e) created the anomalous consequence that a seller actually became better off discriminating in price than providing discriminatory promotional considerations. This is because Section 2(a) contains language specifically requiring a plaintiff to establish possible harm to competition to establish a claim, and also permits a cost justification defense not available under Section 2(d) or 2(e). Yet promotional discriminations will not necessarily result in significant competitive harm merting legal challenge, as the 1984 Breyer opinion noted.

The FTC nevertheless asserted that there were no court decisions suggesting consideration of competitive harm in the enforcement of the promotional provisions, seemingly ignoring then-Judge Breyer's First Circuit opinion.[33] The Commission also sought to distinguish the Supreme Court's 2006 recommendation in *Volvo* that the "Act" should be interpreted in a manner consistent with the Sherman Act, remarking that this statement was irrelevant because *Volvo* concerned a claim asserted under Section 2(a).[34] Yet the Supreme Court did not limit its guidance to Section 2(a) when it referred to the entire "Act."

Interestingly, when considering the issue of buyer liability, the Commission took a different track. Lower courts have ruled that Section 2(f) of the Act permits suits against buyers only when a price discrimination subject to Section 2(a) is involved,[35] but have authorized suits under Section 5 of the FTC Act against a buyer who knowingly receives a promotional discrimination in violation of Section 2(d) or 2(e).[36] Only the FTC may bring suits under the FTC Act.[37] Nonetheless, in this one instance, the FTC acknowledged that in light of the fact that the Supreme Court "instructed" in *Volvo* that "R-P should be construed to be consistent with antitrust policy generally, which focuses on harm to competition,"[38] the FTC would modify Guide 13 to provide that the Commission would enforce Section 5 against *buyers* knowingly receiving discriminatory allowances or services only when "there is likely injury to competition."[39] This is ironic, because the FTC had declared that there was no such burden on a plaintiff in an R-P suit against the *seller* involved in the applicable discrimination.

Guide 4—Definition of Customer. A Note to Guide 4, added by the 1990 revision to the Guides, excluded from the definition of a seller's "customers" retailers who make only "sporadic purchases from [a] seller," or merely "stock[] a few isolated items" in a product category outside its usual business, "unless the seller has been put on notice that the retailer is selling its product."[40] The FTC rejected the ABA Antitrust Section's request that the Commission delete the limiting phrase from the exclusion.[41] As a result, in the FTC's view, a retailer would be considered a "customer"—indeed, a "competing" customer—for purposes of a seller's compliance with the requirements of

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33 *Id.*

34 *Id.*

35 Section 2(f) provides: "It shall be unlawful for any person engaged in commerce, in the course of such commerce, knowingly to induce or receive a discrimination in price which is prohibited by this section." 15 U.S.C. § 13(f).

36 Guides, 79 Fed. Reg. at 58,248.

37 *See, e.g.*, Zoslaw v. MCA Distrib. Corp., 693 F.2d 870, 882 n.15 (9th Cir. 1982), *cert. denied*, 460 U.S. 1085 (1983); Holloway v. Bristol-Myers Corp., 485 F.2d 986, 988–89 (D.C. Cir. 1973).

38 Guides, 79 Fed. Reg. at 58,251.

39 *Id.* at 58,247.

40 16 C.F.R. § 240.4 (1990).

41 Guides, 79 Fed. Reg. at 58,247.

Sections 2(d) and 2(e), if the seller becomes aware of the retailer's existence, likely as reported by the distributor who supplies the retailer. In such a situation, the retailer would need to be given notice and, according to the FTC, should affirmatively be "offered" proportionally equal promotional opportunities.

This leads to an illogical and unduly burdensome consequence. Consider, hypothetically, a golf pro shop that carries aspirin as a convenience for golfers. According to the Guides, if the seller is aware of the golf pro shop's existence, it would be a "customer" competing with a drug chain's branch store in the same neighborhood carrying every SKU of the same brand, as well as other brands of analgesics. Of course, there is no conceivable competitive harm if the seller does not offer advertising allowances to such a retailer; yet, according to the FTC, no showing of competitive harm would be necessary to establish a claim in a suit under Section 2(d) or 2(e).

Guide 6—Interstate Commerce. The Commission declined to provide guidance on whether the "interstate commerce" requirement of the promotional provisions should apply when neither sales transaction at issue in a case crosses state lines.[42] According to the FTC's Comments, the Circuits are split on the issue.[43] The FTC observed that the Ninth Circuit requires that at least one of the sales involved must cross state lines for the provisions to apply,[44] but the Fifth Circuit declared that Sections 2(d) and 2(e) *might* apply if the *payment* for the services moved in interstate commerce, even though none of the sales at issue crossed state lines.[45] The Fifth Circuit has since discarded its earlier dictum, however, ruling that the interstate commerce requirement of both the pricing and promotional provisions should be read *in pari materia*, and that at least one of the sales transactions at issue must cross state lines for Section 2(d) or 2(e) to apply.[46] Thus, the FTC's Comment that "the authorities are not of one mind" lacks judicial support, and is contrary to the Supreme Court's repeated direction not to construe the Act beyond its specific prohibitions.

Guide 7—Services or Facilities. Guide 7 identifies the types of services and facilities the FTC considers to be covered by Section 2(e).[47] The 2014 revisions add two ambiguous examples, which perhaps unintentionally might extend the coverage of the Act to conduct beyond its scope.

The ABA Antitrust Law Section questioned whether the provision of large sizes and special packaging to customers on a discriminatory basis should continue to be listed in Guide 7 as a "service" subject to Section 2(e)—or even subject to the Act. It contended that the fact that a product is offered in a large size or special package only to one or a limited number or customers, while discriminatory, does not in and of itself have anything to do with advertising or promotion, or the Act at all.

The FTC rejected the contention that sizes or packaging discrimination has no place in R-P, while acknowledging that it should provide "additional guidance to underscore that special packaging or package sizes are covered only insofar as they primarily promote a product's resale."[48] It offered two new examples to provide that "additional guidance." In new Example 2 to Guide 7, the FTC declared that the discriminatory provision of a product in a multi-pack with Halloween-

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42 *Id.* at 58,248.

43 *Id.*

44 Zoslaw v. MCA Distrib. Corp., 693 F.2d 870, 881 (9th Cir. 1982), *cert. denied*, 460 U.S. 1085 (1983).

45 Shreveport Macaroni Mfg. Co. v. FTC, 321 F.2d 404, 408 (5th Cir. 1963), *cert. denied*, 375 U.S. 971 (1964).

46 L&L Oil Co. v. Murphy Oil Corp., 674 F.2d 1113, 1115–16 (5th Cir. 1982).

47 16 C.F.R. § 240.7 (1990).

48 Guides, 79 Fed. Reg. at 58,248–49.

themed packaging relates to the resale of the product and therefore would be subject to Section 2(e).[49] But the fact that a multi-pack is involved is not what would subject the conduct to Section 2(e).[50] It would be the Halloween-theme that is promotional, regardless of whether individual or multi-packs are involved. Inclusion of a multi-pack in the example might be misunderstood as indicating that the mere furnishing of multi-packs on a discriminatory basis should be subject to Section 2(e), even when there is no advertising or promotional aspect involved.

Example 2 has already been cited by a district court magistrate as supporting a claim that a refusal to sell large size "warehouse club" packages of laundry products to a "general market" retail chain violated Section 2(e).[51] The magistrate also relied on 1940[52] and 1956[53] FTC decisions as supporting his determination.[54] Without specifically characterizing the package size as a promotional service, the magistrate noted that the plaintiff had alleged that it is "more convenient for customers to purchase and carry home large-pack products," adding "that large-packs can be (and are) offered to customers at a lower cost per unit than the smaller packs of the same product."[55] Those allegations might have been better considered to support a claim under Section 2(a) rather than 2(e), which then would have required a showing of potential injury to competition and permitted the seller to present a possible cost justification defense.

Newly added Example 3 to Guide 7 involves the provision to a customer of a detergent in containers having a different shape than the containers usually provided to customers, in order to assist the customer warehouse and ship the product more efficiently.[56] The Commission explained that because the conduct involves the initial sale of the product, it would not be subject to Section 2(e).[57] But the Commission failed to add that, even though the conduct involves the initial sale of the product, it should not be subject to Section 2(a) either unless the service results in a lower net price to the customer. For Section 2(a) to be applicable, there has to be a discrimination in price, not just a change in the in the shape of a product. By omitting this fact, the Commission might lead some readers to draw the improper conclusion that Section 2(a) could apply simply because the example involves the initial sale of the subject product, even though no price discrimination is involved.

The ABA Antitrust Law Section also contended in its submission that merely limiting the customer base for a particular package size or special packaging constitutes a unilateral partial refusal to deal that is not subject to any aspect of the Act.[58] According to the FTC, the cases the Antitrust Law Section relied on were distinguishable because they only involved refusals to offer

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49 *Id.*

50 The FTC should not have referred to Section 2(d) because no payment to the customer is involved in the example.

51 Woodman's Food Mkt., Inc. v. The Clorox Co., No. 14-cv-734-slc, 2015 WL 420296, at *4–*5 (W.D. Wis. Feb. 2, 2015).

52 Luxor, Ltd., 31 F.T.C. 658 (1940).

53 Gen. Foods Corp., 52 F.T.C. 798 (1956).

54 *Woodman's Food Market*, 2014 WL 420296, at *4.

55 *Id.* at *5.

56 Guides, 79 Fed. Reg. at 58,249.

57 *Id.* In general, discriminations at the time of the initial sale may impact the price of an item and, therefore, are evaluated under Section 2(a) of the Act, while discriminations that depend upon conduct after the initial sale, such as payment of promotional or advertising costs, are evaluated under Sections 2(d) and 2(e).

58 ABA Antitrust Section Response, *supra* note 25, at 8.

different types of products to disfavored customers rather than special packaging of the same types of products.[59] The FTC did not explain why this made a difference legally.

Guide 9—Proportionally Equal Terms. Guide 9 addresses the core statutory requirement that promotional allowances and services must be made available to all competing customers "on proportionally equal terms."[60]

Rejection of an alternative proportionality standard based on "value." Whether the statutory proportionality requirement can only be met based on the customer's cost in providing particular advertising services or alternatively, on the basis of the *reasonable value* of the promotional activity to the seller has, as next discussed, been a recurring issue at the FTC since 1986, when it rejected a "seller's value" proportionality standard 3–2 in a vote supporting a consent order.[61] The FTC did recognize in its 1990 Guide revisions, and again in 2014, that payments may differ based on the "varying value of different media for the seller's promotional efforts," e.g., a seller can offer to pay more for TV advertising than for newspaper advertising based on the value of the *medium* to the seller.[62] However, both in its 1990 and 2014 Guide revisions the FTC rejected the argument as an alternative to payment on the basis of a retailer's cost to perform particular advertising or promotions, payments may be based on the value to the seller of the service involved. The FTC's reasoning, as expressed in its comments to the 1990 revisions and again in 2014, is that "unless carefully monitored, sellers may use elastic, expansive measurements of value which could help disguise persistent systematic discrimination."[63]

The FTC's rejection of an alternative "seller's value" standard for proportionality disregards the Supreme Court's admonition that the Act should not be enforced in a manner that leads to pricing rigidity or restricts interbrand competition.[64] For example:

(i) It is of considerably more value to a seller to obtain a window display or end cap at a customer's high traffic brick and mortar location than at a small neighborhood retail outlet, although the cost of the two displays may not differ greatly.

(ii) Advertising on a major Internet retailer's website that attracts thousands of visitor clicks a day clearly has greater value to a seller than advertising on a site where there is considerably less consumer traffic, although the cost to the two retailers may not be very different.

(iii) Retailer advertisements in certain magazines may have a much greater value to a seller than in other magazines charging similar rates; for example, an advertisement at similar cost may be of less value to a swimsuit manufacturer when it is in *TV Guide* rather than in *In Style* magazine.

(iv) An advertisement in a geographic market's major newspaper for a new, high fashion product will have considerable "spillover" benefits to smaller, neighborhood retailers when a major upscale retailer has placed the advertisement, which also may greatly increase the value of the advertisement to the seller.

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[59] Guides, 79 Fed. Reg. at 58,248–49.

[60] 16 C.F.R. § 240.9 (1990).

[61] Max Factor & Co., 108 F.T.C. 135 (1986), 1986 WL 722142 (comments accompanying consent order).

[62] Guides, 79 Fed. Reg. at 58,250.

[63] *Id.*

[64] For a discussion of the change in the FTC's earlier, more flexible, approach to the proportionality standard, see 3 EARL W. KINTNER & JOSEPH P. BAUER, FEDERAL ANTITRUST LAW 557–66 (1983). Kintner, a former FTC Chairman, declared that a strict "cost" standard makes implementation of legitimate promotional plans "cumbersome and expensive." *Id.* at 566.

The Supreme Court in 1959, in *FTC v. Simplicity Pattern Co.*, noted that the FTC seemed at that time to be applying a "relatively broad scope to the standard of proportional equality."[65] The Court commented that "the tailoring of services and facilities to meet the different needs of two different classes of customers" may constitute proportionality.[66] It is counterintuitive for the FTC to refuse in 2014 to recognize that R-P advertising flexibility should be encouraged rather than restricted.

In 1990, the same year the Guides were last revised, the Supreme Court ruled in *Texaco Inc. v. Hasbrouck* that regardless of the cost involved, Texaco's functional discounts to distributors for the performance of marketing functions, specifically picking up products at Texaco's distribution facility, would not violate Section 2(a) if the discounts "constituted a reasonable reimbursement for the value to *Texaco* of their actual marketing functions."[67] The Court responded to concerns that sellers might rely on subjective or unverifiable measures of value by requiring that the payments be "reasonably related" to the value of the marketing function performed by the customer.[68] Yet, echoing its effort to distinguish *Volvo*, the FTC rejected the *Hasbrouck* standard because the case involved compliance with Section 2(a) and did "not clarify the circumstances under which use of a value standard would be lawful" under Sections 2(d) and 2(e).[69] The Commission did not explain what clarification was necessary.

The FTC's continued refusal to accept an alternative "seller's value" standard for "proportionality" can hardly be appreciated by Internet retailers, whose marginal advertising costs may be miniscule despite the considerable value much of such advertising provides to sellers.

Rejection of combining the value of discounts and promotional assistance. In response to the FTC's request for suggestions relating to the Guides, Richard Steuer, a former Chair of the ABA Section of Antitrust Law, authored an article contending that today's retailers vary in their need for and use of promotional assistance and/or lower prices.[70] Some have little use for promotional assistance and strongly prefer to receive lower prices. Others welcome supplier assistance in funding promotional events, and still others' pricing and promotional needs vary as they seek to compete effectively in an evolving marketplace. For this reason, Steuer recommended that the FTC interpret the Act as permitting a seller to charge competing retailers different prices and provide them different amounts of promotional assistance so long as the combined value to competing retailers is equivalent.[71] He noted that there is no case law holding that such a practice violates the Act. The concept indeed is supported by the Commission's expressed view in its Comments to the 1990 revisions that Sections 2(d) and 2(e) "are complements" to Section 2(a).[72]

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[65] FTC v. Simplicity Pattern Co., 360 U.S. 55, 61 n.4 (1959). *See* Bouldis v. U.S. Suzuki Motor Corp., 711 F.2d 1319, 1329 (6th Cir. 1983) (seller may devise any method of proportionality desired so long as it "does not discriminate in favor of the larger volume buyer.").

[66] *Simplicity Pattern*, 360 U.S. at 61 n.4.

[67] 496 U.S. 543, 562, 571 (1990) (emphasis added).

[68] *Id.* at 561–62; *see also* Coal. for a Level Playing Field, L.L.C. v. AutoZone, Inc., 737 F. Supp. 2d 194, 216 (S.D.N.Y. 2010); Servicetrends, Inc. v. Siemens Med. Sys., Inc., 870 F. Supp. 1042, 1059 (N.D. Ga. 1994).

[69] Guides, 79 Fed. Reg. at 58,250.

[70] Steuer, *supra* note 26, ANTITRUST, Fall 2012, at 64.

[71] *Id.* at 65–67.

[72] Guides, 79 Fed. Reg. at 58,247 (quoting the FTC's 1990 Comments).

The Commission addressed Steuer's views in the FTC Comments. Without disputing that the adoption of Steuer's recommendation would promote competition among different brands—both at the seller and buyer levels—the FTC rejected it because it "seemingly conflicts with the explicit terms of the Act, in which Congress separately and differently addressed discrimination of price . . . and discrimination in the provision of promotional allowances and services . . . ."[73] and so "would be inconsistent with the purpose of the Guides, which is to assist businesses in complying with the Act as it is currently understood."[74] However, the Commission's view fails to comport with the most recent Supreme Court direction in *Volvo* that R-P should be interpreted in a manner that furthers interbrand competition rather than restricting such competition. Taking the FTC's position to the extreme, providing a retailer a proportionally lower amount of advertising funds and at the same time a proportionally greater discount than competing customers could result in the retailer being claimed to be: (i) a *disfavored* customer under Section 2(d), and at the same time (ii) a *favored* customer under Section 2(a), even though the combined cost of the marketing program is no greater than the programs offered by competing suppliers.

Moreover, under the FTC's "price is price and promotion is promotion" compartmentalizing view of the Act, a seller could not rely on the "meeting competition" defense (discussed below) by meeting a competitor's pricing offer with a combination of price reductions and promotional allowances that have a total dollar value equivalent to the competitor's pricing offer. Such a limiting interpretation of the meeting competition defense most certainly conflicts with the Supreme Court's repeated instructions that the Act should be interpreted in a manner that furthers, not limits, interbrand competition.

Guide 11—Wholesaler Performance of Seller's Obligations. The FTC also did not adopt the ABA Antitrust Section's suggestion to add to Guide 11 a warning that the Commission could proceed under Section 5 of the FTC Act against a wholesaler failing to pass through promotional funds intended for the wholesaler's retailer customers.[75] The Commission indicated that the *Guides* were "not an appropriate vehicle for assessing or putting forward new theories of liability under Section 5 of the FTC Act."[76]

Declining to provide that warning was a missed opportunity. The FTC has the authority to express in the Guides its understanding of the applicability of Section 5 to a wholesaler's misuse of promotional funds, just as it did with respect to the application of Section 5 to buyer inducement of discriminatory advertising payments. By refusing to inform wholesalers of the Section 5 risks of engaging in an obvious unfair method of competition, the Commission could create the impression that even though the Commission can proceed against a seller for failing to ensure that a wholesaler passes through promotional funds, a wholesaler will remain free from possible FTC action even if it pockets the funds.

Guide 13—Customer's and Third Party's Liability. In contrast to its position that advertising allowances and price reductions may not be combined to meet the proportionality requirement, the FTC commented that the giving of a "proportionally *unequal* promotional allowance" may be challenged as a discriminatory price discrimination under Section 2(a) when the payment is "not

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73 *Id.*

74 *Id.*

75 ABA ANTITRUST SECTION RESPONSE, *supra* note 25, at 12.

76 Guides, 79 Fed. Reg. at 58,251.

reasonably related to the customer's cost of providing the promotional services."[77] In addition, the buyer knowingly receiving such a discriminatory allowance is subject to a suit under Section 2(f).[78]

As could be expected, the FTC failed to note that Section 2(a) would not apply if the amount of the payment is reasonably related to the value of the seller of the promotional service involved. It cited one district court decision as support for its position.[79] In fact, neither that decision nor any other rejects the proposition that the value to a seller of promotional services performed by a customer can justify an alleged overpayment.[80] But if, as the FTC declares, a claim of overpayment for promotional services should be considered to be a price discrimination subject to Sections 2(a) and 2(f), then the Supreme Court's *Hasbrouck* decision must be applied.[81] Under *Hasbrouck*, the reasonable value of the services involved should be considered in evaluating the claim.[82]

Guide 14—Meeting Competition. Guide 14 reaffirms the principle that the statutory "meeting competition" defense specified in Section 2(b) of the Act applies to discriminatory advertising and promotional payments or services—not just to discriminatory selling prices.[83] The Supreme Court emphasized in *Great Atlantic & Pacific Tea Co. v. FTC*, that this defense "may be the primary means of reconciling the Robinson-Patman Act with the more general purposes of the antitrust laws of encouraging competition between sellers."[84] Thereafter, in *Falls City Industries, Inc. v. Vanco Beverage, Inc.*, the Supreme Court, quoting a 1963 FTC opinion,[85] emphasized that the meeting competition defense should be "flexible and pragmatic," rather than "technical and doctrinaire," and should not be based on abstract theories—because it usually involves what a seller "reasonably believes is a situation of competitive necessity."[86]

Despite these Supreme Court declarations, the FTC rejected the ABA Antitrust Section's recommendation that the Guides should overturn a mischief-making limitation to the meeting competition defense the FTC adopted well before these Supreme Court admonitions.[87] The FTC had ruled in 1957 that the meeting competition defense is unavailable to a seller that lowers its price for a "premium" branded product in order to meet the price of a "popular" brand usually sold by a competitor at the lower price.[88] That ruling was reversed by the Seventh Circuit on appeal, with-

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[77] *Id.* at 58,252.

[78] *Id.* at 58,256.

[79] *Id.* at 58,252 (citing Am. Booksellers Ass'n v. Barnes & Noble, Inc., 135 F. Supp. 2d 1031 (N.D. Cal. 2001)).

[80] *Compare American Booksellers*, 135 F. Supp. 2d at 1067–68 (applying Section 2(a), but without discussing whether the legality of the payment involved could be based on the value of the services to the seller), Intimate Bookshop, Inc. v. Barnes & Noble, Inc., 88 F. Supp. 2d 133, 138 (S.D.N.Y. 2000) (same), *and* Am. Co-op Serum Ass'n v. Anchor Serum Co., 153 F. 2d 907, 913 (7th Cir. 1946) (same), *with* Kirby v. P.R. Mallory Co., 489 F.2d 904, 910–11 (7th Cir. 1973) (applying Section 2(d) but without discussing whether the legality of the payment involved could be based on the value of the services to the seller), United Magazine Co. v. Murdoch Magazines Distrib., Inc., 2001 WL 1607039, at *6 (S.D.N.Y., Dec. 17, 2001) (same), Sofa Gallery, Inc. v. Mohasco Upholstered Furniture Corp., 639 F. Supp. 677, 678–79 (D. Minn. 1986) (same), O'Connell v. Citrus Bowl, Inc., 99 F.R.D. 117, 120-21 (E.D.N.Y. 1983) (same), *and* Rickles, Inc. v. Frances Denney Corp., 508 F. Supp. 4, 6–7 (D. Mass. 1980) (same).

[81] Texaco Inc. v. Hasbrouck, 496 U.S. 543, 567 (1990).

[82] *See* Coal. for A Level Playing Field, L.L.C. v. AutoZone, Inc., 737 F. Supp. 2d 194, 216 (S.D.N.Y. 2010).

[83] 16 C.F.R. § 240.14 (1990).

[84] 440 U.S. 69, 83 n.16 (1979) (overpayment subject to Section 2(a); value of services must be considered under *Hasbrouck*).

[85] Cont'l Baking Co., 63 F.T.C. 2071, 2163 (1963).

[86] Falls City Indus. Inc. v. Vanco Beverage, Inc., 460 U.S. 428, 441 (1983) (citing Cont'l Baking Co., 63 F.T.C. at 2163).

[87] Guides, 79 Fed. Reg. at 58,252.

[88] Anheuser-Busch, Inc., 54 F.T.C. 277, 301 (1957).

out mentioning the FTC's "premium-popular" distinction.[89] In the 1960s, the Commission was reversed in three further efforts to establish the "premium-popular" distinction in meeting competition situations, although the Fifth Circuit indicated in dictum that the distinction might "be appropriate" on the basis of the earlier FTC position.[90]

But courts have occasionally followed the FTC's 1950s point of view. In 1995, a district court did so, noting that if the defendant's product commanded a "premium" price, it could not meet the competition of the plaintiff's non-premium brand.[91] Another district court thereafter accepted the doctrine as well, although without giving credit to the FTC.[92]

Obviously, the FTC's 57-year-old "premium-popular" brand distinction still is causing anticompetitive mischief in the lower courts. But the FTC rejected the ABA Antitrust Section's recommendation to renounce the distinction, because such a "sweeping summary disposition" would be inconsistent with the factual nature of the meeting competition defense.[93] As a matter of basic antitrust policy, however, the "fact" of the consumer popularity of two brands should not prevent a seller from reducing its price in order to avoid losing a customer to a lower-priced competitor.

Conclusion

In its newly revised Guides, the FTC has refused to adopt the central R-P enforcement principles repeatedly recommended by the Supreme Court, to interpret the Act narrowly and consistently with the broader policies of the antitrust laws. The Commission did just the opposite, declaring itself bound by the specific language of the statute to reaffirm outdated compliance principles that increase seller and consumer costs and result in competitive rigidity.

The FTC's claimed ability to understand the statutory language so well is remarkable in view of the litany of authorities who have been perplexed by the Act's language, including: Supreme Court Justice Felix Frankfurter's judgment that "precision of expression is not an outstanding characteristic of the Act,"[94] a former FTC Chairman's evaluation that the statutory language is not a "hallmark of clarity,"[95] and a noted antitrust commentator's criticism that R-P is "the misshapen progeny of intolerable draftsmanship coupled [with] wholly mistaken economic theory."[96]

While the FTC nowhere has indicated that it intends to renew its own enforcement of the Act, it elected to say nothing in its Comments to the 2014 revisions to the Guides that would deter needless and costly private litigation. Moreover, by explicitly refusing to renounce outmoded and discredited legal principles, the Commission did a disservice to the lower courts, which look to the Guides for what should be, but are not, accurate and authoritative statements of the law. ●

[89] Anheuser-Busch, Inc. v. FTC, 265 F.2d 677 (7th Cir. 1959), *rev'd on other grounds and remanded*, 363 U.S. 536 (1960), *on remand*, 289 F.2d 835 (7th Cir. 1961).

[90] Callaway Mills Co. v. FTC, 362 F.2d 435, 443 n.14 (5th Cir. 1966) ("The seller of the premium commodity sometimes must not go down to the price level of the lesser product."); Borden Co. v. FTC, 339 F.2d 133, 138 (5th Cir. 1964). *See also* Forster Mfg. Co. v. FTC, 335 F.2d 47 (1st Cir. 1964) (not mentioning FTC's application of the premium-popular distinction).

[91] High Tech Comm., Inc. v. Panasonic Co., 1995 WL 45847, at *2–3 (E.D. La. 1995).

[92] Power Replacements Corp. v. Air Preheater Co., 356 F. Supp. 872, 898 (E.D. Pa. 1973).

[93] Guides, 79 Fed. Reg. at 58,252.

[94] Automatic Canteen Co. v. FTC, 346 U.S. 61, 65 (1953).

[95] Earl W. Kintner, A Robinson-Patman Primer: A Guide to the Law Against Price Discrimination 13 (2d ed. 1982).

[96] Robert H. Bork, The Antitrust Paradox 382 (1978).

The Academic Research Path of Professor Francine Lafontaine, Director, FTC Bureau of Economics

Roger D. Blair

On November 10, 2014, Professor Francine Lafontaine became the new Director of the Bureau of Economics at the Federal Trade Commission. For a variety of reasons, this was a wonderful choice for the FTC. Professor Lafontaine is serving in this role while on leave from the University of Michigan, where she is the William Davidson Professor of Business Economics and Public Policy at the Stephen M. Ross School of Business and, by courtesy, Professor of Economics. She joined the faculty at Michigan in 1991, after three years on the faculty at the then Graduate School of Industrial Administration, now Tepper School of Business, at Carnegie Mellon University.

Professor Lafontaine has usually—although not exclusively—engaged in empirical research. While she has a solid command of economic theory, she is not a "true believer," and instead requires empirical confirmation before using theory as the foundation for public policy. This orientation will serve the FTC well as she helps to shape the public policy that results from the FTC's advocacy and enforcement efforts.

Professor Lafontaine's research over the course of her career has focused on contracting, especially contracts used in distribution, including franchising, and the study of vertical restraints and vertical integration decisions. She also conducts research on the effect of contracting practices on firm performance and examines issues surrounding business creation and survival in retail and small-scale service industries. Her research (with various co-authors) has been published in, among others, the *American Economic Journal—Applied,* the *American Economic Journal—Micro*, the *Journal of Industrial Economics*, the *Journal of Law and Economics*, the *Journal of Law, Economics and Organization*, the *Journal of Political Economy*, and *The RAND Journal of Economics*. She coauthored a book entitled *The Economics of Franchising*,[1] and also edited a volume on *Franchise Contracting and Organization*.[2]

The degree to which Professor Lafontaine is respected by her peers is evidenced by the professional organization and editorial positions she has held over the years. Professor Lafontaine was awarded an honorary Doctorate from the Université de Rennes 1, in Rennes, France. She was the president of the Industrial Organization Society from 2010 to 2012, having served as its Vice-President from 2008 to 2010 and as a board member from 2012 to the time she joined the FTC. She also served on the board of the International Society for New Institutional Economics, and the International Society of Franchising. From 1997 until joining the FTC, she was a co-editor of the *Journal of Economics & Management Strategy*. She was also a co-editor of the *Journal of Law,*

Roger Blair *is Professor and Chair of the Department of Economics at the University of Florida.*

[1] ROGER D. BLAIR & FRANCINE LAFONTAINE, THE ECONOMICS OF FRANCHISING (2005).

[2] FRANCHISE CONTRACTING AND ORGANIZATION (Francine Lafontaine ed.,2005).

Economics, & Organization from 2006 to 2012, and an associate editor at *The RAND Journal of Economics* from 1997 to 2007.

Professor Lafontaine obtained her Ph.D from the University of British Columbia, in 1988, with Professor Margaret E. Slade as her main advisor. As difficult as it may be to imagine today, when she started her Ph.D., Industrial Organization was mostly an applied theory field, with researchers building on new learning from game theory and asymmetric information models. Having been exposed to the many theoretical advances in the field, Professor Lafontaine wanted to assess the validity and relevance of some of these models. She was particularly interested in principal-agent and incentive models, and wrote her dissertation using data from franchising contracts to assess the importance of factors predicted by theory, such as risk and importance of agent and principal effort, in shaping the organizational decisions (here franchising decisions) of firms. To this day, the paper resulting from her dissertation work remains her best known and most cited paper.[3]

In 1997–98, Professor Lafontaine spent a sabbatical year at the University of Florida, in the Economics Department, where she and I worked on some articles, including one on the then-recent *Khan* decision.[4] At that time, we also started to discuss a project that culminated in our 2005 work, *The Economics of Franchising*. This book combined her detailed knowledge of models and data about franchise contracts with my experience in antitrust matters. Though she had been exposed to the literature on vertical restraints, our joint work was her first extensive foray into this domain. We had decided that the first four chapters of our monograph would focus on both a description of the available data on franchising and franchise contracts, as well as a discussion of relevant theoretical frameworks. Each of the next six chapters was to examine a particular source of conflict in franchise contracting. Because exclusive dealing is the norm in franchise contracts, and these contracts and other distribution contracts also often include other vertical restraints, such as resale price maintenance, tying, and exclusive territories, our coverage of these materials also involved a deep dive into the antitrust treatment of these types of clauses. In the end, the work illustrates the how and the why of these restraints, as well as the way in which the treatment of various restraints has shaped the franchise relationship and distribution contracts in the United States.

Professor Lafontaine has since written a number of articles with an antitrust component. But what is regarded as her second particularly important contribution to the antitrust literature was the production, with Professor Slade, of what she often calls their "trilogy:" three separate but related papers, each of which surveys the empirical evidence on the use and effects of particular contractual and organizational choices.

The first paper in this trilogy was the most narrowly focused and most antitrust oriented of the three articles, as it summarized the literature on the use and effects of vertical restraints specifically.[5] This paper was published in 2008 in the *Handbook of Antitrust Economics*. In writing this first paper, however, Professors Lafontaine and Slade often faced conundrums about how much they could or should mention the large literature on the related decision to vertically integrate or not. Indeed, it is well known that some vertical restraints can solve the same problems that verti-

While she has a solid command of economic theory, she is not a "true believer," and instead requires empirical confirmation before using theory as the foundation for public policy. This orientation will serve the FTC well as she helps to shape the public policy that results from the FTC's advocacy and enforcement efforts.

[3] Francine Lafontaine, *Agency Theory and Franchising: Some Empirical Results*, 23 RAND J. Econ. 263 (1992).

[4] Roger D. Blair & Francine Lafontaine, *Will* Khan *Foster or Hinder Franchising? An Economic Analysis of Maximum Resale Price Maintenance*, 18 J. Pub. Pol'y Mktg. 25 (1999); State Oil Co. v. Khan, 522 U.S. 3 (1997).

[5] Francine Lafontaine & Margaret Slade, *Empirical Assessment of Exclusive Contracts*, *in* Handbook of Antitrust Economics (Paolo Buccirossi ed., 2008).

cal integration solves, and some combinations of such restraints can be equivalent to vertical integration, i.e., they can achieve very similar economic results as would vertical integration. Professors Lafontaine and Slade resolved the dilemma they faced by dividing the literature in such a way as to write a complementary article on the large empirical literature regarding the incidence and effect of vertical integration. Interestingly, this paper, though written later, was published before the one they had written on vertical restraints, appearing in the *Journal of Economic Literature* in 2007.[6]

Finally, as they were completing the work on the *Journal of Economic Literature* paper, they were asked to think about a contribution that would describe empirical evidence relevant to the study of organizational form decisions for the *Handbook of Organizational Economics*, edited by Robert Gibbons and John Roberts. This book was ultimately published by Princeton University Press in 2012.[7] Of the three papers, this last was the most challenging, as Professors Lafontaine and Slade decided to organize and summarize the parts of the empirical literature on inter-firm contracting that did not fit in either of the other two papers. There is less focus on antitrust in this last chapter, as only some portions of the literature on inter-firm contracts relate to the set of constraints that have attracted the attention of antitrust authorities. On the other hand, the authors used the occasion of writing this chapter to bring the literature on vertical restraints into the broader literature on organizational economics. The latter has tended to focus on efficiency motives rather than antitrust motives for contracting practices. Still, as the authors argue, papers written to evaluate the possibility that vertical restraints are adopted for anticompetitive reasons inevitably speak to reasons why firms adopt the restraints and, in that sense, they are relevant to the study of organizations more broadly.

In addition to her academic research, Professor Lafontaine's professional experience prepared her exceptionally well for the FTC position. During her academic career, she has mentored and supervised a large number of Ph.D students, some of whom wrote their dissertations on antitrust topics, including, for example, vertical integration decisions as well as mergers effects. In addition, she has worked with numerous coauthors and obviously enjoys collaboration. At the FTC, she will work with a large number of professional economists, which should prove beneficial to them while also energizing her. And as the chair of the Business Economics and Public Policy group at the Ross School of Business, Professor Lafontaine has developed managerial skills that will no doubt prove useful at the FTC. She has also served leading roles on various academic research associations, as mentioned above.

Finally, over the course of her career, Professor Lafontaine has turned down far more consulting opportunities than she has accepted. There have been occasions, however, when the timing was right and an issue piqued her interest.[8] These consulting assignments have provided her valuable experience in working with economic consulting firms and attorneys in the litigation process. She is familiar with expert reports, depositions, and trial testimony, which should serve her and the FTC well during her tenure as Director of the Bureau of Economics. ●

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6 Francine Lafontaine & Margaret Slade, *Vertical Integration and Firm Boundaries: The Evidence*, 45 J. ECON. LIT. 629 (2007).

7 Francine Lafontaine & Margaret Slade, *Inter-Firm Contracts: The Evidence*, *in* HANDBOOK OF ORGANIZATIONAL ECONOMICS (Robert Gibbons & John Roberts eds., 2013).

8 Professor Lafontaine has not been affiliated with any consulting firm but has worked with several different firms on an ad hoc basis.

Book Review

A Harsh Report Card on the Merger Enforcement Process

John Kwoka

Mergers, Merger Control, and Remedies: A Retrospective Analysis of U.S. Policy

MIT Press 2015

Reviewed by Robert A. Skitol

John Kwoka's new book on the effects of merger remedies is particularly interesting to read in the immediate aftermath of the antitrust agencies' December 2014 celebration of the 100th birthday of the Clayton Act. Officials of both agencies used that occasion to remind the general antitrust community of the "incipiency" feature of that legislation.[1] There is a dramatic disconnect between adherence to that incipiency standard and the picture Kwoka presents on the effects of mergers that the agencies cleared or subjected to negotiated remedies over the last 30 years. More fundamentally, Kwoka undercuts any confidence that the agencies have effectively protected consumers from the anticompetitive effects of merger activity.

The heart of this book is a compilation and synthesis of all available methodologically sound studies of the effects of mergers that survived the antitrust review process over the course of the past three decades. More such "merger retrospectives" were available for this study than most of us might have assumed. Kwoka found nearly 50 qualifying studies encompassing more than 3000 mergers altogether. Combining all of the data from all of these studies, he ends up with a rich lode of material on the extent to which cleared mergers had price-increasing effects or anticompetitive nonprice effects. He was also able to provide observations on the extent to which these effects resulted from mergers subjected to divestiture remedies versus mergers subjected to "conduct" remedies.

It is important to recognize that this book is more than just one more study or summary of prior studies of merger effects. Its contribution is its exhaustive nature. It is a "meta-analysis" of all methodologically sound studies of this sort and thus examines everything presently known about merger effects and about the effectiveness of merger enforcement policies generally. Even for those who might have anticipated the conclusions, this analysis is a substantial advance; for skeptics, it represents a persuasive challenge to their views.

Here are some of Kwoka's more provocative findings:

- "At the product level, the average outcome for all 119 observations on postmerger prices is an increase of 4.3 percent . . . . More than 60 percent of product price changes show

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[1] *See* William J. Baer, Assistant Att'y Gen., Antitrust Div., U.S. Dep't of Justice, Origins of the Species: The 100 Year Evolution of the Clayton Act, Remarks at ABA Clayton Act 100th Anniversary Symposium (Dec. 4, 2014), *available at* http://www.justice.gov/atr/public/speeches/310190.pdf; Terrell McSweeny, Comm'r, Fed. Trade Comm'n, The Clayton and FTC Acts: 100 Years of Looking Ahead, Remarks at ABA Clayton Act 100th Anniversary Symposium (Dec. 4, 2014), *available at* http://www.ftc.gov/system/files/documents/public_statements/603341/mcsweeny_-_aba_clayton_act_100th_keynote_12-04-14.pdf.

increases, and those increases average nearly 9 percent. . . . Of all mergers that resulted in price increases, the agencies acted in only 38 percent of cases, suggesting substantial under-enforcement. Incorrectly cleared mergers on average resulted in price increases in excess of 10 percent."[2]

- "For all cases in which the agencies challenged mergers, the outcome was . . . an average price increase of 7.71 percent, indicating incorrect determinations or ineffective remedies to the mergers. . . . [D]ivestiture remedies are associated with price increases of 6.11 percent," casting doubt on their adequacy. "Conduct remedies result in price increases of 12.81 percent, suggesting that these are largely ineffective in restraining postmerger price increases."[3]
- "Retrospective studies of groups of mergers collectively reporting only their average effect . . . show a product-level price effect of mergers averaging a 5.42 percent increase." Those studies also estimate a 4 percent decrease in quality and a 9.73 percent decrease in R&D.[4]
- "At the merger level, grouped-merger studies report an average price increase of 5.92 percent" and nonprice effects mirroring those found at the product level.[5]

There is a dramatic disconnect between adherence to that incipiency standard and the picture Kwoka presents on the effects of mergers that the agencies cleared or subjected to negotiated remedies over the last 30 years.

Among his overall conclusions are the following:

- "[M]ost studied mergers result in competitive harm, usually in the form of higher price. In a great many cases that harm is substantial, for example, with postmerger price increases exceeding 10 percent. . . . [I]f the sample is representative of mergers that are competitive 'close calls,' then it casts direct light on whether the enforcement line is correctly drawn" and "we can conclude that recent merger control has not been sufficiently aggressive in challenging mergers."[6]
- Merger enforcement "has over time both diminished overall and tilted toward especially problematic mergers. The net effect has been to focus on mergers most directly causing harm, but the diminished attention to mergers involving somewhat lower market shares and concentration appears to have resulted in approval of significantly more mergers that prove to be anticompetitive."[7]
- "Without much obvious evidence, a view has arisen that most large mergers produce efficiencies and consumer benefits and hence that merger policy at the margin should avoid challenges because of the high likelihood of preventing efficiency-enhancing consolidations. The data compiled in this project demonstrate that relatively few Type I errors [false positives] are in fact made" and "[f]ar more common are Type II errors [false negatives]—clearing anticompetitive mergers—with considerable adverse effects on competition and consumers."[8]
- While less frequently studied, "the nonprice effects of mergers generally mirror the measured price effects. Anticompetitive price increases tend to be accompanied by reductions in

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[2] John Kwoka, Mergers, Merger Control, and Remedies: A Retrospective Analysis of U.S. Policy 155 (2015).

[3] *Id.* at 156.

[4] *Id.* at 156–57.

[5] *Id.* at 157.

[6] *Id.* at 158.

[7] *Id.*

[8] *Id.*

Given Kwoka's findings and overall conclusions, his recommendations make great sense. The agencies should want to understand why so many of the mergers they have allowed to occur, with or without negotiated remedies, ended up being anti-competitive.

quantity, quality, and R&D." And while costs may decrease, those cost savings are generally "not passed through to consumers."[9]

- Agency enforcement actions "are not demonstrably effective in preventing postmerger harm. Indeed, challenged mergers result in price increases no smaller than cleared mergers" so "it would appear that agency challenges are often resolved in ways that do not preserve or restore competition."[10]

Those conclusions lead Kwoka to make three recommendations. First, the agencies should develop "a better understanding of the a priori characteristics of incorrectly cleared mergers, and hence the sources of policy errors"; and the incorrectly cleared mergers identified in this book "represent a good body of experiences for examining those issues."[11] Second, the agencies should "determine the circumstances under which divestiture remedies have been more versus less effective—much as the FTC Divestiture Study did [in the 1990s]—and when if ever conduct remedies are effective." Based on those insights, "divestiture remedies can be strengthened in a targeted manner" and "conduct remedies employed only in the very limited circumstances where there is reason to believe they will be effective."[12] Third, there should be more invested in merger retrospectives so as to develop "a more comprehensive basis for understanding the effects of mergers and merger control policy." The agencies could, in particular, "require postmerger production of data by merging parties, data of the sort that could permit ex post evaluations of mergers and remedies on a routine and systematic basis." This "would dramatically increase our understanding of the effects of mergers and the effectiveness of merger control policy."[13]

Given Kwoka's findings and overall conclusions,[14] his recommendations make great sense. The agencies should want to understand why so many of the mergers they have allowed to occur, with or without negotiated remedies, ended up being anticompetitive. Indeed, as FTC Chairwoman Edith Ramirez discussed in some detail two and a half years ago, over the course of the past three decades the FTC has devoted considerable resources to the kinds of retrospective studies that Kwoka seeks to promote. This effort has included studies of the effectiveness of 50 consent orders requiring divestitures; a major study of the effects of consummated hospital mergers that became the foundation for major reforms that decisively strengthened the agency's ability to win recent contested hospital merger cases; retrospective studies of five petroleum industry mergers; and a retrospective study of grocery store mergers across 14 markets.[15] The Department of Justice has no comparable record. It did undertake, however, at least one such study in recent

[9] *Id.* at 159.

[10] *Id.*

[11] *Id.*

[12] *Id.* at 160.

[13] *Id.*

[14] I would assume, and certainly hope, that economists at both of the enforcement agencies will take the time to satisfy themselves on the validity of Kwoka's econometrics and methodologies.

[15] *See* Edith Ramirez, Chairwoman, Fed. Trade Comm'n, Retrospectives at the FTC: Promoting an Antitrust Agency, Remarks at ABA Retrospective Analysis of Agency Determinations in Merger Transactions Symposium, George Washington University Law School (June 28, 2013), *available at* http://www.ftc.gov/sites/default/files/documents/public_statements/retrospectives-ftc-promoting-antitrust-agenda/130628aba-antitrust.pdf.

years involving the effect of the 2006 Whirlpool/Maytag merger that was cleared with no remedy after a lengthy Second Request investigation.[16]

Indeed, the official release of the Kwoka book in the first week of January 2015 coincided with the FTC's announcement at the end of that same week of its new proposal to "study the effectiveness of the Commission's orders in merger cases where it required a divestiture or other remedy. The study would update and expand on the divestiture study the FTC issued in 1999, and should provide information on whether the orders met their remedial goals."[17] The Kwoka book surely will inform and enrich that study over the year ahead.

Indeed, the official release of the Kwoka book in the first week of January 2015 coincided with the FTC's announcement at the end of that same week of its new proposal to "study the effectiveness of the Commission's orders in merger cases where it required a divestiture or other remedy . . ."

A pressing question is whether the 2010 Horizontal Merger Guidelines[18] have improved or diminished the agencies' performance. One test would be whether Kwoka's data show that mergers that the agencies cleared unconditionally—without extracting any remedy—and that gave rise to anticompetitive effects have been either more frequent or less frequent since adoption of the 2010 Guidelines than in the five years prior to that adoption. If less frequent, the agencies might infer appropriately that the new Guidelines are an improvement over prior iterations. If more frequent, however, the new Guidelines could be part of the problem. It would be disheartening, to say the least, to learn that more, rather than fewer, Type II errors result from merger reviews governed by those new standards versus reviews governed by standards adopted two decades ago. Indeed, if the frequency of Type II errors has not declined, the agencies may want to rethink key parts of the 2010 Guidelines to try to understand why.

More specifically, the agencies should want to look for trends in reasons to close investigations without any action when the transaction ends up being anticompetitive. Perhaps, for example, the agencies would discover that a substantial percentage of those instances involved acceptance of an ease of entry rationale for the clearance. This would invite fresh thinking about the ease of entry standards in the current Guidelines and the desirability of a stricter test for any determination that entry is "likely" or would be "sufficient" to protect against an unwarranted postmerger price increase. The agencies similarly might find that a substantial percentage of those clearances involved markets for differentiated products where the reviewing agency erred in finding that each of the merging parties was a closer competitor to a non-merging party than it was to the other merging party, thereby appearing to obviate concern with the potential for unilateral effects. This might prompt revisions to methodologies for determining the risk of unilateral effects generally.

It is also possible that Type II errors have been increasing for reasons unrelated to new aspects of the 2010 Guidelines. The explanation may be that the merger enforcement staffs at both agencies have been overloaded by increasing numbers of mergers requiring Second Request investigations in the face of increasing levels of concentration in many parts of the economy. In short, the agencies may have become seriously underfunded and thus ill-equipped to deal with all of the

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[16] *See* Thomas O. Barnett, Assistant Att'y Gen., Antitrust Div., U.S. Dep't of Justice, Current Issues in Merger Enforcement: Thoughts on Theory, Litigation Practice, and Retrospectives, Lewis Bernstein Memorial Lecture 19 (June 26, 2008) (reporting results "consistent with the predictions made based on our investigation that sufficient competition would remain and that the merger would enable significant efficiencies, which could offset other cost increases, such as the rise in the price of steel"), *available at* http://www.justice.gov/atr/public/speeches/234537.htm. Kwoka reports the results of a more recent study that concluded that the merger harmed consumers because of price increases in other product lines. Kwoka, *supra* note 2, at 77–81 (summarizing Orley Ashenfelter et al., *The Price Effects of a Large Merger of Manufacturers: A Case Study of Maytag-Whirlpool*, 5 Am. Econ. J.: Econ Policy, Feb. 2013, at 239).

[17] Press Release, Fed. Trade Comm'n, FTC Proposes to Study Merger Remedies (Jan. 9, 2015), *available at* http://www.ftc.gov/news-events/press-releases/2015/01/ftc-proposes-study-merger-remedies.

[18] U.S. Dep't of Justice & Fed. Trade Comm'n, Horizontal Merger Guidelines (2010), *available at* http://www.justice.gov/atr/public/guidelines/hmg-2010.html.

transactions demanding their full attention. To the extent this is part of the problem, the agencies could make effective use of the Kwoka findings and overall analysis in support of requests for increased funds for merger enforcement activity.

In any event, the agencies should be particularly interested in understanding why divestiture remedies have not sufficed to protect against anticompetitive effects in an apparently significant number of instances. The typical divestiture remedy in FTC consent orders and DOJ consent decrees in recent years has appeared to be quite comprehensive in the specification of assets to be transferred to the agency-approved buyer and has included a host of provisions requiring interim assistance to that buyer to maximize prospects for competitive viability.

Both agencies have taken publicized steps to strengthen their divestiture remedy requirements in recent years.[19] Perhaps the problem is that there are significant inherent risks of disruption and loss of momentum accompanying the transfer of a going business from one enterprise to another, and those risks might explain why a divestiture process enables the acquiring firm to increase its market share and its market power before the dust settles. The problem may be exacerbated by difficulty in finding a truly strong buyer interested in entering an already highly concentrated market dominated by entrenched incumbents. If that proves to be the explanation for inadequacy of the divestiture remedy in a significant number of instances, the agencies might need to alter expectations that divestiture can "always" be an acceptable conclusion to a merger investigation. More specifically, the agencies might want to signal generally that some products or market share overlaps in some market settings are "Too Big to Fix" (meaning that the proposed merger should be nixed altogether).

The recommendation that the agencies invest comprehensively in merger retrospectives and, in particular, require merging parties to produce post-merger information relevant to such studies might be resisted on grounds of both undue expense and questionable legal authority. Neither objection withstands scrutiny. The agencies can develop standardized protocols for information requests with sensitivity to burden concerns. As far as legal authority is concerned, there should be no issue in situations where a remedy is justified as a condition to merger clearance. The agency can simply include the postmerger information obligation in the consent order or consent decree. Alternatively, the FTC could utilize its broad authority under Section 6(b) of the FTC Act[20] to require periodic submission of information necessary to retrospective analysis from all parties whose merger transactions trigger Second Requests. There is no apparent reason why the FTC could not include in that kind of 6(b) undertaking parties whose transactions are investigated by the DOJ as well as parties whose transactions are investigated by the FTC itself.

Kwoka's new book effectively sets the stage for both enforcement agencies to undertake initiatives and projects along those lines. As noted above, the FTC is now moving ahead with its own major new study of remedies in its merger cases. By establishing the basic facts with regard to merger policy effects over a substantial period of time, the book moves the debate forward and toward steps to improve the effectiveness of merger enforcement policies. ●

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[19] Fed. Trade Comm'n, Statement of the Federal Trade Commission's Bureau of Competition on Negotiating Merger Remedies (2012), *available at* http://www.ftc.gov/bc/bestpractices/bestpractices.shtm; Antitrust Division Policy Guide to Merger Remedies (2011) (updating 2004 guidance), *available at* http://www.justice.gov/atr/public/guidelines/272350.pdf.

[20] 15 U.S.C. § 46(b).